

Pension Plan Fix-It Handbook

Employee Benefits Series

THOMPSON

June 2015 | Vol. 22, No. 9

Is it Education or Is It Advice? Rules For Those Who Give It May be Changing

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The wait is over, but the impact remains to be seen: The U.S. Department of Labor has reissued its proposed regulations on the definition of a fiduciary. Originally set forth in October 2010 (see January 2011 column), the proposed rule was withdrawn after numerous critical

comments and negative public testimony concerning many of its provisions were lodged.

In reaction, the new set of proposed regulations is extensive, and includes amendments to certain prohibited transaction exemptions (see ¶900 in the *Handbook*) that address the concerns that sent it back to the drawing board five years ago.

One of the many exemptions involves “investment education” — which may be offered by plan sponsors or the investment managers they hire — and is the subject of this column.

Why change?

The employee benefit world has changed dramatically since ERISA was enacted 40 years ago. DOL believes that more participant protection is needed today, given the shift from defined benefit plans that shielded participants from the risk of investment decisions to participant-directed defined contribution plans, along with the growth of individual retirement accounts.

Brief overview

Fiduciaries must act in the best interest of plan participants under the “prudent person” rule. A breach of fiduciary duty is very serious: it can leave the fiduciary personally liable for making the participants whole and could lead to lawsuits and being barred from future fiduciary duty.

Currently, a five-part test must be satisfied before someone providing advice will be deemed a fiduciary. The new proposed conflict-of-interest regulation has a

four-part test (see box p. 3). This test not only expands the definition, it also removes some important language that often enabled advisers to avoid fiduciary status.

In addition, a number of “carve-outs” in the proposed regulations provide descriptions of particular activity that would not be subject to the fiduciary standards. One of the carve-outs relates to participant investment education and its providers.

The Current Guidance

Currently, Interpretive Bulletin 96-1 provides the DOL’s views of when investment education for participants and beneficiaries in participant-directed accounts constitutes advice. Briefly, explaining the following categories of information is not be considered to be providing investment advice:

- **Plan information** — general plan information explaining the plans terms. Any investment information provided must be general and not discuss the appropriateness of any individual investment option.
- **General financial information** — information that discusses general financial and investment concepts including risk, return, diversification and dollar-cost averaging; historic differences in rates of return among different asset classes (for example, stocks and bonds); and the effects of inflation and risk tolerance. The information provided must be general and have no direct relationship to the investment options under the plan or to individual participants.
- **Asset allocation models** — information, available to all participants, that provides model asset allocation portfolios of hypothetical individuals with different time horizons and risk profiles.
- **Interactive investment materials** — questionnaires, worksheets, software and similar materials that provide tools for the participant to estimate

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future retirement income needs and assess the impact of different asset allocations on retirement income.

If the asset allocation model or interactive tools identify any specific investment under the plan, the model must include a statement indicating that other investment alternatives having similar risk and return characteristics may be available under the plan, as well as provide where information on those investment alternatives may be obtained.

Proposed Carve-out for Investment Education

The proposed carve-out for investment education incorporates much of IB 96-1, with some exceptions. If finalized, the proposed regulations would supersede IB 96-1.

The proposed regulations apply to all educational information provided by plan fiduciaries to plan participants and beneficiaries, regardless of who provides the information, be it the plan sponsor, another fiduciary or a service provider.

What Is Investment Education?

Investment education comprises general investment information and educational materials for plan participants and beneficiaries.

A new condition for this carve-out is that the information and materials must not include advice or recommendations on specific investment products, investment managers or the value of particular securities or other property.

DOL seems to believe, as did commenters on the 2010 proposed regulations, that asset allocation models and interactive tools for hypothetical allocations may not be recognized as such, instead being seen as being tailored to an individual's own situation. Participants could be

relying on these hypothetical results when they should not. DOL emphasizes that effective allocation material need not be specific. It invites comments on this change.

Although the fiduciary definition was expanded in the new proposed rules to include those giving recommendations related to distributions, the preamble notes that giving participants information about employer plan or IRA distribution options, including the consequences associated with the available types, does not result in fiduciary status.

In addition, providing general information that helps an individual assess and understand retirement income needs and the associated risks, such as increased longevity and inflation, or material that explains general methods for managing those risks, both within and outside the plan, would not result in fiduciary status under the proposal.

The proposed regulations closely follow the Financial Industry Regulatory Authority's guidance. Like the proposed regulation, FINRA provides an exclusion for certain communications, as long as they do not include (either standing alone or in combination with other communications) a recommendation of a particular security or securities. FINRA notes that as allocation information becomes narrower or more specific, it gets closer to becoming a recommendation.

DOL says it believes that the proposal's guidelines on investment education cover information that is generally provided to participants, but the agency encourages input that will help clarify the line between advice and education.

What Is Investment Advice?

The preamble to the new DOL proposed rules states "... that communications must constitute a "recommendation" to fall within the scope of fiduciary investment advice."

The preamble states that materials that identify specific plan investment alternatives also appear to fall within the definition of "recommendation" and could result in bestowing fiduciary status on the provider if the other provisions of the proposal are met. Some have interpreted this to mean that a plan sponsor could not provide plan specific plan investment options to participants at the same time its providing investment education material. Let's hope this is not the case, but clarification will be welcomed.

An asset allocation model that calls for a certain percentage of the investor's assets to be invested in a particular class of mutual funds (such as large-capitalization funds)

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and identifies a specific fund or provider would be treated as investment advice and be subject to fiduciary standards.

DOL says FINRA guidance provides useful guideposts for distinguishing investment education from investment advice under ERISA. Still, DOL asked for comments on whether it should adopt all or some of the FINRA standards in defining communications that rise to the level of recommendation, for purposes of

distinguishing between investment education and investment advice under ERISA.

What Should Plan Sponsors Do?

Follow the developing story regarding the proposed DOL regulations; there undoubtedly will be many comment letters.

1. Talk to your plan service providers and discuss the ramifications of the proposed regulations on your particular situation.

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Note: This chart highlights the main differences between the current and proposed rule. There are many more details in the regulations for each item on this chart.	
Current Rule Defining Fiduciary	Proposed Conflict-of-interest Rule
Render advice on the value of securities or other property, or make recommendations regarding the advisability of investing in, purchasing or selling securities or other property	<p>A recommendation as to the advisability of acquiring, holding, disposing or exchanging securities or other property, including a recommendation to take a distribution of benefits or a recommendation on the investment of securities or other property to be rolled over or otherwise distributed from the plan or IRA.</p> <p>A recommendation on the management of securities or other property, including those on the management of securities or other property to be rolled over or otherwise distributed from the plan or IRA.</p> <p><i>This is an expansion of services.</i></p>
Render such advice on a regular basis	<i>The regular advice criterion has been removed; this is a significant change. Providing advice one time could result in fiduciary status.</i>
Render the advice under a mutual agreement, arrangement or understanding with the plan or a plan fiduciary	<p>An appraisal, fairness opinion or similar statement, whether verbal or written, concerning the value of securities or other property, if provided in connection with a specific transaction or transactions involving the acquisition, disposition or exchange of such securities or other property by the plan or IRA.</p> <p><i>Removal of “mutual agreement” language could result in more advisers being considered fiduciaries.</i></p>
The advice serves as a primary basis for investment decisions using plan assets	<p>A recommendation of a person who is going to receive a fee or other compensation for providing any of the advice noted above. Such person:</p> <ul style="list-style-type: none"> • acknowledges acting as an ERISA fiduciary with respect to the advice; or • renders the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is individualized to, or specifically directed to, the recipient for consideration in making an investment decision about the plan or IRA. <p><i>Removal of the words “primary basis” could result in more advisers being considered fiduciaries.</i></p>
The advice is individualized, based on the particular needs of the plan	<i>Advice does not have to individualized if it is specifically directed at the recipient.</i>

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2. Review your communications material to determine if changes are necessary, should the proposed regulation become final as written.
3. Don't hesitate to write a comment letter; if you have a concern, chances are that other plan sponsors share it.
4. Talk to your counsel regarding the potential impact on your plan.

Written comments on DOL's proposed conflict-of-interest rule are requested by mid-July; a 15-day extension for public comments was announced May 15 by DOL. The additional time given to react to the voluminous proposal came in response to several requests from the retirement plan and investment community, a DOL

spokesman said. Official announcement of the extension, along with dates for the public hearings expected during the week of Aug. 10, will be posted in a future edition of the *Federal Register*, the agency spokesman said, although an exact issue date was not given at press time.

The requirements of final rules generally would be effective eight months after their publication. ❖

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