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The Requirement to Disclose Fiduciary Status: Interesting Angles on the DOL's Fiduciary Rule #49

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This is our 49th article about interesting observations concerning the Department of Labor's fiduciary rule and exemptions. These articles also cover the DOL's FAQs interpreting the regulation and exemptions and related developments in the securities laws.

When the new fiduciary rule applies on June 9, it will convert most non-fiduciary advisers into fiduciaries.

While there is not a disclosure requirement for new fiduciary advisers to IRAs, there is for these newly minted fiduciary advisers to plans. But it's not part of the new regulation. Instead the requirement is found in the 408(b)(2) regulation which was effective in 2012.

As background, that regulation required that service providers to ERISA-governed retirement plans, including advisers, make written disclosures to plan fiduciaries of their services, compensation and "status." The status requirement was that service providers disclose if they were fiduciaries under ERISA and/or the securities laws (*e.g.*, RIAs). The regulation describes the status disclosure as follows:

> *If applicable, a statement that the covered service provider, an affiliate, or a subcontractor will provide, or reasonably expects to provide, services pursuant to the contract or arrangement directly to the covered plan…as a fiduciary…; and, if applicable, a statement that the covered service provider, an affiliate, or a subcontractor will provide, or reasonably expects to provide, services pursuant to the contract or arrangement directly to the covered plan as an investment adviser registered under either the Investment Advisers Act of 1940 or any State law.*

(The reference to "subcontractor" includes representatives of broker dealers who are independent contractors.)

For the most part, broker-dealers, and insurance agents and brokers, have taken the position that

they were not fiduciaries and therefore did not make the fiduciary disclosure. And, if they were not in fact fiduciaries, those disclosures worked from July 1, 2012 until June 9, 2017, when the new definition will make them fiduciaries.

Technically, that last sentence is not absolutely correct. Let me explain. First, the new regulation requires that, to be considered a fiduciary, the adviser (and the supervisory entity) must make an investment recommendation. And, until the first investment recommendation is made, the adviser and entity are not fiduciaries. However, the definition of investment recommendation is so broad that it may be best to treat June 9 as the day they became fiduciaries. For example, a recommendation is a "suggestion" that the plan fiduciaries select, hold or remove investments; that the fiduciaries use a fiduciary adviser to give advice on investments or to help participants with investments; that the fiduciaries include certain specified policies in the IPS; and so on.

In other words, under the new rules it's hard for an adviser to work with a plan without being a fiduciary.

So, accepting that virtually all advisers to plans become fiduciaries on June 9, what does that mean for disclosure of fiduciary status?

The 408(b)(2) regulation generally provides that, after the initial notice is provided, no subsequent disclosures are required until there is a change in the information initially provided. But, of course, where the first notice was silent about fiduciary status, the transition to fiduciary status is a change. Here's what the regulation says about changes:

> *A covered service provider must disclose a change to the information…as soon as practicable, but not later than 60 days from the date on which the covered service provider is informed of such change, unless such disclosure is precluded due to extraordinary circumstances beyond the covered service provider's control, in which case the information must be disclosed as soon as practicable.*

In other words, the service provider (*e.g.*, the broker dealer and adviser) must make a written disclosure of the change to fiduciary status to the "responsible plan fiduciary" within "60 days from the date on which the [broker dealer/adviser] is informed of such change." Unfortunately, there isn't any guidance on when a service provider is "informed" of the change to fiduciary status under these circumstances. For example, was it the day that it was finally determined that the fiduciary regulation would be applicable on June 9? Or, will it be on June 9? Or, will it be the first day that the adviser makes the first post-June 9 recommendation?

In the absence of clear guidance, a conservative approach may be advisable. So, my suggestion is that the change notice be sent in June. That's not my conclusion about the outer limit; instead, it's a conservative position.

The consequence of the failure to make 408(b)(2) disclosures is that compensation paid the broker-dealer and the adviser is prohibited.

The views expressed in this article are the views of Fred Reish, and do not necessarily reflect the views of Drinker Biddle & Reath.

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