To Our Clients and Friends

Memorandum

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U.S. DOL Releases Final ERISA Fiduciary Rule

Almost exactly one year after the U.S. Department of Labor proposed to redefine the term "fiduciary" as it applies in the investment advice context, it has released its final rule on the topic, which is substantially revised from, and less burdensome than, the proposed rule. Please see our previous Client Memorandum, "U.S. DOL Re-Proposes ERISA Fiduciary Rule," for a more in-depth discussion of the 2015 Proposed Rule. Please also see the Department of Labor's website, which contains a number of helpful resources on the topic, including the Final Fiduciary Rule, relevant fact sheets, FAQs and a chart illustrating the differences between the 2015 Proposed Rule and the Final Fiduciary Rule.

Following the release of the 2015 Proposed Rule, the DOL conducted a comment period lasting over five months, and received feedback through more than 300,000 submissions made as part of 30 separate petitions, 3,000 comments, 100 meetings and four days of public hearings. According to the DOL, a number of changes were made to clarify, streamline, and simplify the 2015 Proposed Rule while remaining mindful of the best interests of people receiving advice about their retirement savings.

The remainder of this Client Memorandum will focus on the key features of the Final Fiduciary Rule, and their application to discretionary asset managers of institutional ERISA clients.

Definition of Fiduciary

Like the 2015 Proposed Rule, the Final Fiduciary Rule does away with ERISA's existing five-part test for determining fiduciary status. Instead, an adviser will be an ERISA fiduciary with respect to an employee benefit plan or IRA if the adviser renders "investment advice" for a fee or other compensation (direct or indirect) with respect to moneys or other property of the plan or IRA. For these purposes, a person will be deemed to be rendering investment advice with respect to moneys or other property of a plan or IRA if (1) the person provides to a plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner any of the types of advice described in column (A) below AND (2) such person takes any of the actions described in column (B) below.

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(A) **Provision of the following advice in exchange for a fee or other direct or indirect compensation:**	(B) **Such person directly or indirectly (e.g., through or together with any affiliate) does any of the following:**
(i) A "recommendation" (see definition below) as to the advisability of acquiring, holding, disposing of, or exchanging securities or other investment property, or a "recommendation" as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred, or distributed from the plan or IRA; or (ii) A "recommendation" as to the management of securities or other investment property, including, among other things, "recommendations" on investment policies or strategies, portfolio composition, selection of other persons to provide investment advice or investment management services, selection of investment account arrangements (e.g., brokerage versus advisory); or "recommendations" with respect to rollovers, transfers, or distributions from a plan or IRA, including whether, in what amount, in what form, and to what destination such a rollover, transfer, or distribution should be made.	(i) Represents or acknowledges that it is acting as a fiduciary within the meaning of ERISA or the tax code; (ii) Renders the advice pursuant to a written or verbal agreement, arrangement, or understanding that the advice is based on the particular investment needs of the advice recipient; or (iii) Directs the advice to a specific advice recipient or recipients regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the plan or IRA.

A "recommendation" is a 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 determination of whether a "recommendation" has been made is an objective rather than subjective inquiry, but the term "recommendation" does not include, among other things, (a) general communications that a reasonable person would not view as an investment recommendation, (b) furnishing certain investment education materials to a plan or IRA or (c) furnishing certain general financial and investment matters that do not address specific investment products.

Exemptions of Interest to Discretionary Asset Managers of Institutional ERISA Investors

The Final Fiduciary Rule sets out a number of exemptions from the definition of the term "fiduciary." The two exemptions most relevant to discretionary asset managers of institutional ERISA investors are exemptions covering (a) transactions with independent fiduciaries with financial expertise (the so-called "seller's carve-out") and (b) swap and security-based swap transactions (both are more fully described below). It should be noted that these exemptions are substantially different from those that were included in the 2015 Proposed Rule.

1. *The "Seller's Carve-Out"*

Under the "seller's carve-out," except for persons who represent or acknowledge that they are acting as a fiduciary, a person will not be a fiduciary in connection with the provision of any advice (including the provision of asset allocation models or other financial analysis tools) to a fiduciary of a plan or IRA who is independent of the person providing the advice with respect to an arm's length sale, purchase, loan, exchange or other transaction related to the investment of securities or other investment property if:

- The person knows or reasonably believes that (and may rely on written representations from the plan or independent fiduciary to the effect that) the independent fiduciary of the plan or IRA is: (a) a bank as defined in the Advisers Act or similar institution that is regulated and supervised and subject to periodic examination by a state or federal agency; (b) an insurance carrier which is qualified under the laws of more than one state to perform the services of managing, acquiring or disposing of assets of a plan; (c) an investment adviser registered under the Advisers Act or under the laws of the state in which it maintains its principal office and place of business; (d) a broker-dealer registered under the Exchange Act; or (e) any independent fiduciary that holds, or has under management or control, total assets of at least $50 million;[1]

- The person knows or reasonably believes that (and may rely on written representations from the plan or independent fiduciary to the effect that) the independent fiduciary of the plan or IRA is capable of evaluating investment risks independently, both in general and with regard to particular transactions and strategies;

- The person fairly informs the independent fiduciary that the person is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction and fairly informs the independent fiduciary of the existence and nature of the person's financial interests in the transaction;

- The person knows or reasonably believes that (and may rely on written representations from the plan or independent fiduciary to the effect that) the independent fiduciary of the plan or IRA is a fiduciary under ERISA or the U.S. tax code with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction; and

- The person does not receive a fee or other compensation directly from the plan or IRA for the provision of investment advice (as opposed to other services) in connection with the transaction.

2. *Swap and Security-Based Swap Transaction Exemption*

A person who is a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant or a swap clearing firm will not be a fiduciary in connection with the provision of any advice to an employee benefit plan in connection with a swap or security-based swap if:

- The employee benefit plan is represented by a fiduciary independent of the person;

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[1] The DOL specifically declined to permit an exemption for IRA owners who, although they do not manage $50 million in assets, are nonetheless sophisticated. Sales of investment products to sophisticated IRAs would therefore need to comply with portions of the Final Fiduciary Rule not described here.

- In the case of a swap dealer or security-based swap dealer, the person is not acting as an adviser to the employee benefit plan in connection with the transaction;
- The person does not receive a fee or other compensation directly from the plan for the provision of investment advice (as opposed to other services) in connection with the transaction; and
- In advance of providing any recommendations with respect to the transaction(s), the person obtains a written representation from the independent fiduciary that the independent fiduciary understands that the person is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction(s) and that the independent fiduciary is exercising independent judgment in evaluating the recommendation.

Transition Period and Next Steps

The Final Fiduciary Rule will generally become effective as of April 10, 2017, with a "phased" implementation (which will become fully effective as of January 1, 2018) for certain exemptions not discussed in this Client Memorandum. As noted in the Final Fiduciary Rule, the DOL intends to support advisers, plan sponsors, fiduciaries and other affected parties with their compliance, by way of tools on its webpage.

We expect that most asset managers that market pooled investment funds, funds of one or separately managed accounts to institutional ERISA clients will likely wish to start modifying subscription documentation (and perhaps placement memoranda) to take the "seller's carve-out" into account (this would apply equally to "plan asset" and non "plan asset" funds). We anticipate that representations in many trading agreements will need to be revisited as well.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

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