

The ERISA Litigation Newsletter

May 2015

Editor's Overview

This month we focus on the EEOC's proposed rules concerning wellness programs. As our colleague, Amy Covert, discusses, a recent change of position by the EEOC provides employers with opportunities to use financial incentives to maximize employee participation in their wellness programs without the risk of running afoul of the ADA. While the rules are not "final rules", the EEOC has stated that compliance with the proposed rules would be considered compliance with the ADA pending final regulations.

As always, please don't forget to review this month's rulings, filings, and settlements of interest. We highlight the First Circuit's ruling on the standard of review applicable to top hat plans, a district court ruling finding that lenders to hedge funds are not liable as ERISA fiduciaries, and settlements on mental health parity claims, excessive fee claims and employer stock fund claims. We also review several pieces of significant guidance over the past several weeks, including new California paid sick leave requirements, IRS correction requirements for elective deferral failures under EPCRS, and USDOL proposed rules defining fiduciary investment advice.

Tips for Designing Employee Wellness Programs to Incentivize Participation Without Violating the Americans with Disabilities Act*

By Amy Covert**

Introduction

Many companies that provide their employees with health insurance couple those plans with wellness programs that are designed to encourage employees to lead healthier lifestyles. Wellness programs are supposed to be a win-win proposition for both employers and employees—employees become healthier and enjoy a better quality of life, while employers get lower claim costs, lower rates of absenteeism and greater productivity. For that reason, employers have tried to create financial incentives for employees to participate in wellness programs.

A recent change of position by the Equal Employment Opportunity Commission (EEOC), may help to facilitate these efforts. Until recently, the agency had expressed hostility to many wellness plan designs that incorporated financial incentives for participation, claiming that these incentives unlawfully violated the Americans with Disabilities Act (ADA), over which it has jurisdiction. It even went so far as to sue three different employers over their wellness programs in 2014. The EEOC has now reversed course, however, and proposed rules that would provide employers with significant opportunities to use financial incentives to maximize employee participation in their wellness programs—without the risk of running afoul of the ADA.

Background

Among large employers, wellness programs often take the form of health risk assessments or biometric screenings,^[1] which are designed to identify potential non-genetic health risk factors—such as body mass index, high cholesterol, blood pressure or glucose levels—so that employees can take steps to lessen the risks of preventable, and often catastrophic, health outcomes like diabetes, heart attack and stroke. Because of the perceived health and cost benefits associated with wellness programs, a high percentage of large employers provide financial incentives to encourage employee participation. The EEOC has for some time taken the position that Subchapter I of the ADA prohibits employers from *requiring* employees to undergo medical examinations unless they are "job-related and consistent with business necessity." In other words, the EEOC's position has been that health risk assessments are medical examinations that are generally prohibited under the ADA unless they are *voluntary*.

The EEOC previously took the position that almost any financial distinction between employees who took the health risk assessment and those who did not transformed the medical examination into an involuntary program in violation of the ADA—even though both the Health Insurance Portability and Accountability Act (HIPAA) and the Affordable Care Act (ACA) specifically permit such financial incentives.^[2] The agency brought three lawsuits (all in 2014) challenging employer wellness programs on the basis that each program either provided financial incentives for, or conditioned eligibility for medical benefits on, participation in the program, thus rendering them involuntary programs that violated the ADA.

The EEOC's position was opposed by Congress and the business community. The agency was criticized for taking positions in these litigations that were fundamentally inconsistent with the ACA, which encourages employers to utilize wellness programs to promote employee health and lower health care spending. Congress reacted with legislative initiatives. On March 2, 2015, Senator Lamar Alexander (R-Tenn) and Representative John Kline (R-Minn), together with a number of Republican co-sponsors, introduced the *Preserving Employee Wellness Programs Act* (H.R. 1189, S. 620). That Bill generally provides that wellness programs that otherwise comply with the wellness program provisions of HIPAA and the ACA will be deemed not to violate the ADA.

In apparent recognition of the criticisms and legislative developments, the EEOC has now changed course. On April 16, 2015, it released a long awaited proposed rule that provides guidance on "voluntary" employee wellness programs

Overview of the EEOC's Proposed Rule[\[3\]](#)

The EEOC's proposed rule sets forth safe harbor limits on the levels of financial incentives an employer can provide to encourage (but not coerce) participation in health risk assessments and other wellness program offerings. Other provisions of the rule define what constitutes a bona fide "wellness" program, describes specific notice requirements to participants about the medical information requested, and addresses how the confidentiality of medical information will be protected.

Under the proposed rule, a wellness program is considered an employee health program under the ADA when it is "reasonably designed to promote health or prevent disease." The program must not be overly burdensome, a subterfuge for violating the ADA or other laws prohibiting employment discrimination, or highly suspect in the method chosen to promote health or prevent disease.

Under the safe harbor, the proposed rule permits employers to offer incentives of up to 30% of the total cost of an employee-only health plan (including both the employer's and the employee's contributions) for participation in a wellness program. The additional cost for participant and spouse or family coverage may not be taken into account, even if the wellness incentives are offered to spouses and/or dependents. In addition, the incentive can either be styled as a "reward" or a "penalty."

Tips for Designing Wellness Programs

As a result of the EEOC's proposed rule, employers now have significant leeway to design their wellness programs to bolster employee participation without fear of running afoul of the ADA. When reviewing the design of their wellness programs, employers should consider revising their plans to utilize penalties rather than rewards as incentives to boost employee participation rates, especially if reward-based programs have only resulted in lukewarm levels of participation. The social science around human behavior is very compelling that people, in general, are far more responsive to sticks than they are to carrots. Previously, because of the EEOC's apparent greater hostility to penalties or surcharges than to rewards (even though there is no economic difference), most employers structured their wellness program incentives as rewards. Given the EEOC's newly adopted acknowledgment that rewards and penalties are opposite sides of the same economic coin, employers should be able to significantly increase the level of employee participation in their wellness programs—without changing the fundamental economics of such plans—simply by recasting the incentives as penalties.

Employers can also drive up participation rates by increasing the amount of the incentive. Given the EEOC's previous position that almost any financial penalty rendered a wellness program involuntary, many employers were cautious about setting the incentive level at more than a de minimis amount. Now that the EEOC has provided safe harbor guidance for a 30% cap on incentives, employers should consider increasing their incentives to the maximum threshold. Clearly, the greater the reward or penalty for compliance/noncompliance, the more likely it is to grab an employee's attention and thereby drive greater participation in the wellness program. Employers should be cognizant that the 30% cap applies to the **employee-only** cost and applies to all of an employer's wellness programs combined. Additionally, employers should ensure that the aggregate penalty would not cause the coverage under the plan to exceed the 9.5% "affordability" threshold under the ACA.

Employers should also be sure that their wellness program is a part of a group health plan. The safe harbor proposed rule applies only to group health plans and by tying it to the health plan, state laws such as "smokers' rights laws" can be preempted by ERISA.

In designing the program, employers must ensure that reasonable accommodations are provided to allow sufficient participation in the program for individuals with disabilities. For example, there should be an alternative to a biometric screen that requires a blood draw for hemophiliacs.

To ensure that the program is voluntary under the proposed rule, employers may not (i) require participation in the wellness program, (ii) deny or limit health coverage for employees who choose not to participate, or (iii) take any adverse employment action or retaliate against, interfere with, coerce, intimidate or threaten employees who do not participate or fail to achieve desired health outcomes.

Employers should also be sure to comply with the notice and confidentiality requirements. With respect to the notice requirement, employers should review all plan communications, including the summary plan description and open enrollment materials, for compliance with the proposed rule. The rule requires that the notice to employees clearly set forth what medical information will be obtained; how the medical information will be used; who will receive the medical information; the restrictions on its disclosure; and the methods the employer uses to prevent improper disclosure of medical information. To further protect employee privacy and ensure confidentiality of medical information, the proposed rule requires that any medical information collected through an employee wellness program be provided to an employer only in aggregate terms that do not disclose the identity of specific individuals taking part in the program. Employers should likewise make sure they have their HIPAA firewalls in place to maintain the confidentiality of personal health information.

Employers must be sure to comply with the feedback requirement of the proposed rule. Under the proposed rule, a wellness program must be "reasonably designed to promote health or prevent disease" – that is, designed with an eye toward improving employee health rather than to shift costs of health care from the employer to targeted employees based on their health status. Conducting a health risk assessment or a biometric screening for the purpose of alerting employees of health risks of which they may not be aware would meet the rule's standard. If, on the other hand, the employer does not provide any follow-up information or advice to employees, the wellness program would not be reasonably designed to promote health or prevent disease because the employee would never have received the feedback necessary to take corrective action.

Finally, employers should ensure that their wellness program does not impose an overly burdensome time commitment, require unreasonably intrusive procedures or place significant costs for medical examinations on employees. For example, if an employee had to take a biometric screening at one particular location that was a 6 hour drive from an employee's work location, the EEOC would likely view that requirement as overly burdensome and not within the proposed regulations' safe harbor.

View from Proskauer

The EEOC has stated that compliance with the proposed rule would be considered compliance with the ADA pending final regulations. Accordingly, wellness programs that comply with the proposed rule should have safe harbor protection from challenge by the EEOC, at least until the rules are finalized. Therefore, employers currently designing their wellness programs for the 2016 open enrollment period would be well advised to adhere to these guidelines unless and until further guidance is forthcoming. While the proposed rules are not perfect, they are a vast improvement over the EEOC's prior position and offer employers plenty of opportunity to make effective use of incentives going forward.

Rulings, Filings, and Settlements of Interest

First Circuit Reviews Top Hat Plan Benefits Denial for Abuse of Discretion

By Lindsey Chopin

- The First Circuit recently applied an abuse of discretion standard of review to a claim for top hat plan benefits. Plaintiff Robert Niebauer, a former executive of Crane, brought a claim for executive severance plan benefits and a claim under ERISA section 510 for interference with his rights to benefits. The district court granted summary judgment in favor of Crane on both claims, finding that the denial was not arbitrary or capricious, and there was no adverse employment action to support his interference claim. On appeal, Niebauer argued that the district court erred and that it should have followed decisions from the Third and Eighth Circuits holding that top hat plans are unilateral contracts subject to ordinary contract principles and that determinations made under such plans should be reviewed *de novo*. The First Circuit declined to consider whether such a categorical rule for top hat plans should apply. Instead, it ruled that the distinction between top hat and other plans has no meaning where, as here, the plan grants discretion to the plan administrator. According to the Court, the grant of discretion, even under ordinary contract principles, confers a reasonableness standard equivalent to the deferential review standard ordinarily applied under ERISA. The Court also refused to find a

conflict-of-interest based on Crane's alleged desire to retaliate against Niebauer, ruling that such retaliatory intent is properly treated under ERISA section 510. The Court thus affirmed the lower court's finding that the decision was supported by substantial evidence and therefore was not an abuse of discretion. However, the Court vacated the district's dismissal of Niebauer's section 510 claim because it found that the district court improperly applied an abuse of discretion standard of review to that claim. The case is *Niebauer v. Crane & Co.*, 2015 WL 1787931 (1st Cir. Apr. 21, 2015).

Court Finds Lenders to Hedge Fund Not Liable as ERISA Fiduciaries

By Adam Scoll

- A federal court recently dismissed ERISA breach of fiduciary duty claims asserted by Delphi Beta Fund, LLC, a hedge fund, against two of its bank lenders, because there was no precedent for applying ERISA's fiduciary duties to a third party lender to a hedge fund. See *Delphi Beta Fund, LLC v. Univest Bank and Trust Co.*, 2015 BL 89360 (E.D. Pa. Mar. 27, 2015).

Beta Fund is a hedge fund that consists partly of ERISA-covered pension plans as investors, and allegedly was holding ERISA "plan assets" by virtue of the ERISA plan assets regulation's "Look-Through Rule" (meaning, here, generally that "benefit plan investors" owned 25% or more of the equity interests in the fund). Beta Fund's deceased former manager, William Spiropoulos, allegedly engaged in certain troublesome loan transactions with the Defendant banks, Univest Bank and Trust Co. and MileStone Bank, in connection with certain loans granted to Pheasant Run Hotel, LLC, a portfolio company of Beta Fund. Beta Fund asserted that, by virtue of the Look-Through Rule, Beta Fund was over the "ERISA 25% limit" and holding ERISA "plan assets." Accordingly, Beta Fund contended that it was an ERISA fiduciary to ERISA-covered plans invested therein and had standing to assert ERISA breach of fiduciary duty and prohibited transaction claims against Univest and MileStone arising out of the Spiropoulos loan transactions.

The court ruled that the defendant banks were not ERISA fiduciaries and did not engage in non-exempt "prohibited transactions." In so ruling, the court found that Beta Fund failed to provide any precedent for applying ERISA's fiduciary duties to a third party lender to a hedge fund, and stated that if it accepted Beta Fund's argument, "virtually anyone dealing with Beta Fund could be charged with ERISA's fiduciary duties." In the court's view, neither bank had any "control" over Beta Fund, nor did the banks do anything other than enter into a typical loan with Spiropoulos regarding construction of a hotel project and then act in accord with its contractual remedies.

The court accordingly held that, since neither bank was acting as an ERISA fiduciary to Beta Fund, they could not have breached any ERISA fiduciary duty to Beta Fund, nor could they have engaged in a non-exempt "prohibited transaction" under Section 406(b) of ERISA (which prohibited transaction rules are only applicable to ERISA fiduciaries). Beta Fund's claim that the banks assisted in a "prohibited transaction" under Section 406(a) of ERISA (which may be applicable to non-fiduciaries) also failed because such a claim requires "knowing participation" by the banks, which was not sufficiently alleged in the pleadings.

MHPA Class Action Settlement

By Madeline Chimento Rea

- A federal district court in Washington recently granted preliminary approval to a \$6 million settlement of a mental health parity class action suit against Regence Blueshield. Plaintiffs claimed that defendants routinely excluded and limited coverage of the essential therapies to treat children with developmental disabilities. A fairness hearing is scheduled for September 11, 2015. The case is *K.M. v. Regence Blueshield*, No. 13-1214 (W.D. Wash. Apr. 22, 2015).

Ameriprise Agrees to Pay \$27.5 Million to Settle Fiduciary Breach and Prohibited Transaction Claims

By Joseph Clark

- Defendants Ameriprise Financial, Inc., the fiduciary committees of the Ameriprise 401(k) plan, and individual committee members agreed to settle a lawsuit brought by a class of participants in the Ameriprise 401(k) plan for \$27.5 million. In the lawsuit, plaintiffs alleged: (i) fiduciary breaches associated with (a) using an affiliate as a recordkeeper and failing to ensure recordkeeping fees and expenses were reasonable and (b) including proprietary and high cost investments in the 401(k) plan; and (ii) prohibited transactions associated with Ameriprise's receipt of compensation from the 401(k) plan as a result of these fiduciary breaches.

In addition to the payment of \$27.5 million, the settlement agreement calls for a three-year settlement period during which defendants will conduct a competitive RFP bidding process for recordkeeping and investment consulting services. Among other things, defendants also agreed that during the settlement period they will refrain from receiving compensation for administrative services provided to the 401(k) plan other than reimbursement of direct expenses as permitted by ERISA. Defendants also agreed to pay fees to the plan recordkeeper on a flat fee or fee per participant basis only.

The case is *Krueger v. Ameriprise Financial, Inc.*, D. Minn. Case No. 11-cv-02781.

Settlement Reached in Stock-Drop Case

By Joseph Clark

- A class of former LandAmerica Financial Group employees agreed to a \$5 million settlement of stock-drop claims arising from LandAmerica's 2008 bankruptcy, and have submitted the agreement for court approval. LandAmerica filed for bankruptcy following the 2008 collapse of its title insurance subsidiary. The complaint alleged that certain LandAmerica directors and officers breached their fiduciary duties by, among other things, (i) imprudently investing in LandAmerica stock even though they knew that its title insurance subsidiary was backed by inherently risky subprime mortgage loans, and (ii) concealing the truth about LandAmerica's deteriorating condition. The value of LandAmerica stock in the company's 401(k) plan fell from just over \$28 million to \$76,552.

The case is *Borboa v. Chandler*, E.D. Va Case No. 13-cv-00844.

New California Paid Sick Leave Requirements Effective July 1, 2015

By Mary Bresnan

- Beginning July 1, 2015, California employers will be required to grant paid sick leave to nearly all California employees in compliance with California's new paid sick leave law, the *Healthy Workplaces, Healthy Families Act of 2014*. The law applies to all employers who employ at least one employee who works in California for at least 30 days in a given year, and covers any such employee, including part-time, temporary, and/or seasonal employees. The law includes rules regarding accrual rates, carryover of unused time, usage, payment (including amounts and timing), notices to employees, workplace posters, recordkeeping and retaliation.

For more information on the requirements of the new California law, please refer to our [California Employment Law Blog](#).

You may also learn more about the law and how to manage implementation in our upcoming [webinar](#) on April 29, 2015.

IRS Relaxes Correction Requirements for Elective Deferral (But Not After-Tax Contribution) Failures under EPCRS

By Damian A. Myers

- Less than a week after issuing significant modifications to the Employee Plans Compliance Resolution System (EPCRS) (as described in our March 31, 2015 [blog](#)), the Internal Revenue Service (IRS) further modified EPCRS through the release of [Revenue Procedure 2015-28](#). The new guidance provides welcome relief (provided certain requirements are met) from the current standard (or safe harbor) EPCRS correction method for elective deferral failures, which has been widely viewed as providing affected participants with a windfall. Also, in an effort to facilitate the adoption of automatic contribution arrangements and prompt correction of failures, the IRS has established favorable safe harbor correction methods for elective deferral failures.

The most recent restatement of EPCRS, [Revenue Procedure 2013-12](#), provides a standard correction method for elective deferral failures under 401(k) and 403(b) plans. An elective deferral failure occurs when the plan administrator fails to correctly implement a participant deferral election or automatic deferral. The current standard correction method for elective deferral failures requires a plan sponsor to make a qualified nonelective contribution (QNEC) to the plan on behalf of affected participants to compensate the participants for their missed deferral opportunity. In general, this QNEC is equal to the sum of 50% of the amount the affected participant would have deferred from pay had the elective deferrals been properly implemented (40% in the case of a failure to implement an after-tax election), plus 100% of the matching contributions the affected participant would have received, plus earnings.

Although the mantra of EPCRS is to put affected participants in the same position they would have been in had a failure not occurred, the current standard correction method is generally considered to provide a windfall in the sense that participants benefit from a "free" allocation of elective deferrals (albeit 50% of what they elected) without having to actually reduce their salary. Recognizing that the standard correction is often costly for plan sponsors, Rev. Proc. 2015-28 provides for new, relaxed safe harbor correction methods for elective deferral failures.

Interestingly, the new correction methods described in Rev. Proc. 2015-28 do not apply to failures to implement deferrals of after-tax employee contributions. For purposes of EPCRS, "elective deferrals" means pre-tax elective deferrals and separate rules are provided in Appendix A for after-tax employee contribution deferrals (although the original standard correction method is the same except for the QNEC required (50% versus 40%) for the missed contributions). The modifications to Appendix A in Rev. Proc. 2015-28 do not mention after-tax employee contributions. Perhaps future guidance will expand the new correction methods to include after-tax employee contribution failures.

The new correction methods, and the conditions that must be met to use them, are described below.

1. **Elective Deferral Failures for Plans with Automatic Contribution Features.** If a plan administrator fails to implement automatic contributions when there is no election otherwise (including automatic escalation of elective deferral contributions), or fails to implement an affirmative election to contribute more than the automatic contribution rate, no QNEC equal to 50% of missed elective deferrals is required if the following conditions are met:
 1. The failure does not extend beyond 9-1/2 months after the end of the plan year in which the failure first occurred.
 2. Elective deferrals at the correct rate begin no later than the first payroll date following the period described above, or, if earlier, the first payroll date following the end of the month after the plan administrator receives notice of the failure from an affected participant.
 3. The plan administrator sends a notice to affected participants within 45 days after the correction. This notice must include an explanation of the error and how it was corrected, a statement that a contribution has been made to compensate for missed matching contributions, a statement that the participant is able to increase his or her election to make up for missed deferrals, and contact information in the event the participant has questions.
 4. A QNEC for missed matching contributions, plus earnings, is made no later than the end of the second plan year following the year in which the failure first occurred. If no affirmative investment election has been made, earnings may be determined based on the default investment option, provided that any losses cannot offset the QNEC.

It appears this safe harbor correction method is limited to elective deferrals that are tied to implementing an automatic contribution arrangement, whether an election is made or not. In other words, an election to opt-out of the automatic contribution rate in favor of a higher rate before or shortly after any deferral is made is subject to the safe harbor correction method. However, a failure based on an election to change the automatic contribution rate one year after automatic

contributions commenced would not likely be eligible. In that case, the safe harbor correction methods described below or the original standard correction must be used.

This new correction method is available for eligible elective deferral failures occurring on or before December 31, 2020. The IRS will consider whether the correction method should be extended at a later date.

1. **Elective Deferral Failures Unrelated to Automatic Contributions.** The new guidance provides for two relaxed safe harbor correction methods for elective deferral failures unrelated to automatic contributions. Where the elective deferral failure persists for three or fewer months, no QNEC for the missed elective deferrals is needed provided the plan administrator timely corrects the failure and meets notice requirements similar to that described above. Although this correction method is more favorable than the standard correction, plan administrators should be aware that the new guidance did not make any modifications to Appendix B of Rev. Proc. 2013-12, which contains a special rule for brief elective deferral failures. Under that special rule, if the elective deferral failure only occurs during the first three months of a plan year, no QNEC for the missed elective deferrals is necessary (a QNEC for missed matching contributions, plus earnings, is still required). The special rule does not include a notice requirement.

Where the elective deferral failure extends beyond three months, but not beyond the end of the second plan year following the plan year in which the error occurred, the failure may be corrected by making QNEC equal to 25% of the missed deferral (plus any missed matching contributions and earnings). This correction method is available if the correction is timely implemented and the plan administrator meets the notice requirements described above.

By reducing the QNEC required for the correction, the IRS is making it easier for plan sponsors to implement corrections and, thereby, incentivizing employers to adopt automatic contribution arrangements and to promptly correct elective deferral failures as they occur. The timing and notice conditions do not appear to be onerous, so overall, these modifications are certainly welcome. Rev. Proc. 2015-28 does not supersede Rev. Proc. 2013-12, so plan administrators should ensure compliance with Rev. Proc. 2013-12, subject to the modifications described above and in [Revenue Procedure 2015-27](#), when implementing any correction.

EEOC's Proposed Wellness Regulations Add Burdensome Notice Requirement; Still Prohibit Mandatory HRAs

By Stacy Barrow, Emily Erstling and Damian A. Myers

- On April 16, 2015, the Equal Employment Opportunity Commission (EEOC) released [proposed regulations](#) covering wellness programs that involve disability-related inquiries or medical examinations. The release of the proposed regulations follows months of EEOC enforcement actions against employers alleging that wellness programs sponsored by the employers violated the Americans with Disabilities Act (ADA) despite compliance with 2013 regulations jointly issued by the Department of Labor (DOL), the Department of the Treasury (Treasury) and the Department of Health and Human Services (HHS) that permitted such programs under ERISA and the Affordable Care Act (ACA). With a few notable exceptions (described below), the proposed regulations are somewhat consistent with the existing DOL guidance on employer-sponsored wellness programs. However, the EEOC has requested comments on multiple topics that could significantly alter the regulatory requirements.

Background

ERISA prohibits group health plans and group health insurance issuers from discriminating against covered individuals based on a health factor. An exception to the nondiscrimination rule allows premium discounts or other rewards (including avoidance of a penalty) in return for participation in wellness programs. The DOL, Treasury and HHS jointly issued regulations related to the wellness program exception to the nondiscrimination rule in 2006, and these regulations were updated in 2013 following the passage of the ACA (the 2013 regulations are referred to as the "DOL regulations" in this blog post).

The DOL regulations describe two types of wellness programs – participatory programs and health-contingent wellness programs (which are further divided into activity-only and outcome-based programs). Participatory programs are those programs that either do not provide a reward or do not require that a participant complete an activity or satisfy a condition related to a health factor in order to receive an award. Because participatory programs are not based on a health factor, they do not implicate HIPAA's nondiscrimination rule as long as they are available to all similarly situated individuals regardless of health status. Examples of participatory programs include: reimbursement of gym membership; reimbursement of cost of smoking cessation programs without regard to whether employees quit; reward for attending a monthly health education seminar; and

completion of a health risk assessment (HRA) without any further action (educational or otherwise) required by employees as a result of issues identified by the questionnaire.

Health-contingent wellness programs require individuals to complete an activity or satisfy a standard related to a health factor in order to receive an award. These programs must satisfy four requirements to be nondiscriminatory under ERISA: (i) eligible individuals must be able to qualify once per year; (ii) the maximum incentive amount is 30% of the self-only cost of coverage (taking into account both the employee and employer share of the cost), or if covered dependents can also participate, 30% of the cost of the coverage the employee is enrolled in; (iii) the program is reasonably designed to promote health or prevent disease and (iv) the program is available to all similarly situated individuals. DOL regulations provide more detail on each of these requirements.

Since their release, the DOL regulations have served as a guide for employers establishing wellness programs. However, during a meeting in May 2013, the EEOC stated that wellness programs could violate regulations under the ADA and recognized that guidance regarding the interplay between the ADA and wellness programs was needed. However, before issuing regulations or other guidance under the ADA, the EEOC initiated a number of enforcement actions against employers. Some of these actions were brought against employers that established programs that were in compliance with existing DOL regulations. Due to the apparent conflict between the EEOC's position on wellness programs and the DOL regulations, employers and other stakeholders advocated for specific EEOC guidance.

EEOC's Proposed Regulation

The ADA requires employers to provide reasonable accommodations to enable disabled individuals to have equal access to fringe benefits and prohibits employers from requiring medical examinations or requesting medical information for the purpose of making disability-related inquiries. However, the ADA provides an exception to this rule allowing voluntary medical exams (or requesting voluntary medical histories) which are part of an employee health program, including wellness programs. The EEOC's proposed regulations focus on the ADA exception for voluntary programs that involve disability-related inquiries or medical exams.

The EEOC's apparent concern is that incentives or rewards under wellness programs may be so valuable that eligible individuals are economically coerced into participating, thereby violating the ADA requirement that the program be voluntary. Therefore, the proposed regulations provide that a wellness program will be

considered to be voluntary if it meets the following requirements:

- It does not require employees to participate;
- It does not condition coverage under a group health plan on participation in the program;
- It does not penalize non-participation (other than the failure to receive the reward); and
- When it is part of a group health plan, employees receive a notice that describes the medical information that will be obtained and the purposes for which it will be used and explains the restrictions on disclosure of the information.

In addition to the EEOC's voluntary requirement, the EEOC proposed regulations diverge from the DOL regulations in important respects. First, in contrast to the DOL regulations, which do not restrict the size of reward under a participatory wellness program, the proposed EEOC guidance seeks to extend the 30% maximum award to participatory wellness programs that require employees to answer a health questionnaire with disability-related inquiries or take medical examinations. This would mean, for example, that the reward for participating in a biometric screening program (that does not base the reward on the result of the screening) would be capped at 30% even though there is no maximum under the DOL regulations. The EEOC's rationale for this proposal is that, in the EEOC's estimation, participatory programs rarely offer incentives in excess of 30%. However, this rule prohibits employers from requiring employees to complete an HRA in order to be eligible to participate in the plan, a practice that is permitted under DOL rules as long as the results of the HRA are not used to determine eligibility.

A second difference relates to how the proposed regulations apply the 30% limit in general. The EEOC proposed regulations set the maximum reward at 30% of the self-only cost of coverage (taking into account both the employee and employer share of the cost). The DOL regulations allow a reward to be a maximum of 30% of the cost of family coverage if the wellness program is extended to covered dependents. Additionally, the ACA allows the DOL to increase the 30% limit to 50%, and the DOL has done so by expanding the 30% limit by an additional 20% to the extent that the additional percentage is in connection with a program designed to prevent or reduce tobacco use. The EEOC regulations do not contain similar

flexibility. Nevertheless, the DOL-approved limit of 50% for tobacco-based programs remains acceptable as long as the program does not involve a medical exam or disability-based inquiry.

Finally, when the wellness program is part of a group health plan, the EEOC regulations require that employers provide a detailed notice to participants separate from other notices already required under the HIPAA. The notice must explain what medical information will be obtained, who will receive the information, how the information will be used, the restrictions on disclosure of the information and the methods the covered entity will employ to prevent improper disclosure of the medical information. The DOL regulations do not contain similar notification requirements. The EEOC's proposed notice requirement will likely be a burden on employers, as the notice requires more detail than standard HIPAA notices and must be tailored for each wellness program.

Although the proposed regulations are a step in the right direction toward existing DOL regulations, the EEOC has requested comments on a number of topics that could significantly alter the regulations. For example, the EEOC has requested comments on whether additional protections are needed for low-income individuals. This would include placing restrictions on programs that could result in unaffordable coverage if a reward is not obtained. For this purpose, affordability would be based on the standard established under the ACA. Additionally, the EEOC has requested comments regarding the definition of "voluntary", including whether changes are necessary to reconcile the proposed regulations with DOL regulations.

Overall, the EEOC's release of proposed regulations is a welcome development for employers sponsoring wellness programs, particularly given the EEOC's recent practice of bringing enforcement actions in the absence of guidance. Given the wide-range of comments requested, the final regulations could be significantly different than the proposed regulations. Employers should review their current programs in light of the EEOC guidance and consider submitting comment letters if the proposed EEOC requirement could require significant changes.

The U.S. Department of Labor's New Proposed Rules Defining Fiduciary Investment Advice

By Russell Hirschhorn, Adam Scoll, Pamela Onufer and Ahuva Warburg

- On April 14, 2015, the U.S. Department of Labor (DOL) issued its highly anticipated re-proposed regulation addressing when a person providing investment advice with respect to an employee benefit plan or individual retirement account (IRA) is considered to be a fiduciary under the Employee Retirement Income Security Act of

1974 (ERISA) and the Internal Revenue Code (Code). As discussed below, the new proposal (available [here](#)) offers a general definition of fiduciary investment advice that would expand the group of people who would be considered fiduciaries. The proposal contains a number of carve-outs for particular types of communications that the DOL does not consider to be fiduciary in nature. The DOL also has proposed a new set of prohibited transaction exemptions and certain amendments to existing class exemptions applicable to fiduciaries that would allow certain broker-dealers, insurance agents and others who provide investment advice to continue to engage in certain transactions and to receive common forms of compensation that would otherwise be prohibited as conflicts of interest.

Background

ERISA provides that "a person is a fiduciary with respect to a plan to the extent . . . he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so." ERISA § 3(21)(A)(ii). Pursuant to a 1975 regulation, in order for a person to be held to ERISA's fiduciary standards with respect to investment advice for a fee, such person must: (i) make recommendations as to investing in, purchasing or selling securities or other property, or give advice as to their value, (ii) on a regular basis, (iii) pursuant to a mutual understanding that the advice, (iv) will serve as a primary basis for investment decisions with respect to plan assets, and (v) will be individualized to the particular needs of the plan.

The DOL first published a new proposed regulation on October 22, 2010. In doing so, the DOL stated its belief that the current regulatory scheme no longer adequately protects plans, participants and beneficiaries. The DOL's initial proposal would have broadened significantly the scope of individuals considered to be fiduciaries under ERISA. (See Proskauer's Client Alert available [here](#).) Facing immense pressure, on September 19, 2011, the DOL stated that the proposal would be withdrawn and that a new proposal would be issued at a later date. Since then, lobbyists on both sides of the issue have been voicing their concerns and views about the DOL's proposal.

Now, nearly four years later, the DOL has proposed a new set of rules. The DOL has stated that the new proposal is necessary because the current regulatory scheme no longer adequately protects plans, participants, beneficiaries, and, in particular, IRA owners (to which ERISA's current fiduciary rules regarding prudence and loyalty do not apply) from conflicts of interest, imprudence and disloyalty. The DOL explained that many investment professionals are not subject to ERISA's fiduciary standards and thus, in its view, have the ability to operate with undisclosed

conflicts of interest. Addressing concerns raised over the past several years, the DOL stated that it has consulted with other federal regulators, including the Securities Exchange Commission (SEC), concerning whether the proposal would subject investment professionals who provide investment advice to requirements that are overly burdensome or conflict with their obligations under other federal laws.

The Proposed Regulation

The proposal consists of: (i) a delineation of categories of advice that could be considered fiduciary conduct; (ii) specific carve-outs from the definition of investment advice; and (iii) new and amended prohibited transaction exemptions.

Categories Of Advice

The proposal provides that certain types of advice described below, which, when provided in exchange for a fee or other compensation, directly or indirectly, and given under certain circumstances (described below) would be "investment advice." Except with respect to the category covering appraisals and valuations, the proposed regulation is structured so that a communication must constitute a "recommendation"[\[4\]](#) in order to be treated as fiduciary investment advice.[\[5\]](#) The DOL has requested comments on whether it should adopt all or some of the standards developed by the Financial Industry Regulatory Authority, Inc. for determining whether a communication rises to the level of a recommendation (e.g., FINRA Policy Statement 01-23, which sets forth guidelines to assist brokers in evaluating whether a particular communication could be viewed as a recommendation).

1. **Investment Recommendations.** *"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 as to the investment of securities or other property to be rolled over or otherwise distributed from the plan or IRA."* Unlike the 2010 proposal and contrary to [Advisory Opinion 2005-23A](#), the new proposal provides that recommendations to take distributions or entrust plan or IRA assets to particular advisers would fall within the scope of covered advice. If the proposal is adopted, it would supersede the Advisory Opinion. The proposal makes clear, however, that a person does not act as a fiduciary merely by providing participants with information about plan or IRA distribution options, including the consequences associated with the

available types of benefit distributions. It thus draws an important distinction between investment advice and investment education.

- 2. Investment Management Recommendations.** *"A recommendation as to the management of securities or other property, including recommendations as to the management of securities or other property to be rolled over or otherwise distributed from the plan or IRA."*The proposal defines investment advice as including individualized advice or recommendations as to the exercise of proxy or other ownership rights. However, investment advice does not include guidelines or other information on voting policies for proxies that are provided to a broad class of investors without regard to a client's individual interests or investment policy, and which are not directed or presented as a recommended policy for the plan or IRA to adopt. In addition, a recommendation addressed to all shareholders in a proxy statement would not constitute investment advice.
- 3. Appraisals Of Investments.** *"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."*This provision differs from the 2010 proposal in several respects. First, it is narrower in that it covers only those appraisals, fairness opinions, and similar statements that relate to a particular transaction. Second, the DOL expanded the 2010 proposal's carve-out for general reports or statements of value provided to satisfy required reporting and disclosure rules under ERISA and the Code to include any federal or state law, rule, regulation or self-regulatory organization. Third, the proposal limits what constitutes investment advice addressing valuations or appraisals provided to an investment fund, in that a person providing an appraisal, fairness opinion, or statement of value to a collective investment fund or pooled separate account, in which more than one unaffiliated plan has an investment or which holds "plan assets" of more than one unaffiliated plan under the DOL's plan assets regulation will not be considered to be providing investment advice.[\[6\]](#) Fourth, the proposal does not extend fiduciary coverage to valuations or appraisals for employee stock ownership plans. The DOL stated that while it remains concerned about the potential for abuse in this context, these concerns raise unique issues more appropriately addressed in a separate regulatory initiative.

- 4. Recommendations Of Persons To Provide Investment Advice For A Fee Or To Manage Plan Assets.** *"A recommendation of a person who is also going to receive a fee or other compensation for providing any of the types of advice described [above]."* In the DOL's view, the current regulation already treats as fiduciary conduct a recommendation of a person who also is going to receive a fee or other compensation for providing any of the types of investment advice, and this provision is being proposed "to remove any possible ambiguity."

The DOL stated that this category includes recommendations of persons to perform asset management services or to make investment recommendations. However, general advice as to the types of quantitative and qualitative criteria to consider in hiring an investment manager would not rise to the level of investment advice, nor would a trade journal's endorsement of an investment manager. Recommendations of administrative service providers, property managers, or other service providers who do not provide investment services also would not be covered.

The Circumstances Under Which Advice Is Provided

Unless a carve-out (discussed below) applies, a category of advice described above would constitute "investment advice" if the person providing the advice, either directly or indirectly (e.g., through or together with any affiliate):

1. Represents or acknowledges that he or she is acting as a fiduciary within the meaning of ERISA or the Code with respect to the advice described above; or
2. Renders the advice pursuant to a written or verbal agreement, arrangement, or understanding that the advice is individualized, or that such advice is specifically directed to the advice recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA.

The proposal elaborates on this provision in several respects. First, advisers who claim fiduciary status may not later argue that their advice was not fiduciary in nature. They also would not be able to rely on any of the carve-outs provided in the proposal. Second, unlike the 2010 proposal, which provided that investment recommendations provided by an investment adviser under the Investment Advisers Act of 1940 would, absent an applicable carve-out, be automatically treated as investment advice, the new proposal dropped this provision in favor of a

"functional approach" to fiduciary status. Third, the proposal avoids treating recommendations made to the general public, or to no one in particular (e.g., the general circulation of newsletters, television talk show commentary, or remarks made in speeches and presentations at financial industry education conferences) as investment advice. Fourth, the proposal does not require a meeting of the minds as to the extent to which the recipient will actually rely on the advice, but the parties must agree or understand that the advice is individualized or specifically directed to the particular advice recipient for consideration in making investment decisions. In this regard, unlike the 2010 proposal, there is no requirement that the advice be specific to the needs of the plan, participant or beneficiary or IRA owner; rather, the advice only needs to be specifically directed to such recipient. Lastly, there is no requirement that the advice be provided on a regular basis.

Fee Or Other Compensation

Fiduciary status under ERISA requires that the investment advice be provided for a "fee or other compensation, direct or indirect." The proposed regulation defines this phrase to mean "any fee or compensation for the advice received by the person (or by an affiliate) from any source and any fee or compensation incident to the transaction in which the investment advice has been rendered or will be rendered." "Fee or compensation" includes, but is not limited to, brokerage fees, mutual fund sales, and insurance sales commissions. "Direct or indirect compensation" includes any compensation received by affiliates of the adviser that is connected to the transaction in which the advice was provided.

Carve-Outs From Definition Of Investment Advice

Acknowledging that the proposed categories of investment advice, standing alone, could sweep in certain relationships that are not appropriately considered fiduciary in nature, the DOL included a number of specific carve-outs in the proposal.

1. Seller's and Swap Carve-Outs

Seller's Carve-Out

Under the seller's carve-out, the proposal would not treat incidental advice and recommendations made to an expert plan adviser in an arm's-length transaction where there is generally no expectation of fiduciary investment advice as imposing fiduciary status. This carve-out is subject to several conditions. First, the person must provide advice to an ERISA plan fiduciary, who is independent of such person, and who exercises authority or control with respect to the management or disposition of plan assets, with respect to an arm's-length sale, purchase, loan or

bilateral contract between the plan and the counterparty, or with respect to a proposal to enter into such transaction. Second, either of two alternative sets of conditions must be met.

Under the first alternative, prior to providing any recommendation with respect to the transaction, such person:

1. Obtains a written representation from the plan fiduciary that he or she is a fiduciary who exercises authority or control with respect to the management or disposition of plan assets, that the plan has 100 or more participants, and that the fiduciary will not rely on the person to act in the best interests of the plan, to provide impartial advice, or to give advice in a fiduciary capacity;
2. Fairly informs the plan fiduciary of the existence and nature of the person's financial interests in the transaction;
3. Does not receive a fee or other compensation directly from the plan or plan fiduciary for the provision of investment advice in connection with the transaction (this does not preclude a person from receiving a fee or compensation for other services); and
4. Knows or reasonably believes that the plan fiduciary has sufficient expertise to evaluate the transaction and determine whether it is prudent and in the best interest of participants (a written representation from the plan or plan fiduciary is sufficient).

The second alternative applies if the person knows or reasonably believes that the fiduciary has responsibility for managing at least \$100 million in plan assets (information on an individual plan's most recent Form 5500 can be relied upon, and, in the case of a fiduciary acting as an asset manager for multiple plans, representations from the fiduciary as to the value of plan assets under management may be relied upon). In this case, no written representations are required, but the adviser must fairly inform the fiduciary that the adviser is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, and the adviser may not receive a fee or compensation directly from the plan or the plan fiduciary for the provision of investment advice in connection with the transaction.

This carve-out is significantly different from the 2010 proposal. The changes reflect the DOL's desire to ensure that it appropriately distinguishes between incidental advice as part of an arm's-length transaction, with no expectation of trust or acting in the customer's best interest, from those instances where a customer may be expecting unbiased investment advice that is in its best interest.

Notably, this carve-out does not apply to recommendations to retail investors, including "small" plans (less than 100 participants), IRA owners and plan participants and beneficiaries. The DOL believes that recommendations to retail investors and small plan providers are generally not "arm's-length" and are presented routinely as advice, consulting, or financial planning services.

Swap Carve-Out

The swap carve-out relates to advice and other communications by counterparties in connection with certain swap or security-based swap transactions under the Commodity Exchange Act or Securities Exchange Act. The carve-out would allow swap dealers, security-based swap dealers, major swap participants and security-based major swap participants who make recommendations to plans to avoid becoming ERISA fiduciaries when acting as counterparties to a swap or security-based swap transaction. In order to qualify for the carve-out, if the person providing recommendations is a swap dealer or security-based swap dealer, it must not be acting as an adviser to the plan with respect to the transaction or in connection with the transaction within the meaning of the applicable regulations of the Commodities Futures Trading Commission or the SEC. In addition, before providing any recommendations with respect to the transaction, the person must obtain a written representation from the plan fiduciary that the fiduciary will not rely on the recommendations provided.

2. Employees of Plan Sponsor

Employees of a plan sponsor of an ERISA plan will not be given fiduciary status with respect to advice they provide to the fiduciaries of the sponsor's plan as long as they do not receive compensation for the advice beyond their normal compensation. This would protect internal employees, such as human resources professionals, who routinely may develop reports and recommendations for investment committees and other named fiduciaries of sponsors' plans.

3. Platform Providers/Selection and Monitoring Assistance

These related carve-outs are intended to cover service providers, such as record-

keepers and third party administrators, that offer a "platform" or selection of investment vehicles to participant-directed individual account ERISA plans. The proposal makes clear that persons would not be providing investment advice by marketing or making available to a plan specific investment alternatives to be made available to participants, without regard to the individualized needs of the plan or its participants and beneficiaries, as long as they disclose in writing that they are not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity.

Similarly, the carve-out covers certain common activities that platform providers may carry out to assist plan fiduciaries in selecting and monitoring investment alternatives that they offer to participants. Merely identifying investment alternatives meeting objective criteria specified by the plan fiduciary (e.g., expense ratios, fund size, or asset type specified by the plan fiduciary) or providing objective financial data regarding available alternatives to the plan fiduciary would not constitute the rendering of investment advice.

In response to comments about the 2010 proposal, the DOL confirmed that the platform provider carve-out is available in the 403 (b) plan marketplace, but does not extend to IRAs and other non-ERISA plans, since there typically is no separate independent plan fiduciary to interact with the platform provider.

4. Investment Education

The investment education carve-out makes clear that the furnishing or making available of specified categories of information and materials to a plan, plan fiduciary, participant, beneficiary or IRA owner will not constitute the provision of investment advice, regardless of who provides the information (e.g., plan sponsor, fiduciary or service provider), the frequency with which the information is shared, the form in which it is provided (e.g., on an individual or group basis, in writing or orally, via a call center, or by way of video or computer software), and whether an identified category of information and materials is provided or made available alone or in combination with other categories identified, or the type of plan or IRA involved.

The proposal incorporates much of [DOL Interpretive Bulletin 96-1](#) (IB 96-1). For example, similar to IB 96-1, the categories of investment education information and materials include, but are not limited to: (i) plan information; (ii) general financial, investment and retirement information; (iii) asset allocation models; and (iv) interactive investment materials.

There are, however, several exceptions and, if the proposal is adopted, it would result in IB 96-1 being superseded. First, a new condition of the carve-out is that the information and materials may not include advice or recommendations as to specific investment products, specific investment managers, or the value of particular securities or other property. Second, the proposal includes a new provision clarifying that the distribution of certain general information that helps an individual assess and understand retirement income needs past retirement and associated risks, or explains general methods for the individual to manage those risks both within and outside the plan, would not result in fiduciary status. Third, asset allocation models and interactive investment materials that refer to specific investment products available under the plan or IRA would now be considered individualized investment recommendations, rather than investment education, even when accompanied by a statement that other similar investment alternatives may be available.

New Prohibited Transaction Class Exemptions and Amendments to Existing Class Exemptions

The DOL's proposal also includes two new prohibited transaction class exemptions, as well as amendments to several existing class exemptions, that are intended to preserve the ability of certain fiduciary advisers, broker-dealers and insurance agents to continue to receive common forms of compensation that would otherwise be prohibited as conflicts of interest. In addition, the DOL proposed to revoke certain parts of existing class exemptions in recognition that the transaction would be covered by one of the new exemptions or proposed amendments to other existing class exemptions. The DOL intends to make the new and amended exemptions available at the same time as the regulatory proposal becomes effective. Set forth below is a summary of certain material aspects of the proposed exemptions and amendments. It is important to emphasize that compliance with these (and other) prohibited transaction exemptions requires a comprehensive analysis of the applicable facts and circumstances as well as satisfaction of all applicable conditions of the exemption.

Proposed "Best Interest Contract Exemption"

The Best Interest Contract Exemption is designed to promote the provision of investment advice that is in the best interest of retail investors, including plan participants and beneficiaries, IRA owners and "small" plans (less than 100 participants) (collectively referred to in the proposal as "retirement investors"). The proposed exemption represents a departure from the typical DOL class exemption model in that it is intended to provide relief for a broad range of current business

practices, rather than being transaction-specific.

ERISA and the Code prohibit fiduciary advisers to plans and IRAs from receiving compensation that varies based on their investment recommendations and from receiving compensation from third parties in connection with their advice. The exemption would permit certain investment advice fiduciaries (and their affiliates and related entities) to receive common forms of such "prohibited compensation" for services provided in connection with the purchase, sale or holding of certain "assets" by plans, participants, beneficiaries and IRAs in accordance with the advice provided by the investment advice fiduciary, provided that all applicable conditions of the exemption are satisfied. Under the exemption, (a) the common forms of "prohibited compensation" contemplated are commissions paid by a plan, participant or beneficiary, or IRA owner, and commissions, sales loads, 12b-1 fees, revenue sharing and other payments from third parties that provide investment products; and (b) "assets" are defined to include bank deposits, CDs, shares or interests in registered investment companies, bank collective funds, insurance company separate accounts, exchange-traded REITs and funds and certain exchange-traded equity securities, certain corporate bonds, agency debt securities and Treasury securities, insurance and annuity contracts and guaranteed investment contracts.

Among other things, the exemption would require the adviser to:

1. contractually acknowledge its status as a fiduciary;
2. contractually agree to, and comply with, certain "impartial conduct standards," which include (a) only providing advice that is in the "best interest" of the retirement investor (generally, a standard similar to the ERISA duties of prudence and loyalty), (b) avoiding misleading statements, and (c) receiving no more than reasonable compensation;
3. contractually warrant that it will comply with all applicable laws governing the provision of investment advice and that it has adopted written policies and procedures reasonably designed to mitigate the impact of conflicts of interest;

4. provide certain disclosures relating to material conflicts of interest, including informing the retirement investor of its right to obtain information in regards to the adviser's direct and indirect fees; and
5. provide certain initial and annual financial/transaction disclosures, comply with certain recordkeeping requirements, and provide advance notification to the DOL of the adviser's intention to rely on the exemption.

Importantly, the proposed exemption does not allow the investment advice contract between the adviser and the retirement investor to provide for the retirement investor's waiver of its right to bring a class action lawsuit in court to resolve disputes or to include any exculpatory provisions disclaiming or limiting the adviser's liability for violation of the contract.

The "best interest" standard of the exemption is particularly important for IRA owners. Fiduciaries to ERISA-covered plans are already subject to duties of prudence and loyalty, but IRA fiduciaries are not subject to similar standards under the Code. By requiring the "best interest" standard to be included within the investment advice contract as an exemption condition, the exemption would provide IRA owners a private right of action for the adviser's failure to comply with such standard, which would not otherwise be available.

The exemption separately provides relief with respect to certain purchases of insurance or annuity contracts by a retirement investor from an insurance company that is a "party in interest" or "disqualified person," where the transaction is for cash, in the ordinary course of business and the insurance company's fees are reasonable.

The exemption also provides relief to advisers with respect to compensation received in connection with the purchase, sale or holding of a covered asset (defined above) pursuant to an agreement or arrangement that was entered into prior to the effective date of the new rules, provided additional advice with respect to the asset is not provided after the effective date and the transaction was not a "prohibited transaction" on the date it occurred.

Lastly, the DOL noted that it also is considering, and seeking public input in regards to, a separate streamlined exemption that would allow advisers to receive otherwise prohibited compensation in connection with plan, participant and beneficiary accounts, and IRA investments in certain high-quality, low-fee investments with minimal potential for material conflicts of interest, subject to

fewer conditions.

Proposed "Principal Transaction Exemption"

"Principal transactions," *i.e.*, transactions in which a fiduciary is acting on behalf of its own account, generally are prohibited under ERISA and the Code, absent an exemption. The Principal Transaction Exemption would permit certain broker-dealers and other advisers to engage in "principal transactions" involving certain widely-held debt securities^[7] that possess moderate credit risk when the transaction is a result of the adviser's advice (*e.g.*, the adviser's sale of a debt security to a plan out of the adviser's own inventory). The proposed exemption includes all of the contract requirements of the proposed Best Interest Contract Exemption (described above), and further requires, among other things, that the written contract disclose the material conflicts of interest involved and set forth the retirement investor's written consent to such transactions (only prospectively), which must be terminable at will at any time without penalty. The exemption also includes certain pricing conditions, pre-transaction and annual disclosure requirements and recordkeeping requirements.

Proposed Amendments to Prohibited Transaction Exemptions (PTE) 86-128 and 75-1 (Parts I(b) and (c) and II(2))

ERISA and the Code generally prohibit a fiduciary from using its authority to affect or increase its own compensation, absent an exemption. PTE 86-128 currently contains two covered transactions: (i) it allows a fiduciary, including an investment advice fiduciary, to cause a plan or IRA to pay it, or its affiliate, a fee for effecting or executing securities transactions as agent under certain circumstances, and (ii) it allows a fiduciary to act as an agent in an "agency cross transaction" for both the plan and its counterparty and to receive a reasonable fee from the counterparty in connection with the agency cross transaction.

The DOL is proposing to amend PTE 86-128 to require all fiduciaries (not only investment advice fiduciaries) relying on the exemption to adhere to the "impartial conduct standards" required in the proposed Best Interest Contract Exemption (described above).

In addition, the amendment would add a third covered transaction to PTE 86-128 for fiduciaries who sell mutual fund shares out of their own inventory to plans and IRAs and receive commissions in connection with such transactions. While these transactions are currently the subject of another exemption, PTE 75-1 (Part II(2)), the DOL stated they are more accurately described as "riskless principal"

transactions that are most similar to the agency transactions already covered by PTE 86-128. That exemption permits a fiduciary to use its authority to receive a commission for effecting or executing a plan's or IRA's securities transactions on an agency basis. As a corollary to moving the mutual fund exemption to PTE 86-128, the DOL also is proposing to remove it from PTE 75-1 (Part II(2)).

The amendment also would provide that an investment advice fiduciary to an IRA would not be able to rely on PTE 86-128. Instead, such fiduciaries would be required to rely on the Best Interest Contract Exemption. However, a fiduciary with full investment discretion over an IRA (*i.e.*, an investment manager) would still be able to rely on PTE 86-128, although the DOL proposes to require such fiduciaries to comply with all of the exemption conditions (including those to which they are not currently subject, *e.g.*, prior written authorization and certain disclosures and quarterly and annual reporting).

Finally, the DOL proposes to revoke Parts I(b) and (c) of PTE 75-1, which currently provide exemptive relief for certain non-fiduciary services (*e.g.*, effecting securities transactions on an agency basis (other than by a fiduciary), including clearance, settlement or custodial functions, and furnishing advice regarding securities or other property under circumstances which do not make such party a fiduciary) to plans and IRAs. The DOL is proposing to require reliance on the existing statutory exemptions under ERISA Section 408(b)(2) and Code Section 4975(d)(2) and the DOL's regulations thereunder to exempt these services.

Proposed Amendment to PTE 75-1 (Part V)

PTE 75-1 (Part V) currently permits the extension of credit to a plan or IRA by a broker-dealer in connection with the purchase or sale of securities. As a practical matter, the exemption permits broker-dealers to extend credit to a plan or IRA as a normal part of the execution of securities transactions; for example, so as to permit settlement within the customary settlement period, purchases of securities on margin, short sales and the writing of options contracts. However, the exemption does not permit broker-dealers that are fiduciaries with respect to the plan assets involved in the transaction to receive compensation for such an extension of credit. The DOL is proposing to amend PTE 75-1 (Part V) to permit investment advice fiduciaries to receive compensation for lending money or otherwise extending credit to plans or IRAs, but only for the limited purpose of avoiding a failed securities transaction, provided that the terms of the extension of credit are at least as favorable to the plan or IRA as the terms available in an arm's-length transaction between unrelated parties and the plan or IRA receives certain written disclosures prior to the extension of credit.

Proposed Amendment to PTE 84-24

PTE 84-24 currently provides relief for certain classes of transactions involving purchases with assets of a plan or IRA of insurance contracts, annuity contracts and securities issued by registered investment companies (*i.e.*, mutual funds), and the receipt of sales commissions in connection therewith by insurance agents, insurance brokers, pension consultants, and investment company principal underwriters (that, in each case, are "parties in interest," "disqualified persons" or fiduciaries to such plan or IRA). PTE 84-24 also provides relief for sales to a plan or IRA by an insurance company of an insurance or annuity contract and for sales by an investment company of mutual fund shares.

The amendment would require all fiduciaries relying on the exemption to adhere to the "impartial conduct standards" required in the proposed Best Interest Contract Exemption (described above), and would define more precisely the types of payments ("insurance commissions" and "mutual fund commissions") that are permitted under the exemption. The amendment also would provide that investment advice fiduciaries to IRA owners would no longer be able to rely on PTE 84-24 (and would have to instead rely on the proposed Best Interest Contract Exemption) with respect to transactions involving variable annuity contracts and other annuity contracts that constitute securities under federal securities laws, and mutual fund shares.

Proposed Amendments to PTEs 75-1 (Parts III and IV), 77-4, 80-83 and 83-1

The DOL is proposing to amend PTEs 75-1 (Parts III and IV), 77-4, 80-83 and 83-1 to require all fiduciaries relying on the exemptions to adhere to the "impartial conduct standards" required in the Best Interest Contract Exemption (described above).

PTE 75-1 (Part III) permits a fiduciary to cause a plan or IRA to purchase securities from a member of an underwriting syndicate other than the fiduciary or its affiliate, when the fiduciary or affiliate is also a member (but not manager) of the syndicate.

PTE 75-1 (Part IV) permits a plan or IRA to purchase or sell securities in a principal transaction from or to a fiduciary that is a market-maker with respect to such securities.

PTE 77-4 permits a plan or IRA to purchase or sell open-end investment company shares (*e.g.*, mutual fund shares) where the mutual fund investment adviser is also a fiduciary to the plan or IRA (or an affiliate of such fiduciary).

PTE 80-83 provides relief for a fiduciary causing a plan or IRA to purchase a security when the proceeds of the securities issuance may be used by the issuer to retire or reduce indebtedness to the fiduciary (or its affiliate).

PTE 83-1 permits the sale of certificates in an initial issuance of certificates by the sponsor of a mortgage pool to a plan or IRA when the sponsor, trustee or insurer of the pool is a fiduciary with respect to the assets of the plan or IRA invested in such certificates.

Comment Period Comments on the proposed regulation, the proposed class exemptions and the proposed amendments to existing class exemptions must be submitted on or before the day that is 75 days after the proposed regulation is published in the Federal Register.

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[\[1\]](#) A health risk assessment is typically a questionnaire that employees complete on their own, while biometric screenings typically take the form of third party administered tests, such as a blood draw, that elicit the desired health information. For purposes of this article, I will refer to both as "health risk assessments."

[\[2\]](#) HIPAA prohibits discrimination on the basis of health status. Following changes made by the ACA, the Department of Health and Human Services, the Department of Labor, and the Department of the Treasury released final regulations on nondiscriminatory wellness programs under HIPAA.

[\[3\]](#) This article assumes that the reader is already familiar with the proposed rule and is not intended to provide a detailed summary of its provisions.

[\[4\]](#) The proposal defines "recommendation" to mean "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."

[\[5\]](#) Consistent with the 1975 regulation, mere execution of a securities transaction at the direction of a plan or IRA owner is not considered fiduciary activity.

[6] The carve-out does not appear to apply to: (a) a "fund of one" or separate account, or (b) a fund holding "plan assets," but that had only one plan investor large enough to be over 25% of the interests.

[7] The DOL purposefully excluded from coverage under the exemption "principal transactions" involving other financial instruments and assets such as equity securities, futures, derivatives, and currencies because the DOL was not persuaded that an exemption would be in the best interests of, and protective of, retirement investors. Note, however, that other exemptions (e.g., PTE 75-1 (Parts II and IV)), may be applicable to provide relief for the purchase or sale of certain securities under certain circumstances. In addition, transactions between a plan or IRA and a fiduciary that are "blind transactions" executed on an exchange may not need exemptive relief.

Related Professionals

- **Russell L. Hirschhorn**
Partner
- **Myron D. Rumeld**
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