This post highlights the significant impact the proposed regulations may have on advisers to mid-sized and small 401(k) retirement plans if adopted. Previously, Part 1, Part 2 and Part 3 of this series described the Department of Labor’s recently proposed regulations governing fiduciary status under ERISA, an important accompanying exemption, and the rule’s impact on large retirement plans (i.e., plans with more than 100 participants or more than $100 million in assets).

As a consequence of increased attention paid by the Department to the maintenance and operation of ERISA-regulated retirement plans generally and 401(k) plans in particular, it has become commonplace for most large, and some mid-sized, 401(k) plans to hire an independent consultant to assist with fiduciary compliance with an emphasis on the selection and monitoring of the menu of investment alternatives made available to plan participants. As we explained in a previous post:

"Large plans are usually overseen by a fiduciary committee appointed by the plan sponsor’s board and increasingly governed by a formal, written charter. Fiduciary committees tend to be advised by external professional consultants who readily accept fiduciary status as part of the services that they provide. A principal duty of these consultants is to help plan sponsors curate the menu of investment options made available to participants. While not required by current law to be fiduciaries, the market for these services generally demands that consultants act as fiduciaries."

Among mid-sized and small retirement plans, this model is less often taken. Instead, we routinely encounter three approaches to a consultant’s potential fiduciary role.

**Operating as a Co-Fiduciary**

Under this variant, the consultant voluntarily agrees to accept co-fiduciary status. When advising medium and small plans, these consultants will generally be unaffected by the proposed regulations. To the extent that these consultants also provide advice on IRA rollovers, they will be similarly unaffected. Under current law (DOL Advisory Opinion 2005-23), a recommendation to take a distribution is not investment advice unless the person making the recommendation is already a fiduciary.

Consultants that sign on as fiduciaries are typically compensated under some sort of “fee-leveling” approach. With fee leveling, the consultant is paid at the same rate irrespective of which of its investment recommendations are acted on. The consultant thereby forgoes the ability to vary compensation in a manner that would result in a fiduciary breach. Alternatively, the consultant’s discretion over the receipt of fees may be eliminated by using independently verified, or computer-driven, financial models. (This latter approach was adopted as a statutory prohibited transaction exemption in the Pension Protection Act of 2006).

The particulars of legally-compliant fee-leveling arrangements are explained in a series of Department of Labor advisory opinions.

- In Advisory Opinion 97-15A (May 22, 1997) (Frost National Bank), the Department opined that, if
each dollar of mutual fund fees paid to the fiduciary is used to offset the fiduciary’s fees that the plan is otherwise legally obligated to pay, ERISA’s fiduciary standards will not be violated. According to the Department of Labor, a fiduciary that uses this approach is not considered to be dealing with plan assets for his or her own account.

- A subsequent advisory opinion, 2005-10A (May 11, 2005) (Country Trust Bank) approved of a fee leveling or “offset” approach under which fees are paid from either affiliated or unaffiliated mutual funds based on one of five model investment strategies.
- In accordance with Advisory Opinion 2001-09A (Dec. 14, 2011) (SunAmerica), it is also possible for a financial institution to offer an investment advice program to plan investors under which it would pay an independent financial expert to formulate investment recommendations using a computer model. Under this approach, an independent fiduciary determines whether the plan should participate in the program. The independent fiduciary also designates the investment alternatives to be offered under the plan with respect to which the financial institution would furnish recommendations to participants regarding allocations. Certain other requirements also apply.

Disclaiming Fiduciary Status

Using this approach, the consultant either disclaims fiduciary status, or—in a particularly noxious approach in our view—“gestures” at fiduciary compliance. Under this latter approach, consultants will imply or even state that they are assuming fiduciary status in marketing materials and sales pitches only to do all they can to disclaim fiduciary status in their client service agreements.

Disclaimers or limits on fiduciary status will no longer be allowed if the proposed regulations are adopted. Consultants in this category must either (1) sign on as a fiduciary, (2) operate under a carve out other than the seller’s exemption, (3) fit within a prohibited transaction class exemption, (4) apply for an individual prohibited transaction exemption, or (5) qualify for the statutory exemption for advice to participants in 401(k) plans and IRAs provided by the Pension Protection Act of 2006.

Option (2) (operate under a carve-out other than the seller’s exemption) is addressed the preamble to the proposed regulations:

“Although the seller’s carve-out may not be available in the retail market, the proposal is intended to ensure that small plan fiduciaries, plan participants, beneficiaries and IRA owners would be able to obtain essential information regarding important decisions they make regarding their investments without the providers of that information crossing the line into fiduciary status. Under the platform provider carve-out . . . persons that help plan fiduciaries select or monitor investment alternatives for their plans can perform those services without incurring fiduciary status. Similarly, under the investment education carve-out . . . general plan information, financial, investment and retirement information, and information and education regarding asset allocation models would all be available to a plan, plan fiduciary, participant, beneficiary or IRA owner and would not constitute the provision of investment advice, irrespective of who receives that information.”

Thus, it may be that consultants who are averse to accepting fiduciary status will rely on the platform provider and educational carve-outs. They may even attempt to take advantage of the statutory exemption under the Pension Protection Act of 2006 (option (5)). Whether this bundle of services qualifies as “consulting,” and whether these services would be compensated as such, is something the market will need to sort out.

When assisting plan fiduciaries to select and monitor the funds and other investment options that comprise the plan’s investment menu, the Best Interest Contract exemption (under option (3)) would be unavailable. If there are other prohibited transaction class exemptions that might work in the medium- and small-plan market, we are unaware of them. Nor does applying for an individual prohibited transaction exemption (option (4)) seem to us to hold out much promise, as it’s hard to see how such an exemption would be protective of participants’ interests.

Operating as a Platform Provider
Under this approach, the adviser (i.e., financial institution) merely makes available a roster of investment options from which plan fiduciaries can populate plan investment menus. The proposed regulations contain carve-outs for these providers under which “persons that provide access to securities or other property through a platform or similar mechanism” and “persons that help plan fiduciaries select or monitor investment alternatives for their plans” can perform those services without incurring fiduciary status. A related carve-out applies in instances where a financial institution “identif[i]es offered investment alternatives meeting objective criteria specified by the plan fiduciary or provid[es] objective financial data regarding available alternatives to the plan fiduciary.” These actions do not cause a platform provider to be a fiduciary. Provided that these advisers satisfy the criteria for these two carve outs, they are not fiduciaries, which means that they may be paid variable compensation.

The carve-out for platform providers recognizes a trend in the large plan market under which a plan’s financial services provider (mutual fund, bank, or insurance company) disclaims fiduciary status and defers to the plan’s independent consultant on matters relating to investment advice generally and the selection and monitoring of the investment menu in particular. (While the financial services provider’s representative might present a report on market conditions and trends to a plan fiduciary committee, he or she will assiduously avoid providing any financial advice or investment recommendations.) The carve-out for platform providers green-lights this approach, subject to certain conditions.

When compared to their large-plan counterparts, small and mid-sized plans that are subject to ERISA are at a disadvantage: the ERISA fiduciary standards and prohibited transaction rules apply with equal force to all such plans, but large plans are better able to afford the costs and other burdens of compliance. This divide between large plans, on the one hand, and small- and mid-sized plans, on the other is exacerbated by the proposed regulations’ seller’s carve-out, which is unavailable to the latter. In practice, the large-plan market is far ahead of the proposed regulations, since consultants in that market are, in the vast majority of cases, already operating as fiduciaries. We suspect that the proposed regulations will put added pressure on mid-sized plan consultants to follow suit—or choose instead to operate under the platform provider and educational carve-outs. Vendors to small plans will likely take advantage of the platform provider and educational carve-outs. Whether any these non-fiduciary approaches translates into higher levels of fiduciary compliance, and at what cost to plan participants, remains to be seen.

Authors

Alden J. Bianchi, Member / Chair, Employee Benefits &amp; Executive Compensation Practice

Alden J. Bianchi is an employee benefits and compensation attorney at Mintz. He advises clients on retirement plans, compensation arrangements, ERISA issues, benefits issues in mergers and acquisitions, and health and welfare plans. Alden is an authority on health care reform.