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DOL's Fiduciary Rule To Apply June 9th, Investment Managers and Advisers May Want to Take Action Now

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The U.S. Department of Labor's (DOL) final rule significantly expanding when a person is considered to be a fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (Code) as a result of providing investment advice is set to become applicable at 11:59 PM (local time) on June 9, 2017. The expanded final rule might cover certain marketing and other related activities common to the investment management industry (including the private investment fund industry).

The final rule was initially set to become applicable on April 10, 2017, but the DOL delayed the final rule's applicability date for sixty days, until June 9, 2017.[1] Although the DOL has since indicated that it will not further delay the applicability date of the final rule,[2] the DOL has also issued a new temporary enforcement policy for the transition period commencing on June 9th and ending on December 31, 2017. During the transition period, the DOL will not pursue claims against fiduciaries who are working diligently and in good faith to comply with the final rule and the related exemptions.[3]

The following is a high-level executive summary of certain material aspects of the final rule as it relates to private investment fund managers and other investment advisers, followed by a list of potential action items to consider. To review a more fulsome summary of the final rule, please see our prior client alerts (available here and here).

Executive Summary

- The final rule affects common marketing and other related activities involving ERISA plan and/or individual retirement account (IRA) investors, prospective investors, clients and/or prospective clients (Targeted ERISA/IRA Parties).
    - Certain common marketing or offering activities for private investment funds and separately managed accounts involving ERISA plans and/or IRAs could be

considered "investment advice" under the final rule.

- Similarly, some fund managers' and investment advisers' periodic newsletters could be viewed as a "recommendation" to remain invested in a fund or continue a separately managed account arrangement.

- Discussions with Targeted ERISA/IRA Parties might be considered "investment advice" and fiduciary in nature if they are considered tantamount to a "recommendation" to invest (or maintain an investment) in the fund or establish (or maintain) a separately managed account arrangement, even though, in the case of a prospective investor or client, a fee will not be charged until after the investor invests in the fund or the separately managed account is established.

- If such marketing materials, pitch practices and/or periodic distributions are considered a "recommendation", such as a recommendation to purchase or hold a security (e.g., an equity interest in a private investment fund) or continue a separately managed account arrangement, then the fund manager or investment adviser would most likely be considered to be providing fiduciary "investment advice" to Targeted ERISA/IRA Parties to purchase or continue to hold an interest in the fund manager's or adviser's own funds and/or establish or continue a separately managed account arrangement with the fund manager or adviser (and to pay any related management or other fees), as the case may be. This advice could be treated as "conflicted," resulting in a violation of fiduciary duty and/or a prohibited transaction absent an exemption.

- A request to "hire me" to provide investment management services by touting the quality of an individual's or entity's advisory or investment management services that is not combined with a "recommendation" on how to invest or manage ERISA plan or IRA assets might not constitute "investment advice." Unfortunately, the line between "hire me" communications and advice that triggers fiduciary obligations is not clear. The "hire me" exception generally will not work for marketing of specific funds and preset investment strategies.

- Fund managers and other investment advisers might be able to avail themselves of an "expert fiduciary exclusion" when dealing with most ERISA-covered investors and clients. However, this exclusion is not available for recommendations to IRA owners, small plan fiduciaries or plan participants and beneficiaries that are not

separately advised by fiduciaries. This "expert fiduciary exclusion" will generally apply if the fund manager or investment adviser:

1. knows or reasonably believes that the independent fiduciary of the ERISA plan or IRA is a US-regulated bank, a US-regulated insurance carrier, a registered investment adviser, a registered broker-dealer, or an independent fiduciary that holds, or has under management or control, total assets of at least $50 million (and it may rely on written representations to satisfy this requirement);

2. knows or reasonably believes that the independent fiduciary of the ERISA plan or IRA is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies (and it may rely on written representations to satisfy this requirement);

3. fairly informs the independent fiduciary that it is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction and fairly informs the independent fiduciary of the existence and nature of its financial interests in the transaction;

4. knows or reasonably believes that the independent fiduciary is a fiduciary under ERISA or the Code, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction (and it may rely on written representations to satisfy this requirement); and

5. does not receive a fee or other compensation directly from the ERISA plan, ERISA plan fiduciary, ERISA plan participant or beneficiary, IRA, or IRA owner for the provision of investment advice (as opposed to a fee for other services) in connection with the transaction.

Potential Action Items

- Private investment fund managers and other investment advisers that determine that their typical marketing activities would (or could) be treated as "investment advice" under the final rule should decide whether or not to continue to pitch their products to IRAs or small plans, or to alter such activities so as to not constitute "investment advice".

    - Similarly, managers and advisers of open-end, liquid private investment funds and separate accounts that have IRAs or small plan investors should determine whether to permit such investors to remain in their funds or whether to continue such separate account arrangements.

    - The BICE might be available in certain cases to permit the status quo for IRAs and small plans, but the conditions for the exemption may prove too complicated or impractical (even with certain requirements of the BICE not applicable until January 1, 2018).

- With respect to any commitments to be accepted from, or separate account arrangements to be entered into with, large institutional ERISA investors after June 9th, fund managers and investment advisers should determine whether or not to revise any offering materials and/or require additional written representations from such investors. For example, fund managers and investment advisers might want to confirm the availability of the "expert fiduciary exclusion" with respect to any potential "investment advice" that may be provided to such investors in connection with the commitment/engagement and/or throughout the term of the investment/engagement.

- With respect to open-end, liquid private investment funds that have large institutional ERISA investors and existing separate account arrangements with large institutional ERISA investors, fund managers and investment advisers should consider requiring the ERISA investors to make additional written representations to confirm the availability of the "expert fiduciary exclusion" with respect to ongoing communications. For example, the representations would confirm the understanding that communications to such ERISA investors about performance and developments is not intended to be fiduciary advice to remain invested in the fund or account.

- With respect to closed-end, illiquid private investment funds that are no longer fundraising as of June 9th, fund managers and investment advisers should determine whether any action is necessary under those circumstances.

[1] When the DOL issued the final rule it also issued new prohibited transaction exemptions (including the Best Interest Contract Exemption or "BICE") and amendments to existing prohibited transaction exemptions, which were aimed at easing the potential prohibited transaction impact of the final rule. The DOL also delayed the applicability date for most of the new requirements of the BICE and such other new and amended exemptions until January 1, 2018. However, the BICE's "impartial conduct" standard (acting in the client's best interest) is still set to apply as of June 9th.

[2] The DOL has noted that it is continuing to review the final rule and the related exemptions, and it is possible that changes thereto may be issued prior to the end of the transition period, including potentially further delaying the January 1, 2018 applicability date of the delayed exemption requirements. The DOL intends to issue a Request for Information in the near future for additional public input on specific ideas for possible new exemptions, other regulatory changes, and as to whether an additional delay of the January 1, 2018 applicability date of the delayed exemption requirements is appropriate.

[3] The temporary enforcement policy also includes confirmation from the Treasury Department and the Internal Revenue Service that Section 4975 of the Code (which provides excise taxes relating to prohibited transactions) and related reporting obligations will not be applied during this transition period with respect to any transaction or agreement to which the DOL's temporary enforcement policy would apply.

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