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DOL Fiduciary Rule

Impact on Health and Life Insurance and Beyond

Agenda

- How did we get here?
  – Prohibited Transactions
- DOL Fiduciary Rule
  – History and Existing Rules
  – DOL's New Fiduciary Definition
- Best Interest Contract Exemption
  – Impact of DOL Rule on IRA Markets
  – Timeline for DOL Fiduciary Rule

Why are we here?

Prohibited Transactions

- Under ERISA and IRC, certain transactions are strictly prohibited
  - To prevent dealings with parties who may be in a position to exercise improper influence over the plan

Prohibited Parties

"Parties in interest" (or "disqualified persons") include:

– Employer
– Union
– Plan fiduciaries
– Service providers
– Owners
– Officers
– Relatives of the above

Prohibited Transactions

- A sale, exchange, or lease between plan and PII
- Lending money or extending credit between the plan and PII
- Furnishing goods, services, or facilities between the plan and PII
- Fiduciaries using plan assets in their own interest or who act on both sides of a transactions involving a plan
- Self-dealing activities

Prohibited Transaction Exemptions

- Statutory exemptions, class exemptions, individual exemptions
- Exemption for Service Provider Fees:
  - Under ERISA and the Code, fees may be paid by a plan in exchange for services, so long as the services are necessary for the plan's administration and the fees are <u>reasonable</u>
  - Unreasonable = breach of fiduciary duties and prohibited transaction

Prohibited Transaction

- Party-in-interest (i.e., the service provider) subject to 15% excise tax on amount of fees
- Service provider (particularly if a fiduciary) could have to reverse the transaction, i.e., <u>disgorge</u> fees

Health Plan Prohibited Transactions

- HSA contributions
  - Employers who fail to promptly transmit participants' HSA contributions may violate the prohibited transaction provisions of Code §4975
  - DOL plan asset regulations apply to all workplace HSAs (whether or not they are subject to ERISA) through the prohibited transaction provisions of Code §4975

- Use of Plan Assets for Prohibited Expenses
  - Plan assets (e.g., trust assets or participant contributions) should not be used to pay PCORI fees since ERISA's prohibited transaction rules prohibit plan assets from being used to offset employer obligations

- Selection of Service Providers
  - Prohibited transactions are possible whenever an ERISA plan fiduciary involved in the decision to retain a TPA has any interest (e.g., financial or familial) in the potential TPA.
  - There is no prohibited transaction exemption available for a fiduciary involved in the decision to retain such a TPA

- Multiemployer plans
  - Vast majority of the reported prohibited transaction cases (in the health and welfare world) involve multiemployer plans. Most prohibited transactions involve plan assets. All multiemployer welfare plans have relatively large amounts of plan assets held in trust.

Examples and Recent Developments

- Watch out for:
  - Discounts
  - Rebates
  - Excessive fees (Cigna)
  - Hidden fees (BCBS)
  - Hidden fiduciaries (COBRA administrators)

Who are Fiduciaries?

Fiduciary Definition

A person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

Evolving Fiduciary Rules

Fiduciaries must act prudently and in the best interests of the plan

In order to protect the interests of the plan participants and beneficiaries, IRA owners, and plan fiduciaries . . . institutions and advisors must give <u>prudent advice</u> that is in the customers' best interest, avoid misleading statements, and receive no more than reasonable compensation

Fiduciary Defined

- ERISA Fiduciary Status of Advisor
  - Triggered if "investment advice" relating to plan investments is provided for compensation
- Existing Definition of "Investment Advice" (5-Prong Test)
  - Recommending plan investments
  - Regular basis
  - Mutual understanding (written or verbal)
  - Primary basis for plan's investment decisions
  - Individualized to plan's needs

New Fiduciary Rule

- Overview of Regulatory Process
  - DOL issued a proposed fiduciary rule on April 20, 2015
  - DOL announced the final rule on April 6, 2016, which was formally published on April 8, 2016
- Delayed Effective Date
  - New fiduciary rule becomes effective on April 10, 2017
  - Many advisors, such as brokers, will be deemed fiduciary advisors for the first time under the new rule

Overview

- ERISA Fiduciary Status of Advisor Under New Rule
  - Still triggered if “investment advice” is provided to retirement clients for compensation
  - DOL has clarified that IRA advisors (in addition to plan advisors) may be viewed as fiduciaries
- New “Investment Advice” Definition
  - Broadly covers recommendations relating to advisability of:
    - **Investments** such as securities or other property
    - **Investment Management,** such as recommending investment strategies or other advisors
    - **Rollover/Transfer/Distribution** from a plan or IRA

Investment Advice Nuances

- Advice to whom?
  - Plan, plan fiduciary, participant, beneficiary, IRA or IRA owner
- Types of Advice?
  - Provided for compensation
    - For a fee or other compensation
    - Direct or Indirect

Investment Advice Nuances

- Investment Advice Regarding:
  - Acquiring, holding, disposing of, or exchanging of
  - Securities or other investment property
    - Does not include:

    health insurance policies, disability insurance policies, term life policies or other property <u>to the extent the policy or property does not include an investment component</u>

Investment Advice Nuances

- Investment Advice Regarding:
  - Recommendation as to how securities and property should be invested <u>after</u> rollover, transfer, or distribution
  - From a plan or IRA

Investment Management Nuances

- Recommendation relating to
  - Management of securities or other investment property
  - Recommendations on policies, strategies, portfolio composition, selection of other investment advisors/managers, investment arrangements

Investment Management cont.

- Management Advice
  - Recommendations regarding rollovers, transfers, or distributions
    - Including form, destination, and amount
  - From a plan or IRA

Recommendations

- What are the factors?
  - Would it “reasonably be viewed as a suggestion”?
  - Objective standard not subjective
  - If individually tailored, likely a recommendation
  - Series of actions, taken as a whole can constitute recommendations

Impact on Health/Life Arena

- HSAs
  - Included in definition of “plan”
- Annuities
  - Indexed products subject to new rules
  - Fixed products covered by existing PTE 84-24
    - Benefits cannot vary based upon investment experience

Implications

- Fiduciary Status More Easily Triggered for Advisors
  - Client merely needs to receive advice
    (and there is no need for a mutual understanding that it will serve as the primary basis for investment decisions)
  - Investment advice potentially includes one-time advice
    (even if not provided on a regular basis)
  - Advice merely needs to address a particular investment decision or particular investment needs
    (and therefore does not necessarily need to be individualized)
  - Brokers making covered recommendations are highly likely to be viewed as fiduciaries

Exclusions

- Platform providers
- Investment monitoring assistance (RFPs, benchmarking)
- Generalized communications
- Investment education

Education Exception

- Existing Safe Harbor for Non-Fiduciary Education (I.B. 96-1)
  - Plan Information
  - General Financial/Retirement Information
  - Asset Allocation Models
  - Interactive Investment Materials
- New Exclusion from “Investment Advice“ Definition
  - Expanded to include education for both plans and <u>IRAs</u>
  - Plan-related education generally may reference specific menu options if they are subject to plan sponsor’s oversight
  - IRA-related education cannot reference specific investments

Exemptions

- Broader Fiduciary Definition and Prohibited Transactions
  - Prohibited transaction rules ban fiduciary advisors from earning variable compensation (commissions)
  - Advisors making covered recommendations and receiving commissions (brokers) would be fiduciaries
  - Exemption from prohibited transaction rules would be required for brokers, including advisors to IRAs
- Best Interest Contract Exemption
  - Released by DOL along with its new fiduciary rule

Best Interest Contract Exemption

- Purpose of Exemption
  - Enables fiduciary advisors to earn variable compensation
  - Brokers serving as fiduciaries would be able to earn commissions
- Scope of BIC Exemption
  - Provides relief for variable compensation earned in connection with <u>non-discretionary</u> investment advice only.
  - Imposes numerous requirements on individual advisor and firm that are designed to mitigate conflicts of interest

BICE Requirements

- BIC Exemption's "**Impartial Conduct Standards**"
  - Advice must be in "Best Interest" of retirement client
  - "Best Interest" standard is similar to customary "Prudent Man" standard for fiduciaries under ERISA
  - Only reasonable compensation may be earned
  - No misleading statements
- Additional Operational Requirements
  - Requirements vary by type of retirement client
    - IRAs and Sole Proprietor Plans (such as solo 401(k) plans)
    - Employer-Sponsored Plans

IRAs

- Operational Requirements Under BIC Exemption
  - **Written contract**
    - Must include fiduciary standards and general disclosures for compensation and conflicts
  - **Transaction disclosures** for each recommended investment focusing on fiduciary standards and conflicts
  - **Web disclosures** focusing on business model and conflicts
  - **Specific compensation figures** available upon request
  - **Compliance policies** must address conflicts of interest
    - Individual advisor's differential compensation must be based on <u>neutral factors</u> tied to differences in services (such as time needed to recommend particular investment)

Employer Plans

- Operational Requirements Under BIC Exemption
  - Written statement and disclosures
    - Must include fiduciary standards and general disclosures for compensation and conflicts
    - No written contract is required (as plan clients have legal rights under ERISA, even without a contract)
  - Other operational requirements mirror those for IRAs and Sole Proprietor Plans
    - **Transaction disclosures**
    - **Web disclosures**
    - **Specific compensation figures** available upon request
    - **Compliance policies**

Operational Requirements

- Oversight of advisers' recommendations
- Written policies and procedures relating to conflict mitigation practices (must be available to DOL)
- Polices to employ Impartial Conduct Standards for advisers
- Document material conflicts of interest
- Designate responsible party for addressing conflicts of interest and monitoring advisers
- Prohibiting quotas, bonuses, contests, differential compensation that would cause advisers to deviate from best interest standard

Rollover Advice from Level Fee Fiduciaries

- Required Compliance Under BIC Exemption
  - Advisors who earn level compensation only (**Level Fee Fiduciaries**), such as RIAs, generally will not need to comply with BIC Exemption when offering regular investment advice
  - However, an exemption is necessary for Level Fee Fiduciaries when offering <u>rollover advice</u>
    - Conflict arises if rollover advice (fiduciary advice) triggers rollover and additional compensation for advisor
    - BIC Exemption offers relief to Level Fee Fiduciaries with these types of conflicts if document rationale for rollover recommendation
    - Streamlined operational requirements are available for Level Fee Fiduciaries

Level Fee Exemption

- Streamlined Requirements Under BIC Exemption
  - Rollover advice from Level Fee Fiduciaries must meet **Impartial Conduct Standards**
  - Streamlined operational requirements for advisor include:
    - Providing written statement of fiduciary status
    - Internally documenting advisor’s reasons for concluding that rollover advice is in client’s Best Interest

Transition Relief

- Fewer BIC Requirements Apply During Transition Period
  - DOL's new rule becomes effective as of April 10, 2017
  - Advisor may elect to comply with reduced number of requirements for BIC Exemption during Transition Period
  - Transition Period is from **April 10, 2017** to **January 1, 2018**
- Reduced BIC Requirements for Transition Period
  - Advice must meet **Impartial Conduct Standards**
  - Reduced operational requirements for advisor include:
    - Providing written statement of fiduciary status and conflicts disclosures

Grandfathered Contracts

- For Investment Transactions Prior to April 10, 2017
  - Relief for brokers earning ongoing commission trail from investments sold to retirement clients prior to April 10, 2017
  - No need to comply with regular BIC Exemption requirements for commissions from these "grandfathered" transactions
- Requirements for Grandfathered Transactions
  - Original transaction did not violate prohibited transaction rules
  - Compensation must be reasonable
  - Other conditions apply

Take Away

- BIC Exemption Requirements
  - Similar requirements apply to all retirement clients (but written contract only required for IRAs and sole proprietor plans)
  - Streamlined requirements available for rollover advice from Level Fee Fiduciaries
  - Reduced requirements available during Transition Period
- Observations
  - Impacts brokers offering investment advice for commissions
  - Also affects RIAs offering rollover advice

Conclusions

- Determine whether you are a fiduciary
- Watch for prohibited transactions
- More to come
  - Moving to Universal Fiduciary Standard
  - DOL seeking to impose fiduciary status on all types of retirement advisors
  - Fiduciary advisors earning commissions will be subject to BIC Exemption (and higher compliance costs)
  - RIAs offering rollover advice may comply with streamlined requirements under BIC Exemption
  - Significant impact on IRA markets


IT'S A QUESTION PARTY!
MY FAVORITE!

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