VOL. 32, NO. 1 SPRING 2019

BENEFITS LAW JOURNAL

Fiduciary Rule Remnants: The Strange Case of Field Assistance Bulletin 2018-02

Kristina M. Zanotti

Can something be relied upon that doesn't exist? Can a rule be like Schrödinger's cat—both alive and dead? Or like a zombie—dead, but undead? Field Assistance Bulletin (FAB) 2018-02 says yes—at least for now.

At the beginning of 2018, brokers, investment advisers, and an array of other industry participants were working to comply with the Department of Labor's (DOL's) new Fiduciary Rule, which expanded the types of activities that made one a fiduciary under the Employee Retirement Income Security Act of 1974, as amended (ERISA).[1] They were also busy preparing for the "transition period" to end on July 1, 2019, when full compliance with all of the conditions of related prohibited transaction exemptions, including the Best Interest Contract (BIC) Exemption and the Principal Transactions Exemption, would be required. During the transition period, fiduciaries could rely on these exemptions by complying with simplified conditions known as "impartial conduct standards," but once the transition period ended, more onerous conditions were scheduled to be applicable.

And then the unexpected happened; on March 15, 2018, a three-judge panel of the U.S. Court of Appeals for the Fifth Circuit issued a

Kristina M. Zanotti is a partner in the investment management practice group at K&L Gates LLP, based in the DC office. Her practice concentrates in the ERISA Fiduciary and Derivatives practice areas.

decision to vacate the Fiduciary Rule in its entirety.[2] On June 21, 2018, the Court issued its mandate, making the March 15th opinion effective and voiding the Fiduciary Rule along with the related exemptions.

Meanwhile, in anticipation of the Fiduciary Rule's removal, DOL issued FAB 2018-02 on May 7, 2018. FAB 2018-02 announced a temporary enforcement policy stating that, until DOL issues new regulations, exemptions, or administrative guidance, "the Department will not pursue prohibited transactions claims against investment advice fiduciaries who are working diligently and in good faith to comply with the impartial conduct standards for transactions that would have been exempted in the BIC Exemption and Principal Transactions Exemption or treat such fiduciaries as violating the applicable prohibited transaction rules." The Internal Revenue Service (IRS) will also abide by the same policy.

The result: fiduciaries can continue to rely on relief under the BIC Exemption and Principal Transactions Exemption, even though those exemptions no longer exist. Note, however, this approach is not risk-free. Although DOL and the IRS will not bring enforcement actions against fiduciaries working diligently and in good faith to comply with the impartial conduct standards, FAB 2018-02 does not address the rights or obligations of other parties. It is possible that participants in plans subject to ERISA, along with plan fiduciaries, may be able to bring claims against a fiduciary that is engaging in transactions without an applicable exemption.[3]

One may wonder: when does the relief provided under FAB 2018-02 even matter? While the Fiduciary Rule's expanded definition created a number of new situations in which fiduciary status applied, and therefore necessitated new exemptive relief, with the Fiduciary Rule vacated the scope of who is a fiduciary reverted back to what it was pre-Fiduciary Rule. The old/current again regulation defines fiduciary investment advice as having five required elements (the five-part test):

1. Advice as to the value of securities or other property or recommendations as to the advisability of investing in, purchasing, or selling securities or other property;

2. Rendered on a regular basis;

3. Pursuant to a mutual agreement, arrangement, or understanding with the plan or a plan fiduciary that;

4. The advice will serve as a primary basis for investment decisions with respect to plan assets; and

5. The advice will be individualized based on the particular needs of the plan.

Each of these five elements must be present in order for fiduciary status to attach; if even one is missing, there is no fiduciary investment advice. The Fiduciary Rule had essentially nullified the second (regular basis), third (mutual agreement), and fourth (primary basis) elements. The result was that traditionally nonfiduciary activity such as marketing (which may not be on a regular basis and, even if it is, usually disclaims any mutual agreement and advises potential buyers to check with their own advisers before purchasing—negating the primary basis element) was likely to be considered fiduciary activity under the Fiduciary Rule. A fiduciary engages in prohibited self-dealing under ERISA if the fiduciary uses their authority to cause the plan (or a third party) to pay the fiduciary (or a person in whom the fiduciary has an interest, such as an affiliate) an additional fee, so under the Fiduciary Rule marketing a product or service and then having the plan buy the product or hire the service provider (resulting in fees) often involved prohibited transactions, which required an exemption such as the BIC Exemption. A nonfiduciary, however, does not need an exemption for fiduciary self-dealing. So is FAB 2018-02 pointless?

Not entirely.

The now-voided exemptions actually allowed fiduciaries to engage in one particular type of activity that under prior DOL guidance was very ambiguous: cross-selling (*i.e.*, recommending new products or services of the fiduciary or its affiliates to clients for which a service provider had a pre-existing fiduciary relationship). It is very common for a service provider to want to offer additional services to an existing client, or to recommend that the client hire one of its affiliates. This type of activity, however, had been fraught with uncertainty, particularly since the DOL released Advisory Opinion 2005-23A (the Deseret Letter).

The Deseret Letter discussed whether providing recommendations to a plan participant regarding an account rollover, including recommendations regarding how any distribution should be invested, constituted fiduciary investment advice under the five-part test. DOL expressed the view that providing these types of recommendations is not typically fiduciary in nature: "merely advising a plan participant to take an otherwise permissible plan distribution, even when that advice is combined with a recommendation as to how the distribution should be invested, does not constitute 'investment advice'" within the meaning of the five-part test. A recommendation to take a distribution is not advice about purchasing or selling securities or other property (*i.e.*, it does not meet element number 1 above), and any recommendations regarding the proceeds of a distribution would be advice with respect to funds that are no longer assets of the plan. *However*, the Deseret Letter goes on to take the controversial position that when provided by "someone who is already fiduciary of the plan," such advice *would* be fiduciary investment advice subject to ERISA's fiduciary duties. Whether DOL is correct or not in its analysis is debatable[4]; however, the position in the Deseret Letter creates uncertainty and, therefore, risk. Furthermore, this position can be extrapolated to other types of recommendations given to clients in pre-existing fiduciary relationships. Therefore, while marketing and selling activity is typically not fiduciary activity under the five-part test, DOL may view that activity as fiduciary investment advice if done by a person who is already a fiduciary to the plan. Also, if the recommendations are for products or services that would generate additional fees for the fiduciary or its affiliates (as is usually the case in cross-selling situations), there is a risk that DOL would consider the fiduciary to have engaged in fiduciary self-dealing prohibited transactions.

Under the Fiduciary Rule, most cross-selling would have been clearly fiduciary activity, but could be engaged in if the conditions of the BIC Exemption or Principal Transactions Exemption were met. With the Fiduciary Rule and related exemptions gone, we are back to ambiguity. If the activity is not fiduciary activity, then no exemption is needed—but if it *is* fiduciary activity, no exemption is available. In this situation, FAB 2018-02 allows the fiduciary to continue to rely on the BIC Exemption or the Principal Transactions Exemption, even though those exemptions technically no longer exist.

Per DOL's current regulatory agenda, the department is considering regulatory options related to the Fiduciary Rule in light of the Fifth Circuit opinion, with an anticipated action date of September 2019.[5] As, by its terms, the enforcement policy set out in FAB 2018-02 will be available until DOL issues new regulations, exemptions, or administrative guidance, the protection FAB 2018-02 offers should be available at least until then. Any fiduciaries engaged in cross-selling should examine their procedures to make sure such activity is in compliance with ERISA. And anyone continuing to rely on the BIC Exemption or Principal Transactions Exemption pursuant to FAB 2018-02 should consider their options to avoid engaging in prohibited transactions.

NOTES

1. The Fiduciary Rule was a regulation issued by the DOL that redefined when one is acting as a "fiduciary" under ERISA by reason of providing nondiscretionary investment advice to employee benefit plans subject to ERISA and plans (such as individual retirement accounts (IRAs)) subject to IRC § 4975. The Fiduciary Rule was issued with a package of new and amended prohibited transaction exemptions. 81 Fed. Reg. 20946 (Apr. 8, 2016).

2. *Chamber of Commerce of the USA, et al., v. U.S. Dep't of Labor, et al.,* No. 17-10238 (5th Cir. Mar. 15, 2018).

3. Unlike ERISA plan participants, IRA owners would not have the ability to bring a private right of action for breach of fiduciary duty.

4. The position in the Deseret Letter with respect to existing plan fiduciaries is difficult to reconcile with ERISA § 3(21), which limits fiduciary status so that a person is a fiduciary only to the extent he performs a defined fiduciary function. *See, e.g., Pegram v. Herdich,* 530 U.S. 211, 226 (2000) ("In every case charging breach of ERISA fiduciary duty, then, the threshold question is not whether the actions of some person employed to provide services under a plan adversely affected a plan beneficiary's interest, but whether that person was acting as a fiduciary (that is, was performing a fiduciary function) when taking the action subject to complaint."). Pre-Fiduciary Rule, courts typically held that marketing activities are generally not subject to ERISA fiduciary responsibilities, as long as the marketing activity does not comprise fiduciary investment advice, and the marketing entity does not have discretion to purchase or invest in the product or service being marketed. *See American Fed'n of Unions, Local 102 Health & Welfare Fund v. Equitable Life Assurance Soc.,* 841 F.2d 658, 664-65 (5th Cir. 1988) (insurance company did not become an ERISA fiduciary simply by urging the purchase of its products); *Fink v. Union Central Life Ins. Co.,* 94 F.2d 489 (8th Cir. 1996) (person did not become a fiduciary merely by being "a salesperson earning commissions").

5. *https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201810&RIN=1210-AB82*