

MEMO# 24662

October 27, 2010

DOL Proposes New Definition of Investment Advice Fiduciary

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TO: BROKER/DEALER ADVISORY COMMITTEE No. 50-10
BANK, TRUST AND RECORDKEEPER ADVISORY COMMITTEE No. 43-10 RE: DOL PROPOSES
NEW DEFINITION OF INVESTMENT ADVICE FIDUCIARY

The Department of Labor proposed a new rule on the circumstances under which a person will be considered to be a fiduciary under ERISA by providing investment advice. [\[1\]](#) The proposal would amend the existing rule, 29 C.F.R. § 2510.3-21, which dates from 1975. Comments are due January 20, 2011. DOL proposes to make the new rule effective 180 days after publication of final regulations.

Background

ERISA defines fiduciaries to include persons that render investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or property of an ERISA-governed plan. The existing DOL regulation uses a five-part test to determine when a person will be deemed to be an ERISA fiduciary by reason of providing advice. To meet the test, the adviser must:

1. render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property
2. 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 that
5. the advice will be individualized based on the particular needs of the plan.

DOL states in the preamble that there is a need to re-examine the types of advisory relationships that should give rise to fiduciary duties.

New two-part general test

The new proposed test has two parts, both of which must be satisfied in order for a person to be treated as rendering “investment advice.” Under the first part, the person must perform one of the following for a plan, plan fiduciary, or plan participant or beneficiary:

- provide advice, an appraisal or fairness opinion concerning the value of securities or other property;
- make recommendations as to the advisability of investing in, purchasing, holding, or selling securities or other property; or
- provide advice or make recommendations as to the management [\[2\]](#) of securities or other property.

Under the second part of the test, the person must directly or indirectly:

- represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA with respect to providing advice or making recommendations;
- otherwise be a fiduciary under ERISA’s definition (i.e. exercise discretionary authority or control respecting management of the plan or its assets or have discretionary authority or responsibility for the administration of the plan);
- be an investment adviser within the meaning of section 202(a)(11) of the Investment Advisers Act of 1940; or
- provide advice or make recommendations pursuant to an agreement, arrangement or understanding, written or otherwise, that the advice may be considered in connection with making investment or management decisions with respect to plan assets, and will be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary. [\[3\]](#)

DOL makes clear that these four conditions are independent: if any one of these four conditions is satisfied, the second part of the test is met.

Exclusions

DOL proposes to exclude certain activities from triggering fiduciary status.

Acting as purchaser or seller. A person is not considered to be a fiduciary by reason of providing investment advice if the person can demonstrate that the recipient of the advice knows or, under the circumstances, reasonably should know, that the person is providing the advice or making the recommendation in its capacity as a purchaser or seller of a security or other property, or as an agent of, or appraiser for, such a purchaser or seller, whose interests are adverse to the interests of the plan or its participants or beneficiaries, and that the person is not undertaking to provide impartial investment advice. This limitation does not apply, however, to a person who has represented or acknowledged that it is acting as a fiduciary.

Educational materials. Providing investment education information and materials described in Interpretative Bulletin 96-1 will not be treated as rendering investment advice.

Offering platform of investments. The marketing of or making available (through a platform or similar mechanism) securities or other property from which a plan fiduciary may designate investment alternatives to which participants may direct the investment of their accounts will not be considered investment advice. The platform must be offered without

regard to the individual needs of the plan or its participants and the person must disclose in writing that it is not undertaking to provide impartial investment advice. In addition, in connection with offering the platform, the provision of general financial information and data to assist the plan fiduciary's selection or monitoring of the investments will not be considered advice.

Statements reflecting the value of an investment. The term "advice, or appraisal or fairness option" does not include the preparation of a general report or statement that merely reflects the value of an investment, provided for purposes of compliance with the reporting and disclosure requirements of ERISA, the Internal Revenue Code, and the regulations, forms and schedules issued thereunder, [4] unless such report involves assets for which there is not a generally recognized market and serves as a basis on which a plan may make distributions to plan participants and beneficiaries.

Definition of fee or other compensation

The proposal defines fee or other compensation as any fee or compensation received by the person or its affiliate for the advice from any source and any fee or compensation incident to the transaction in which the investment advice has been or will be rendered. The term includes, for example, brokerage, mutual fund sales, and insurance commissions and fees and commissions based on multiple transactions involving different parties.

Application to IRAs and plan distributions and rollovers

The proposal makes clear that the new provisions would apply to all plans and arrangements subject to the prohibited transaction rules in section 4975 of the Internal Revenue Code, which includes not just qualified plans but also IRAs, Archer MSAs, HSAs, and Coverdell ESAs.

The DOL notes that in Advisory Opinion 2005-23A [5] it took the position that the recommendation to take an otherwise permissible distribution does not constitute investment advice, even when that advice is combined with a recommendation as to how the distribution should be invested. The proposal does not modify this position. DOL states that concerns have been raised about this position and asks for comment on whether and to what extent the final regulation should define the provision of investment advice to encompass recommendations related to taking a plan distribution. DOL asks for information on other laws that apply to the provision of these types of recommendations, whether and how those laws safeguard the interests of plan participants, and the costs and benefits associated with extending the regulation to these types of recommendations.

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endnotes

[1] A copy of the proposal is available here:
<http://www.gpo.gov/fdsys/pkg/FR-2010-10-22/pdf/2010-26236.pdf>.

[2] DOL explains in the preamble that this would include advice and recommendations on the exercise of voting rights and the selection of persons to manage plan investments.

[3] Unlike the current rule, there is no requirement that the advice be provided on a regular basis or that the parties have a mutual understanding that the advice will service as a primary basis for investment decisions.

[4] It is unclear if this exception applies if the valuation report or statement is provided solely for purposes of compliance with another law, like the securities laws.

[5] See [Memo](#) to Pension Members No. 5-06, Investment Adviser Members No. 5-06, and Investment Adviser Associate Members No. 2-06 [19609], dated January 20, 2006.

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