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Department of Labor Expands the Definition of Fiduciary

Background

As you may know, the Department of Labor (DOL) has updated the rules on determining who is a fiduciary to retirement plan investors. The new rule expands the definition of who will be a fiduciary as a result of providing investment advice. Under the prior rule, an investment advisor needed to meet a more restrictive five-part test to be considered a fiduciary as a result of the investment advice. Under the new rule, any person who provides investment advice or recommendations for a fee or other compensation with respect to assets of a plan or an IRA, will be considered a fiduciary. A recommendation includes any communication that, based on its content, context and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action.

The new fiduciary rule was finalized in April of 2016 with an applicability date of April 10, 2017. However, on February 3, 2017, the Trump Administration issued a memorandum requesting further analysis of the new rule to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice. On April 7, 2017, the DOL issued revisions to the regulations to postpone the

applicability date to June 9, 2017, to allow for extended time to perform this analysis. It was expected within the retirement industry that an additional delay would be issued to provide the DOL with adequate time to perform this analysis. However, on May 22, 2017, Labor Secretary Acosta issued an announcement indicating the applicability date would not be further delayed and would become effective June 9, 2017. Acosta went on to indicate that the impact analysis is not yet complete and further changes to the rule could be made in the future depending on the outcome of the analysis.

Fiduciary Standard of Care

The general purpose of the new rule is to expand on who is considered a fiduciary. Under ERISA (Employee Retirement Income Security Act of 1974), a fiduciary is held to a standard of care to act in a prudent manner and in the best interest of the plan and/or participant. As a fiduciary, any recommendation of investments is subject to ERISA's fiduciary standards and will result in a prohibited transaction, if there is a conflict of interest as a result of the investment recommendation. In addition, a fiduciary is subject to the disclosure requirements of ERISA Code Section 408(b)(2) which requires acknowledgement of fiduciary status, as well as up-front disclosure of fees.

Types of Investment Advice Fiduciary

The DOL identifies the two types of an investment advice fiduciary in the new rule as a level-fee or a variable-fee fiduciary. A level-fee fiduciary is where the investment advisor will receive the same fee (either as a flat dollar amount or a percentage of assets), regardless of which investment the recipient of the advice chooses to invest. A variable-fee fiduciary is where the investment advisor may receive various levels of compensation depending on which investment is selected. For example, one investment fund may pay the advisor a higher commission or 12b-1 fee over another investment option.

Prohibited Transaction

If a fiduciary receives a level-fee regardless of the investment fund(s) selected by the investor based on the recommendation of the fiduciary (i.e., a level-fee fiduciary), then the advice does not result in a conflict of interest. However, if the investment advisor's fee may vary based on the investment fund(s) selected by the investor, there is a potential for a conflict of interest. If a fiduciary provides conflicted advice, a prohibited transaction has occurred.

The DOL indicates that investment advice fiduciaries must provide written acknowledgement of their fiduciary status and comply with the following Impartial Conduct Standards:

- Make recommendations that are in the client's best interest (i.e., recommendations that are prudent and loyal)
- Avoid providing misleading statements
- Charge no more than reasonable fees for their services

On January 1, 2018, some additional provisions will become effective for individuals who provide variable fee advice. In order to avoid a prohibited transaction for the conflicted advice, the fiduciary will need to comply with the Best Interest Contract Exemption (BICE). In addition to the requirements imposed above, the fiduciary will need to set forth the standards of fiduciary conduct and fair dealing in an enforceable contract with the investor.

Impacts of New Rule

The new fiduciary rule primarily affects financial advisors and broker dealers who provide investment advice or recommendations to retirement investors for a fee, but were not previously considered a fiduciary based on the old rule. An individual who provides investment advice for a fee will now be considered a fiduciary and will be subject to the ERISA's fiduciary standard of care.

American Trust is and has been a fiduciary to your plan. American Trust serves as a §3(21) fiduciary in our role as discretionary trustee and as a §3(38) fiduciary as an investment manager. As such, we have always been subject to the fiduciary standard of care that is now being imposed on an investment advice fiduciary. Our service agreement/fee disclosure statement acknowledges our status as a fiduciary, identifies the services that we provide to your plan and the fees associated with those services. Our investment policy statement identifies our due diligence process for monitoring, selecting and deselecting the investment options available under your plan.

The Department of Labor continues to review the impact of the regulations in accordance with President Trump's memorandum. There is still a potential that changes will be made to the provisions of the rule before January 1, 2018. American Trust will continue to monitor this issue closely and communicate any important changes to the rule.

If you have any questions, please contact your Relationship Manager at 800.548.2995.