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RetireWell Administrators, Inc.

Third-party Pension Administration and Consulting Services

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RetireWell Administrators, Inc. provides total retirement plan solutions by combining TPA services with the employee benefits practice at The Law Firm of Anthony L. Scialabba, LLC.

The Status of the New DOL Fiduciary Regulations and How Plan Sponsors and Plan Fiduciaries Should Respond to Them

By Anthony L. Scialabba, Esq.

On April 6, 2016, the Department of Labor ("DOL") promulgated final regulations ("Final Regulations") that clarify the definition of an "investment advice" fiduciary under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), to retirement plans and Individual Retirement Accounts/Annuities ("IRAs"). The rules generally provide that any person or entity making an "investment

Welcome Laurie Robertson

We are pleased to announce that Laurie Robertson has joined the Retirewell team as of June 3, 2017. Prior to joining Retirewell, she worked as Director of Business Development and Marketing for a financial advisory firm. Laurie has also worked in various industries throughout her career.

Laurie's focus with Retirewell is to expand its client base by working with its strategic partnerships as well as expanding new avenues of business. *(continued on page 10)*

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recommendation" to a plan sponsor or a participant of a covered plan will be considered a fiduciary under fiduciary responsibility requirements and "prohibited transaction" rules of ERISA and the prohibited transaction rules of the Internal Revenue Code of 1986, as amended ("Code"). The application of the new rules has been delayed due to the change of administration in the White House. In addition, the White House has created considerable uncertainty that the Final Regulations will not be significantly amended in the future. This article will discuss: 1) the background of the Final Regulations, 2) their respective effective dates, 3) their significant provisions, 4) how plan sponsors and plan fiduciaries should respond to them, and 5) what may happen to the rules and retirement investment industry in the future as a result.

I. Background

Section 3(21)(A) of ERISA defines the term fiduciary by listing three categories of functions with regard to a plan that would cause a person to become a fiduciary. The second category listed in the statute is providing "investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of" an ERISA plan. In 1975, DOL issued regulations that effectively narrowed the concept of "investment advice" through a five-factor test ("1975 Regulations"). In addition to satisfying the "fee or other compensation" requirement, for an advisor to be deemed a fiduciary under the 1975 Regulations it must: (1) provide investment recommendations, or advice on property values (2) on a regular basis (3) pursuant to a mutual agreement, arrangement, or understanding with the plan (4) that the advice will serve as a primary basis for plan investment decisions and (5) that the advice will be individualized based on the particular needs of the plan. In 1976, the DOL further narrowed the definition of such a fiduciary by issuing an advisory opinion that concluded that a valuation of closely held employer securities for an employee stock ownership plan ("ESOP") would not constitute investment advice.

In 2010, the DOL attempted to revise the 1975 Regulations by issuing proposed regulations ("2010 Proposed Regulations"). See A. Scialabba, "The Department of Labor Newly Proposed Regulation to Expand the Definition of Fiduciary Under ERISA" Journal of Pension Benefits Vol. 18, No. 4 Summer 2011. However, the proposed regulations were withdrawn due to industry criticism.

The DOL studied the 1975 Regulations for four years. As a result, in April 14, 2015, the DOL published another set of proposed regulations ("2015 Proposed Regulations") that would revise the original regulations. See A. Scialabba, "DOL Proposes Significant Expansion of 'Investment Advice' Fiduciary Definition" Journal of Pension Benefits Vol. 22, No. 4, Summer 2015. Subsequently, the Final Regulations were issued in the last year of the Obama administration.

The Final Regulations technically became effective June 7, 2016. Originally, they were not made "enforceable" (technically "applicable") until April 10, 2017 for some provisions and not until January 1, 2018 for other provisions. However, after last year's presidential election, the new administration considered the viability of a number of Obama-era regulations, including the Final Regulations. Thus, on February 3, 2017, President Trump issued a presidential memorandum which required the DOL to review these rules. However, the memorandum did not request their outright withdrawal. Subsequently, the DOL delayed the "applicability" date of the Final Regulations from April 10, 2017 to June 9, 2017 for some provisions and the applicability date for a number of other provisions until January 1, 2018.

On May 23, 2017, the newly sworn-in Secretary of Labor, Alexander Acosta, wrote a Wall Street Journal Op-Ed which stated that the Final Regulations would become effective on June 9, 2017. However, the article also stated that the rules "may not align with President Trump's deregulatory goals". Thus, Mr. Acosta added that the Final Regulations would be undergoing further

review. Many commentators have interpreted this to mean that it is highly probable that there will be significant revisions to the new rules. See e.g., G. Van Loon and S. Hoffman, "The New DOL Investment Fiduciary Rules – Effective June 9, 2017, But How Long Will They Last?" Butler/Snow Benefits Brief/Benefits Commentary (2017).

On the same day that the Secretary of Labor's "Wall Street Journal" article was published, the DOL issued a Field Assistance Bulletin 2017-2 which provided that prior to January 1, 2018, the DOL would not pursue claims against fiduciaries who were working diligently and in good faith to comply with the Final Regulations. The Bulletin also stated that a similar enforcement policy would apply to the provisions of the rules over which the Internal Revenue Service had primary authority (i.e., IRAs). Thus, the guidance set forth in the Bulletin is additional evidence that the Final Regulations may be substantially modified.

On August 9, the DOL submitted a proposal to the Office of Management and Budget ("OMB") to extend the transition period applicable to the remaining portions of the Final Regulations from January 1, 2018 to July 1, 2019. On August 28, 2017, the OMB approved the DOL's proposal. At the time of this writing, the DOL will now need to release a proposed rule concerning the delay at issue in the Federal Register with a comment period of no longer than 30 days.

II. The DOL's Rationale for Providing the Final Regulations

ERISA requires that a fiduciary must operate a plan solely in the interest of participants and beneficiaries. In addition, ERISA proscribes a fiduciary from engaging in prohibited transactions. Certain types of prohibited transactions involve fiduciaries having conflicts of interest with a retirement plan. Thus, ERISA prohibits fiduciary advisers (brokers, dealers and financial institutions) to plans and IRAs from receiving compensation in the form of commissions, so-called "12b-1" fees from mutual funds and other revenue sharing arrangements.

Violations of the "solely in the interest" and prohibited transaction rules can result in liability to the fiduciary and equitable remedies. These include subjecting the advisor to personal liability to make good the loss to the plan and its participants, including disgorging any profits made by the advisor, and paying for the plaintiff's attorney fees. In addition, a violation of the prohibited transaction rules under section 4975 of the Code can cause a fiduciary to incur excise taxes annually until the prohibited transaction is "corrected".

The Final Regulations arose because the DOL was concerned that some advisors and investment advisory firms could avoid being fiduciaries under prior law, even when their advice was conflicted. In addition, the DOL was concerned about the increased risk of abuse in connection with rollovers from retirement plans to IRAs by retiring employees, especially given the increasing number of retirees each year in connection with the baby boomer retirements.

Although the government was concerned about advisors providing conflicted advice, there may have been another, subtler rationale for the creation of the rules. In this regard, the preamble to the 2010 Proposed Regulations which were also aimed at expanding the scope of who could be an investment advice fiduciary. The preamble to the rules provided that the broadened definition of who is a fiduciary was intended to improve the DOL's ability to redress violations of ERISA by investment advisors. The DOL also noted that this could be accomplished by reducing the amount of time, costs and resources required to establish that an investment advisor is a fiduciary, as was necessary under the 1975 Regulations. However, this rationale was not stated by the DOL in the preamble to the 2015 Proposed Regulations or the 2016 Final Regulations.

Often, a defense in an ERISA law suit is to aver that the person being sued is not a fiduciary.

The DOL found itself litigating this issue often when trying to include financial advisors in lawsuits. Thus, an unstated purpose behind the enactment of the recent rules could have been that they make it administratively convenient for the government in litigation.

III. The Provisions of the Final Regulations that Are Effective on June 9, 2017

Under the Final Regulations, the general rules regarding who a fiduciary is because he or she provided investment advice are as follows. A person that receives a fee for providing investment advice to an ERISA-covered retirement plan (401(k), profit sharing, and defined benefit plans, Section 403(b) tax-sheltered annuities, and Section 457 plans) or IRA (both traditional and Roth IRAs) is a fiduciary if the person:

- provides the advice pursuant to an agreement that the advice is based on the particular investment needs of the advice recipient,
- directs the advice to a particular recipient(s) concerning the advisability of a particular investment or management decision, or
- represents that he or she is acting as a fiduciary.

In addition to these actions, the following are considered to be investment advice:

- recommendations as to the advisability of acquiring, holding, or disposing or exchanging plan assets (including after a rollover from a plan to an IRA),
- recommendations regarding investment policies/strategies, or
- recommendations regarding rollovers from a plan/IRA.

The determination as to whether an advisor makes a recommendation is based on all of the surrounding facts and circumstances.

When these rules are compared to the 1975 Regulations, it is clear that there is no longer a "regular basis" requirement, or a requirement that the advice will serve as the primary basis for the investment decision. In addition, there is no longer a need for a mutual understanding between the advisor and the recipient. This has been replaced with a determination as to whether based on the content, context, and presentation, the communication would reasonably be viewed as a suggestion to engage in or refrain from taking a particular course of action.

There are exceptions to the general rule. A significant exception applies to certain advisors to independent fiduciaries who are independent of the advisors. This concerns a transaction with certain independent fiduciaries with financial expertise (a bank, an insurance company, a registered investment advisor, or a broker-dealer, or the independent fiduciary must have $50 million in assets under its management or control). This exception applies when an advisor is acting as a counterparty under a transaction with a plan/IRA. With regard to this exception, the advisor must reasonably believe that the independent fiduciary is capable of independently evaluating the investment risks. The advisor must also tell the independent fiduciary before the transaction that the advisor is not acting as a fiduciary and is not providing impartial investment advice. In addition, the advisor must not receive a fee from the plan or the plan sponsor. A similar exemption exists for "swap" transactions. There are also exceptions in the following areas:

- employees of the plan sponsor,
- platform providers to ERISA plans,
- sales pitches,
- general communications, and
- investment education (as opposed to investment advice).

IV. Exemptions Provided by the New Rules

Financial advisors to retirement plans are generally compensated on a percentage of the plan assets under management or by commissions. Prior to the issuance of the Final Regulations, advisors paid by commissions or other types of variable compensation would often claim that they were not fiduciaries. Thus, they could determine the compensation they received based on the investment recommended. However, the prohibited transaction rules of ERISA and the penalty provisions of the Code proscribe a fiduciary from "self-dealing" with plan assets. This means that the advisor cannot determine the compensation the advisor will receive for services to the plan.

The use of commissions and variable compensation is widely utilized to compensate advisors in the "small plan" market. This market space is the largest area within which retirement plan investment advisors work. However, as mentioned above, absent some exception to the prohibited transaction rules, the Final Regulations would effectively proscribe commissions and variable compensation. Thus, the rules would cause a significant portion of these advisors to have to change their business strategies.

With regard to any modifications in business strategies that could be potentially caused by the Final Regulations, ERISA and the Code provide statutory exemptions to the aforementioned prohibited transaction rules. In addition, the Secretary of the DOL has the authority to grant administrative "Prohibited Transaction Exemptions" ("PTEs"). As a part of the promulgation of the Final Regulations, the DOL issued new PTEs and amendments to several existing PTEs. These new PTEs are intended to quell the necessity for an advisor to have to modify his or her business model in certain situations that would have otherwise occurred from the wide scope of the Final Regulations. The following addresses the more significant exemptions.

A. The Best Interest Contract Exemption

The most significant of the PTEs at issue is the "Best Interest Contract Exemption" ("BIC Exemption"). This is the primary vehicle through which advisors to small plans/IRAs can receive variable compensation (e.g., commissions) and revenue sharing payments. Compliance with the BIC Exemption is burdensome. Thus, adherence with the exemption will expose advisers to significantly augmented compliance costs and obligations and increased litigation risk.

The BIC Exemption which applies to all types of assets allows financial institutions and their investment advisors to receive all types of compensation for providing investment advice to a "Retirement Investor", so long as the institution and the advisor comply with the requirements of the exemption. In this regard, a Retirement Investor is: a participant/beneficiary of a participant-directed plan, an IRA owner, or a "retail" fiduciary of a plan/IRA (generally persons who manage less than $50 million in assets).

An actual contract is required for IRAs and non-ERISA plans. However, although there is no written contract required for ERISA plans, advisors must provide significant written materials to be provided to Retirement Investors. In addition, the advisor's financial institution may not:

- disclaim ERISA obligations,
- waive the Retirement Investor's right to have a class action,
- require arbitration, or
- otherwise limit the ability of a Retirement Investor to assert claims protected by the exemption.

The financial institution must affirmatively state in writing that it and its advisors are acting as fiduciaries with respect to advice that is the subjection of the BIC Exemption. This affirmation must be included in the BIC Exemption for IRAs and non-ERISA plans.

The BIC Exemption also requires that in the case of IRAs and non-ERISA plans, the financial institution must state in its contract that the institution and its advisors will comply with "Impartial Conduct Standards". With regard to ERISA plans, the financial institution and the investment advisor must comply with these standards. The Impartial Conduct Standards require the financial institution and advisor to act in the best interest of the Retirement Investor. This means that the institution and advisor must always consider the needs of the plan and Retirement Investor; and without regard to the financial or other interests of the institution or advisor. In addition, the standards require that the institution and advisor only receive reasonable compensation (as defined by section 408(b)(2) of ERISA and Section 4975(d)(2) of the Code). Furthermore, these parties must not make any misleading statements in their dealings with the Retirement Investor.

The financial institution must adopt policies that are designed to prevent material conflicts of interest. In addition, the financial institution must warrant that it and its advisors will comply with such policies.

The BIC Exemption also requires the financial institution to make certain disclosures to a Retirement Investor. These disclosures concern:

- the best interest standard of care,
- description of fees,
- description of compensation practices,
- description of material conflicts of interest, and
- access to firm's policies under the BIC.

The financial institution must also inform the DOL (via e-mail) of its intent to utilize the BIC Exemption. Finally, the institution must keep records concerning the transaction for six years.

The BIC Exemption does not apply to plans sponsored by the investment advisor, financial institution or affiliate. In addition, the exemption cannot be utilized with online "robo-advice". The BIC Exemption also does not apply to a situation where the investment advisor has discretionary authority or control with regard to the recommended transaction. Finally, the exemption does not apply to a "Principal Transaction".

A Principal Transaction generally involves the purchase or sale of an investment product if an advisor or financial institution is purchasing from or selling to a plan/IRA on behalf of the institution's own account (a transaction involving the sale from or purchase for the financial institution's own inventory). However, a "Riskless Principal Transaction" is eligible for the BIC Exemption. Such a transaction is one in which a financial institution, after having received an order from an investor to purchase or sell an investment product, purchases or sells the asset for the financial institution's own account to offset the contemporaneous transaction with such investor.

1. 'BIC Lite' Exemption for Level Fee Fiduciaries

Less onerous BIC Exemption requirements (referred to as the "BIC Lite Exemption") apply to fiduciaries who qualify as a "level-fee" fiduciary. This is a fiduciary whose fee is a fixed percentage of the value of plan assets or a set fee that does not vary based on the investment used, taking into account the compensation paid to the financial institution, the advisor, and related parties and affiliates. In addition, fee offset is allowed, for example, where third-party payments received by the advisor reduce the set or formula fee the advisor was to be paid. A fiduciary who is considered a level fee fiduciary only has to satisfy the BIC Exemption's "fiduciary acknowledgement" and Impartial Conduct Standards.

B. The Principal Transaction Exemption

Another significant PTE, although less widely applicable than the BIC Exemption, is the "Principal Transaction Exemption". As mentioned above, a Principal Transaction generally involves the purchase or sale of an investment product if an adviser or financial institution is purchasing from or selling to a plan/IRA on behalf of the institution's own account. The exemption permits a plan/IRA to sell any asset to an adviser or financial institution. A Riskless Principal Transaction is also eligible for the Principal Transaction Exemption. The exemption also has a contract requirement and a policies and procedures requirement that mirror the requirements in the BIC Exemption. The Principal Transaction Exemption also includes some conditions that are different from the BIC Exemption, including credit and liquidity standards for debt securities sold to plans and IRAs pursuant to the exemption and additional disclosure requirements.

C. Exemption for Advisors Selling Insurance and Annuity Products

In 1984, the DOL published PTE 84-24 which provided relief from the prohibited transaction penalties for advisors selling insurance and annuity contracts to retirement plans. In this regard, an advisor can receive commissions (which include renewal fees and trailing compensation but not revenue sharing or marketing payments) in connection with the sale of an insurance or annuity contract to a retirement plan. The requirements to satisfy this exemption are: (1) the advisor is not a discretionary trustee or discretionary investment advisor; (2) the transaction must be on terms at least as favorable to the plan as an arm's length transaction with a third party; (3) the amalgamation of all fees and compensation must be reasonable; (4) specified disclosure requirements must be met; and (5) the plan fiduciary must provide authorization after receipt of the disclosure.

D. 'Transition' BIC Exemption and Principal Transaction Exemption Requirements (until January 1, 2018)

The actions of the DOL and White House indicate a trend to delay the full application of the rule. This is evidenced by the President's memorandum, the DOL's delay in the applicability date from April 10, 2017 to June 9, 2017, the comments made by Secretary Acosta and the non-enforceability guidance emanating from Field Assistance Bulletin 2017-2. Thus, until January 1, 2018 (and probably until July 1, 2019), the only requirements necessary to satisfy the BIC Exemption and Principal Transaction Exemption are to adhere to the Impartial Conduct Standards. As mentioned above, this means that financial institutions and advisors must: (1) provide prudent and loyal advice to the plan and plan participants' best interests; (2) charge no more than reasonable compensation; and (3) avoid misleading statements. The first part of this requirement is the ERISA standard of care. This means that the advice must be based on the investment objectives, risk tolerance, financial circumstances, and needs of the plan and plan participants, and the advice must not take into consideration the interests of the financial institution, advisor, and related parties.

With regard to all sales of annuity and insurance products, an advisor will have to satisfy the Impartial Conduct Standards of the BIC Exemption until January 1, 2018 (and probably until July 1, 2019 (for the same reasons that concern the DOL's requirement to delay certain rules necessary to satisfy the BIC Exemption and Principal Transaction Exemption discussed above)). However, subject to the same transitional relief, sales of annuities other than fixed rate annuities (such as variable annuities and fixed indexed annuities), will also have to satisfy all of the more demanding BIC Exemption requirements rather than the requirements set forth in PTE 84-24.

IV. Impact of the Final Regulations on Plan Sponsors and Fiduciaries

The impact of the Final Regulations is primarily on advisors to retirement plans and financial institutions providing investment services to retirement plans and participants. However, a fiduciary must discharge his or her duties in a prudent manner. Thus, plan sponsors and plan fiduciaries must understand these rules. This is because such fiduciaries could be personally liable if their acts or omissions allowed the advisor to breach his/her/its fiduciary duties.

The Final Regulations may help force some financial advisors from providing conflicted investment advice. They may raise investment costs because of the money and effort to satisfy the BIC Exemption. The Final Regulations could provide another pocket to share in a law suit settlement or damage award. Finally, the new rules may cause material changes to financial advisor relationships which require modifications to existing service contracts.

V. The Rule's Possible Destiny and Impact on the Retirement Investment Industry

As mentioned above, it is likely that the DOL will also extend the period of "non-enforceability" originally set forth in Field Assistance Bulletin 2017-2 to July 1, 2019. Moreover, the trend to extend the application of the rule raises doubt as to whether it will ever be fully enforced as is.

Regardless as to whether the full application of the Final Regulations has been and will be extended, major investment advisory firms have already "geared-up" to comply with all of the regulations provisions (including those that have been extended). Thus, these firms are already requiring their financial advisors to charge level fees. In addition, the BIC Exemption is somewhat onerous to satisfy. Thus, the full application of the Final Regulations makes it difficult for financial advisors who do not specialize in retirement plans to compete with more established, erudite firms. Therefore, the so-called "onesy/twosy" advisors (i.e., advisors who do not have many retirement plan clients) may have to team up with a more established investment advisory firm or leave the retirement plan investment space.

Since the full enforcement of the Final Regulations will be delayed to at least until January 1, 2018 at the time of this writing or even to July 1, 2019, it will be interesting to see whether competitive pressures (from, for example, the onesy/twosy advisors who also wish to work in the retirement plan investment industry) cause some investment advisory firms to eventually pull back from their current total compliance with all of the Final Regulations regardless as to whether some of its rules have been delayed.

New Proposed Treasury Regulations that Permit More Flexibility With the Use of Forfeitures

By Anthony L. Scialabba, Esq.

The Internal Revenue Service ("IRS") recently issued proposed regulations that allow more flexibility in the way 401k plans can utilize forfeitures. In this regard, even though the regulations are only proposed, the government has indicated that plan sponsors can rely on them prior to the adoption of any final regulations in this regard. Thus, for plan years ending on or after January 18, 2017, a plan sponsor may now use amounts in a plan's forfeiture account to offset Safe Harbor Contributions, Qualified Non-elective Contributions and Qualified Matching Contributions.

If a plan sponsor is interested in availing itself of these rules, **the employer should amend its plan before January 1, 2018**. If this is not done, then a plan sponsor may not amend its plan to implement the rules at issue until the plan year in which the amendment is adopted.

When an employer is using a pre-approved plan document (such as a Volume Submitter or

Master and Prototype document) that specifically prohibits the use of forfeitures for such purposes, amending a plan to comply with the rules at issue can be challenging. This is because pre-approved plans only allow a limited number of provisions that can be amended. Thus, unless the pre-approved document already has already been revised to contain the amendment at issue, making such an amendment may eliminate the ability of the employer to rely on the IRS Determination Letter issued with respect to the plan.

Although some plan sponsors will have to wait for their document sponsors to revise their pre-approved plan documents, the FT William document system have already been changed to permit documents on its system to contain the amendment at issue. The clients of RetireWell Administrators, Inc. that have their plans on this document system (which are almost all of "RetireWell's" clients) can be amended in this regard. Thus, **if you would like to amend your plan to adopt the new provisions, please let our Client Services team at RetireWell know, and we will prepare the amendment at issue in accordance with our Service Agreement that we have with you**.

Welcome to Laurie Robertson (cont'd)

In addition to sales expertise, Laurie has experience in marketing and account management. Her diverse skill set will assist in the growth of Retirewell. Laurie is a graduate of The College St. Elizabeth in New Jersey with a Bachelor's degree in dual majors. She also lived in Monte Carlo, St. Tropez and London respectively for ten years.

Laurie currently resides in Monmouth County with her two children. She is very involved in various charities and fundraisers.

Welcome to Megan Gunderson

Megan Gunderson recently joined the Retirewell team this year to provide administrative support alongside the Financial Office Administrator to coordinate strategy development and implementation. She directly handles all financial matters such as client billing, accounts payable, payroll and banking. Prior to joining the team, Megan worked in banking, where she was responsible for handling various transactions and tasks. Currently living in South Jersey, Megan is currently attending Rowan College at Burlington County, working on her degree in business.

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