Simpson Thacher

Memorandum

Department of Labor Proposes Expanded Definition of ERISA Fiduciary

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I. Background

On April 20, 2015, the U.S. Department of Labor (DOL) published proposed regulations that would dramatically expand the circumstances in which a person providing investment advice to an employee benefit plan subject to the Employee Retirement Income Security Act of 1974, as amended (ERISA) (an ERISA Plan) or an Individual Retirement Account (IRA) is considered a "fiduciary" under ERISA and for purposes of the excise tax provisions of the Internal Revenue Code of 1986, as amended.[1]

With the proposed expanded definition of "fiduciary," the DOL proposed two new prohibited transaction class exemptions and amendments to four existing prohibited transaction class exemptions.

The entire package of the expanded definition of "fiduciary," new proposed exemptions and proposed amendments to existing exemptions is open for comment for 75 days, starting April 20, 2015. After a public hearing, another comment period is expected. The new rules will require compliance within eight (8) months following finalization of the regulations and exemptions.

II. Highlights

- The DOL proposed an expanded definition of ERISA fiduciary for persons who provide investment advice to certain service recipients, which covers the provision of individualized investment advice and recommendations to ERISA Plans, individual ERISA Plan participants and to IRA owners.
- Investment advisors who are covered by the proposed definition would need to satisfy a new ERISA

[1] In 2010 the DOL had proposed an expanded fiduciary definition but withdrew that proposal after it received many adverse comments related to the additional burdens that the proposal created.

prohibited transaction exemption in order to continue to receive all of the types of compensation and fees that are typically paid to investment advisors (see Section IV, below).

- The proposed definition includes carve-outs (subject to specified limitations) for:
  - Transactions with ERISA Plans when the ERISA Plan is represented by an independent fiduciary;
  - Swap and asset-based swap transactions;
  - An employee's provision of services for his or her own employer's ERISA Plan;
  - Investment platform providers;
  - Investment selection and monitoring assistance;
  - Financial reports and evaluations;
  - Investment education; and
  - Securities transactions.
- Sponsors of ERISA Plans, ERISA Plan participants and IRA owners would be able to bring breach of warranty claims against investment advisors who are fiduciaries under the proposed definition.
- The proposed regulatory package includes two new prohibited transaction class exemptions to cover (1) service providers who become fiduciaries by reason of the expanded definition and (2) principal transactions in debt securities.
- The DOL has proposed changes to four existing class exemptions.

III. Proposed Regulations

The expanded definition of "fiduciary" and the new and amended prohibited transaction class exemptions are principally directed at service providers who provide investment advice to individual ERISA Plan participants and IRA owners, in addition to small ERISA Plans that do not typically have the help of an independent professional investment advisor. Proposed changes will have the greatest impact on advisors to small ERISA Plans, individual ERISA Plan participants and IRA owners. However, alternative investment funds whose investors include IRAs will need to make sure that their communications with investors are not picked up by the proposed changes to the rules, if the proposed rules become effective.

A. Current Definition of "Fiduciary"

The current regulations provide that one is a "fiduciary" by reason of providing investment advice if the person (1) renders advice as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing or selling securities or other property (2) on a regular basis (3) pursuant to a mutual agreement, arrangement or understanding with the plan or fiduciary that (4) the advice will serve as the primary basis for investment decisions with respect to plan assets, and that (5) the advice will be individualized based on the particular needs of the plan.

B. Proposed Definition of "Fiduciary"

The 2015 proposal seeks to move away from the existing five part test and instead define a person as a "fiduciary" if the person provides personalized or directed investment advice to an ERISA Plan or an IRA for a fee or other compensation and does not meet the requirements of available carve-outs. Under the new proposal, a person who provides investment advice to an ERISA Plan or an IRA is a "fiduciary" if the person provides, directly to an ERISA Plan, ERISA Plan fiduciary, participant, beneficiary, IRA or IRA owner, one or more of the following types of advice for a fee and the person (or an affiliate) acknowledges fiduciary status or provides the advice pursuant to an individualized, directed agreement:

1. A recommendation about the advisability of acquiring, holding, disposing of or exchanging securities or other property (including recommendations as to ERISA Plan or IRA distributions);

2. A recommendation about the management of securities or other property, including recommendations relating to the management of property or securities to be rolled over from an ERISA Plan or IRA;

3. An appraisal or fairness opinion if provided in connection with a specific transaction for an ERISA Plan or IRA; or

4. A recommendation of an investment advisor who would give any of the above-mentioned types of advice for a fee.

C. Carve-Outs to Definition

The DOL has tried to fashion a very broad general definition of who is a fiduciary in the investment advice context and has supplemented the definition with very specific carve-outs where the DOL has concluded that the advice in question should not be considered the advice of a fiduciary. Unless the adviser otherwise acknowledges in writing that he or she is a fiduciary, the provision of individualized and directed investment advice or recommendations to an ERISA Plan or IRA will not make the adviser a fiduciary if any of the following carve-outs applies:

- Counterparty. The person provides the advice about an arms-length arrangement or sale to an ERISA Plan fiduciary who is independent of the person and who has authority and control regarding the management and disposition of ERISA Plan assets. This carve-out comes with written disclosure requirements and can only apply if the ERISA Plan has at least a certain number of participants and the ERISA Plan fiduciary manages at least a certain amount of plan assets.

- Swap Counterparty. Counterparties who regularly engage in swaps or asset-based swaps with ERISA Plans are carved out if specific requirements are met.

- Employees. Employees of an ERISA Plan sponsor who provide services to the fiduciary of their own employers' ERISA Plan and receive no extra compensation for their work supporting the ERISA Plan fiduciary are carved out.

- Platform Providers. Businesses that market and make available securities or other property on a platform from which ERISA Plan fiduciaries or IRA owners may select their investment alternatives are carved out. The platforms that the DOL intends to carve out are those from which an ERISA Plan fiduciary may select an ERISA Plan's fund lineup and/or monitor investment alternatives. The choices and the information must be made available without regard to individualized needs of the plan, participants or beneficiaries. The provider needs to disclose in writing that it is not trying to provide impartial investment advice or give advice in a fiduciary capacity.

- Selection and Monitoring Assistance. A carve-out is available when the service provider only identifies investment alternatives that meet objective criteria specified by an ERISA Plan fiduciary and provides objective financial data and comparisons with independent benchmarks.

- Financial Reports and Evaluations. There is a carve-out available for service providers who provide appraisals, fairness opinions or statements of value. The valuations can be provided to an employee stock ownership plan or to an investment fund, such as a collective investment fund or pooled separate account in which more than one ERISA Plan has an investment, or which holds ERISA Plan assets of more than one unaffiliated ERISA Plan. The appraisal or valuation needs to be provided to an ERISA Plan, fiduciary, participant, IRA or IRA owner, solely for compliance with reporting and disclosure obligations or solely for use in completing forms and schedules for disclosure.

- Investment Education. A service provider will not be a fiduciary under the new definition if the provider makes investment information and materials available to an ERISA Plan, fiduciary, participant, IRA or IRA owner. To satisfy the carve-out, the information must not include recommendations with respect to specific investment products or specific ERISA Plan or IRA alternatives or recommendations on investment, management or value of a particular security or securities, or other property.

- Securities Transactions. Neither a broker, dealer, reporting dealer who makes primary markets nor a bank will be deemed to be a fiduciary with respect to an ERISA Plan or IRA by reason of executing transactions in the ordinary course. This relief is only available if (1) neither the fiduciary nor any affiliate of the fiduciary is a broker, dealer or bank and (2) the transaction instructions specify the security to be purchased or sold, the price range within which such security is to be bought or sold, the time span during which the transaction is to be executed, and the minimum and maximum quantity or total dollar value.

IV. New Prohibited Transaction Exemption: Best Interest Contract Exemption

Recognizing that the expanded definition would make fiduciaries out of many ERISA Plan and IRA service providers, the DOL is proposing an expansive class exemption that is meant to permit service providers to continue to receive fees and compensation for their services as fiduciaries, but, unlike typical individual and class exemptions, is not specific to a discrete type of transaction or transactions. The exemption is needed because once the service providers are fiduciaries to the ERISA Plans and IRAs, the fees that they receive could constitute impermissible self-dealing under the prohibited transaction rules, as the amount and timing of their compensation would be affected by the investment advice provided.

To rely on the exemption, a service provider must acknowledge in writing that it is a fiduciary with respect to any investment recommendations made, and the service provider must execute a contract that includes a commitment to follow "Impartial Conduct Standards" (as defined in the exemption) when giving advice. The service provider must also warrant that it has adopted policies and procedures that are designed to mitigate the risk of material conflicts of interest and must disclose information about fees, compensation and conflicts. In addition, the service provider will be required to keep records regarding investment recommendations that it makes. The contract with service recipients cannot include exculpatory provisions or an agreement from the ERISA Plan participant, IRA or IRA owner to waive or limit its right to join class actions or other representative disputes.

V. New Prohibited Transaction Exemption: Principal Transactions in Debt Securities

The DOL also proposed a new prohibited transaction class exemption that would allow investment advisors to engage in principal transactions involving debt securities with ERISA Plans and IRAs.

VI. Proposed Changes to Existing Prohibited Transaction Exemptions

In addition to the two new exemptions, the DOL proposed amendments to four existing class exemptions that cover a variety of common transactions, including mutual fund share purchases when the fiduciary and the fund advisor are affiliated, transactions with broker-dealers and banks, cross-trading, transactions with insurance agents and brokers, transactions with principal underwriters, transactions with fiduciary market makers, and transactions involving mortgage pool certificates.

For further information about this regulatory proposal, please contact one of the following members of the Firm's Executive Compensation and Employee Benefits Practice.

Tristan Brown
+1-650-251-5140
tbrown@stblaw.com

Gregory T. Grogan
+1-212-455-2477
ggrogan@stblaw.com

Laurence M. Moss
+1-212-455-2280
larry.moss@stblaw.com

Brian D. Robbins
+1-212-455-3090
brobbins@stblaw.com

David E. Rubinsky
+1-212-455-2493
drubinsky@stblaw.com

Jeanne M. Annarumma
+1-212-455-7395
jannarumma@stblaw.com

Jamin R. Koslowe
+1-212-455-3514
jkoslowe@stblaw.com

Aimee M. Adler
+1-212-455-7716
aadler@stblaw.com

Andrew Blau
+1-212-455-2380
andrew.blau@stblaw.com

Paul R. Koppel
+1-212-455-2341
pkoppel@stblaw.com

David B. Teigman
+1-212-455-3428
david.teigman@stblaw.com

Simpson Thacher Worldwide

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
1155 F Street, N.W.
Washington, D.C. 20004
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3919 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
West Tower, Mirae Asset Center 1
26 Eulji-ro 5-gil, Jung-gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori
Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino
Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000