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DOL Decides to Re-propose Amendments to its Fiduciary Definition Regulation

On September 19, 2011, the Department of Labor ("DOL") publicly announced its intention to re-propose amendments to the "definition of fiduciary" regulation. The announcement, in the form of a press release, cites President Obama's January 18, 2011, executive order aimed a streamlining federal regulation, as well as the need for further review and dialogue, as reasons for its decision. The press release states that a new proposal is expected to be issued in early 2012.

Background

Section 3(21) of ERISA defines the term "fiduciary" to include any person who provides investment advice with respect to money or property of the plan for a fee, direct or indirect. In 1975, the Department promulgated a regulation that set forth a five-part test for determining when a person would be a "fiduciary" by reason of providing investment advice for a fee. That test provides that a person shall be deemed to be providing investment advice for a fee only if he or she (1) makes recommendations on investing in, purchasing or selling securities or other property, or gives advice as to their value; (2) on a regular basis; (3) pursuant to a mutual understanding that the advice; (4) will serve as a primary basis for investment decisions; and (5) will be individualized to the particular needs of the plan. See 29 C.F.R. § 2510.3-21. The regulation makes clear than an investment adviser would not be subject to ERISA unless each of the above five prongs were met. Importantly, the DOL's regulation defining "fiduciary" also defines "fiduciary" for purposes of the prohibited transaction excise tax provisions under section 4975 of the Internal Revenue Code, and therefore, also applies with respect to certain transactions involving individual retirement accounts (IRAs) even if not subject to ERISA.

Citing substantial changes in the financial industry over the last 35 years, the increased complexity of investment products, and challenges the DOL has faced in the enforcement arena, the DOL proposed to amend the 35-year old regulation on October 22, 2010. Definition of the Term "Fiduciary," 75 Fed. Reg. 65263 (proposed Oct. 22, 2010). The Department's proposed amendment would significantly broaden the scope of persons who could be deemed fiduciaries subject to ERISA's stringent conflict of interest, prohibited transaction provisions and other fiduciary provisions. Notably, the proposed amendment would eliminate from the definition the requirements that fiduciary advice be provided on a "regular basis" and with a "mutual understanding" that the advice would form the primary basis of plan investment decisions. Moreover, the proposed amendment could subject some advisers to fiduciary status in connection with one-time appraisals or valuations of plan assets.

Re-Proposal

The proposed amendment has been extraordinarily controversial and has generated substantial debate, both in the industry and in government. The DOL received more than 260 written public comments, held a two-day public hearing in March of 2011, and held scores of meetings with interested parties as well as members of Congress. The press release states that the DOL's decision to re-propose the amendment means that the initiative will benefit from additional review and research as well as coordination with other agencies, including the Securities and Exchange Commission and the Commodities Futures Trading Commission. Moreover, issuing a new proposal will ensure that the public has an opportunity to review and comment on the DOL's changes to its previous proposal and updated economic analysis before the amended regulation becomes legally effective.

While the DOL's decision to re-propose is good news, it is not entirely clear what DOL has in mind for the next round. The press release did, however, give us a few hints. First, the DOL specifically noted that it intends to clarify that "fiduciary advice" is limited to individualized advice directed to specific parties. This should be helpful in avoiding fiduciary status in the development of advice products before there is a specific customer in mind. Second, DOL intends to respond to concerns about the proposed amendment's application to routine appraisals. DOL is clearly responding to significant pressure brought by appraisers and valuation firms. DOL also anticipates issuing or amending administrative prohibited transaction class exemptions ("PTEs") to address concerns about the impact of the new regulation on certain long-standing class exemptions. For example, brokers and advisers have long relied on class exemptions such as PTE 84-24, PTE 86-128, and PTE 75-1 in connection with plan transactions involving the sale of mutual funds, stocks and insurance products. With respect to these class exemptions, DOL intends to "preserve beneficial fee practices" while protecting plan participants and IRA holders from conflicted advice. This is something we have advocated for several months. It will be interesting to see how DOL will re-structure these class exemptions to make them "workable" in today's investment marketplace.

We have been following this important regulatory project closely and will keep you informed as developments unfold.

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