CLIFFORD CHANCE

Employee Benefits & Executive Compensation Newsletter
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DOL Fee Disclosure Regulations

The U.S. Department of Labor (the "DOL") has in recent years undertaken to increase disclosure of fees paid to service providers to employee plans. The DOL's initiative has resulted in the issuance of several forms of guidance. In 2008 the DOL revised the annual fee reporting requirements by plan fiduciaries on Schedule C of DOL Form 5500. These revisions to Schedule C, effective for plan years beginning on and after January 1, 2009, require plan fiduciaries to obtain and report information regarding fees paid directly and indirectly to plan advisors and service providers, including in certain cases advisors to collective investment vehicles in which the plan invests.

More recently, as discussed further below, the DOL issued an interim final regulation (the "Regulation") under Section 408(b)(2) of the U.S. Employee Retirement Income Security Act of 1974, as amended ("ERISA"), which will require certain service providers to employee pension benefit plans to disclose fee-related information to plan fiduciaries. Disclosure of such information will be necessary to ensure the provision of services to the plan does not result in an inadvertent prohibited transaction. The DOL had proposed a version of these rules in 2007. However, the current interim regulations described below make some significant departures from the original proposal.

The DOL also recently released proposed rules relating to fee disclosures to participants in self-directed retirement plans. Those rules will be discussed in a future Alerter.

Section 408(b)(2) - Background

Section 408(b)(2) of ERISA provides an exemption from the prohibited transaction rules under Section 406(a) of ERISA for the provision of services by a party in interest to a plan subject to Section 406 of ERISA or Section 4975 of the US Internal Revenue Code of 1986, as amended (the "Code"). Specifically, Section 408(b)(2) of ERISA generally provides relief for services pursuant to contracts or arrangements between a plan and a party in interest, if (i) the contract or arrangement is reasonable, (ii) the services are necessary for the establishment or operation of the plan, and (iii) no more than reasonable compensation

Welcome...

... to Clifford Chance's Employee Benefits & Executive Compensation Newsletter. In the Winter Edition, we outline some important developments in the benefits and executive compensation area.

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- Non-discrimination Rules for Medical Plans
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is paid for such services.

The Regulation aims to clarify the meaning of a "reasonable" contract or arrangement by adding that service contracts or arrangements with plans will not be considered “reasonable” unless the service provider has disclosed to a fiduciary with authority to cause the plan to enter into, extend or renew the contract or arrangement (a "Responsible Plan Fiduciary") specified information regarding its compensation. The Regulation is currently intended to be effective on July 16, 2011.

Service Contracts or Arrangements Affected by the Regulation

The Regulation only applies to service contracts or arrangements between a "Covered Plan" and a "Covered Service Provider". A "Covered Plan" is generally any "employee pension benefit plan" or "pension plan" within the meaning of ERISA, which includes both defined benefit and defined contribution plans. Simplified employee pensions, simple retirement accounts, individual retirement accounts and individual retirement annuities are not included in the definition. Welfare benefit plans are not currently Covered Plans, however the DOL has reserved a subsection in the Regulation to potentially address guidance pertaining to such plans in the future.

A "Covered Service Provider" generally includes a service provider that enters into a contract or arrangement with a Covered Plan under which the Covered Service Provider reasonably expects to receive at least $1,000 in direct or indirect "compensation" in connection with the services described below, regardless of whether such services will be performed or such compensation will be received by the Covered Service Provider, an affiliate or a subcontractor. For these purposes, “Compensation" includes anything of monetary value (such as money, gifts, awards and trips), other than non-monetary compensation with an aggregate value of $250 or less during the term of the contract or arrangement.

Covered Services

The term “Covered Services” generally include the following:

- Services as a Fiduciary or Registered Investment Advisor: (i) Services provided *directly* to a Covered Plan as a fiduciary, (ii) services provided as a fiduciary to an investment contract, product or entity (an "Investment Entity") that holds (or is deemed to hold) "plan assets" for purposes of ERISA and in which the Covered Plan has a *direct* equity investment (a "Plan Asset Vehicle"), or (iii) services provided directly to a Covered Plan as an investment adviser (registered under the Investment Advisers Act of 1940 (the "Advisers Act") or any state law). The Regulations specifically state that the rule does not apply to service contracts or arrangements with Plan Asset Vehicles in which the Covered Plan only has an *indirect* equity investment (i.e., services provided to an Investment Entity in which a Plan Asset Vehicle invests (i.e., to a second-tier investment vehicle), even if such Investment Entity is also considered to hold "plan assets" for purposes of ERISA).

  Importantly, the Regulation also indicates that because Section 408(b)(2) is a prohibited transaction exemption the rules do not apply to services provided to non-Plan Asset vehicles. This differs from the Form 5500 Schedule C requirements under which providers of services to vehicles that are not deemed to hold plan assets may nevertheless be required to be disclosed unless the entity is an “operating company” for purposes of ERISA (for instance, certain fee reporting applies to non-Plan Asset vehicles that do not satisfy the operating company exception, but satisfy the "significant participation" test (or "25% Test")).

- Recordkeeping or Brokerage Services: Recordkeeping or brokerage services provided to a Covered Plan that is an individual account plan (such as a 401(k) plan) which permits participants and beneficiaries to direct the investment of their accounts, if one more "designated investment alternatives" (as defined below) will be made available (e.g., through a platform or similar mechanism) in connection with such recordkeeping or brokerage services. A "designated investment alternative" generally includes any investment alternative made available under the plan into which participants may direct the investment of their individual accounts, other than brokerage windows, self-directed brokerage accounts or similar arrangements.

- Other Services for Indirect Compensation: Accounting, auditing, actuarial, appraisal, banking, consulting (with respect to the development or implementation of investment policies or objectives, or the selection or monitoring of service providers or plan

investments), custodial, insurance, investment advisory (for either the Covered Plan or its participants), legal, recordkeeping, securities or other investment brokerage, third party administration or valuation services if the Covered Service Provider, an affiliate or a subcontractor reasonably expects to receive either (i) "indirect compensation," or (ii) compensation paid by a "related party" (each term, as described below). However, no person or entity will be considered a Covered Service Provider solely because it (i) provides any of the Covered Services as an affiliate or subcontractor under the contract or arrangement with the Covered Plan, or (ii) provides *non-fiduciary* services to an Investment Entity in which a Covered Plan invests, regardless of whether the Investment Entity is a Plan Asset Vehicle.

Required Disclosures

A Covered Service Provider is required to disclose in writing the following information to a Responsible Plan Fiduciary:

- Services: A description of the services to be provided to the Covered Plan pursuant to the contract or arrangement. If applicable, a statement that the Covered Service Provider, an affiliate or a subcontractor will provide, or reasonably expects to provide, services *directly* to the Covered Plan or to a Plan Asset Vehicle either as (i) a fiduciary, or (ii) as an investment adviser registered under the Advisers Act or any state law. Non-fiduciary services to be provided to an Investment Entity in which a Covered Plan invests do not need to be disclosed, even if the Investment Entity is a Plan Asset Vehicle.
- Direct Compensation: A description of all "direct compensation" (i.e., compensation received directly from the Covered Plan), either in the aggregate or by service, that the Covered Service Provider, an affiliate or a subcontractor reasonably expects to receive in connection with the disclosed services.
- Indirect Compensation: A description of all "indirect compensation" (i.e., compensation that is received from any source other than the Covered Plan, the plan sponsor, the Covered Service Provider or its affiliate or subcontractor) that the Covered Service Provider, an affiliate or a subcontractor reasonably expects to receive in connection with the disclosed services, including identification of (i) the services for which the indirect compensation will be received, and (ii) the payer of the indirect compensation.
- Compensation Paid Among Related Parties: The description of compensation must include a description of any compensation that will be paid among the Covered Service Provider, its affiliate or subcontractor that is either determined on a transaction basis (e.g., commissions, soft dollars, finder's fees or other similar incentive compensation based on business placed or retained) or that is charged directly against the Covered Plan's investment and reflected in the net value thereof (e.g., Rule 12b-1 fees), including identification of (i) the services for which such compensation will be paid, and (ii) the payers and recipients of such compensation (including their status as an affiliate or subcontractor).
- Compensation for Termination of Contract or Arrangement: A description of any compensation that the Covered Service Provider, an affiliate or a subcontractor reasonably expects to receive in connection with the termination of the contract or arrangement, and the manner in which any prepaid amounts will be calculated and refunded upon termination.
- Manner of Receipt: A description of the manner in which the compensation will be received (e.g., direct billing, deduction from account, etc.).

Additional Disclosure Issues

- Recordkeeping Services: A Covered Service Provider that provides recordkeeping services and reasonably expects that recordkeeping services will be provided in whole or in part without explicit compensation, or if the compensation for these services will be offset or rebated based on other compensation received by the Covered Service Provider, an affiliate or a subcontractor, then the Covered Service Provider must nevertheless provide (i) a reasonable and good faith estimate of the cost of those recordkeeping services, including an explanation as to the methodology and assumptions used in preparing the estimate, and (ii) a detailed explanation of the recordkeeping services that will be provided to the Covered Plan.
- Fiduciary Services to a Plan Asset Vehicle: A Covered Service Provider that provides fiduciary services to a Plan Asset Vehicle (unless such information is provided by a Covered Service Provider providing recordkeeping or brokerage services) is required to provide (i) a description of

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any compensation that will charged directly against the amount invested in connection with the acquisition, sale, transfer of, or withdrawal from the Plan Asset Vehicle, (ii) if the investment return is not fixed, a description of the annual operating expenses and (iii) a description of any ongoing expenses in addition to annual operating expenses. As noted above, services to a non-Plan Asset Vehicle and non-fiduciary services to a Plan Asset Vehicle are generally not Covered Services.

- Individual Account Retirement Plans: A Covered Service Provider that provides recordkeeping or brokerage services to a participant directed individual account plan in connection with one or more designated investment alternatives is required to disclose with respect to each designated investment alternative (i) a description of any compensation that will charged directly against the amount invested in connection with the acquisition, sale, transfer of, or withdrawal from the investment alternative, (ii) if the investment return is not fixed, a description of the annual operating expenses and (iii) a description of ongoing expenses in addition to annual operating expenses. A Covered Service Provider can satisfy this disclosure requirement by providing current disclosure materials of the issuer of the designated investment alternative containing the necessary information, provided that such issuer is not an affiliate of the Covered Service Provider, the materials are regulated by a state or federal agency, and to the Covered Service Provider's knowledge, the materials are not incomplete or inaccurate.

Form of Disclosure

- A description or an estimate of compensation may be expressed as a monetary amount, formula, percentage of the Covered Plan's assets, or a per capita charge for each participant or beneficiary, or by any other reasonable method if the compensation can not reasonably be expressed in such terms.
- The required disclosures must be furnished in writing to the Responsible Plan Fiduciary, however a formal written contract delineating the disclosure obligations is not required (as was proposed in the initial proposed regulations).

Timing of Disclosures

Initial Disclosures

A Covered Service Provider must generally disclose the required information to the Responsible Plan Fiduciary reasonably in advance of the date the contract or arrangement is entered into, extended or renewed.

- With respect to contracts or arrangements entered into prior to the effective date of the Regulation (i.e., July 16, 2011), the required disclosures must be furnished no later than such date.
- When a Covered Plan invests in an Investment Entity that is not a Plan Asset Vehicle at the time of the Covered Plan's investment, but is subsequently determined to be a Plan Asset Vehicle, the disclosures must be made as soon as practicable thereafter, but not later than 30 days from the date the Covered Service Provider knows such Investment Entity has become a Plan Asset Vehicle.
- With respect to any designated investment alternative disclosure required for recordkeeping or brokerage services to participant-directed individual account plans, if the investment alternative is not designated at the time the contract or arrangement is entered into, disclosure must be made as soon as practicable, but not later than the date the investment alternative is designated by the Responsible Plan Fiduciary.

Changes

A Covered Service Provider must disclose a change to any information previously disclosed as soon as practicable, but not later than 60 days from the date on which the Covered Service Provider is informed of such change. If such disclosure is precluded due to extraordinary circumstances beyond the Covered Service Provider's control, then disclosure must be made as soon as practicable thereafter.

Additional Requested Information

Upon the request of the Responsible Plan Fiduciary or Covered Plan administrator, a Covered Service Provider must provide any other information relating to the compensation received in connection with the contract or arrangement that is required for the Covered Plan to comply with the reporting and disclosure requirements of Title I of ERISA. Such information is required to be disclosed not later than 30 days following receipt of the written request, unless such disclosure is precluded due to extraordinary circumstances beyond the Covered Service Provider's control (in which case

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the information must be disclosed as soon as practicable thereafter).

Relief for Disclosure Errors

A contract or arrangement will not fail to be "reasonable" solely because the Covered Service Provider makes an error or omission in disclosing the required information, provided that the Covered Service Provider (i) was acting in good faith and with reasonable diligence, and (ii) discloses the correct information to the Responsible Plan Fiduciary as soon as practicable, but not later than 30 days from the date it knows of such error or omission.

Exemption for Responsible Plan Fiduciary

The Regulation sets forth a prohibited transaction class exemption which provides that the prohibited transaction rules under Section 406(a)(1)(C) and (D) of ERISA will not apply to a Responsible Plan Fiduciary as a result of a Covered Service Provider's failure to make the required disclosures, provided that (i) the Responsible Plan Fiduciary did not know that the Covered Service Provider failed or would fail to make the required disclosures and reasonably believed that the Covered Service Provider had made all of the required disclosures, and (ii) upon discovering the failure, the Responsible Plan Fiduciary requests in writing that the Covered Service Provider furnish such information, and if the Covered Service Provider does not comply with such written request within 90 days of the request, then the Responsible Plan Fiduciary must notify the DOL of such failure within certain timeframes. After discovering the failure to make the required disclosures, the Responsible Plan Fiduciary must determine whether to terminate or continue the contract or arrangement, and shall take into account the (i) nature of the failure, (ii) availability, qualifications and cost of replacement service providers, and (iii) Covered Service Provider's response to notification of the failure.

Effective Date

The Regulation is effective on July 16, 2011 and will apply to contracts or arrangements between Covered Plans and Covered Service Providers existing on that date, and to those that are entered into on or after such date. Due to the interim status of the Regulation, the Regulation may be subject to revision based on any comments that the DOL receives. It is not clear whether any additional changes to the Regulation will have an extended effective date for compliance.

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SEC Proposed Rules For Institutional Investment Manager Reporting of Proxy Votes on Executive Compensation

On October 18, 2010, the SEC proposed rules to implement Section 14A(d) of the Securities Exchange Act of 1934 (the "Exchange Act") that will require certain institutional investment managers to report how they vote with respect to certain executive compensation matters. Section 14A was added to the Exchange Act by Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). Section 14A(d) of the Exchange Act and any final rules that are adopted will impact only those institutional investment managers subject to Section 13(f) of the Exchange Act. Reporting requirements under the proposed rules will be effective for shareholder meetings occurring on or after January 21, 2011.

Covered Institutional Investment Managers

Under the proposed rules, an institutional investment manager will be subject to the executive compensation voting disclosure rules if (i) (A) it is a person, other than a natural person, investing in or buying and selling securities for its own account, and (B) any person exercising investment discretion with respect to the account of any other person and (ii) the investor is required to file reports under Section 13(f) of the Exchange Act because it exercises investment discretion with respect to accounts holding 13(f) securities having an aggregate fair market value on the last trading day of any month of at least $100 million.

Reporting Requirements

Institutional investment managers will be required to file reports on Form N-PX to disclose annually how they voted on say-on-pay resolutions with respect to any security which the investment manager, whether directly or indirectly, through any agreement, understanding or otherwise, had or shares the power to vote or to direct the voting thereof. Under the proposed rules, the following votes required under Section 14A of the Exchange Act must be reported on Form N-PX:

- "say-on-pay" vote, regarding the approval of executive compensation;
- "say-when-on-pay" vote, regarding whether future say-on-pay votes will occur every one, two or three years; and
- "say-on-golden parachutes" vote, regarding the approval of agreements or understandings that the soliciting person has with its named executive officers which concerns compensation that is based on or otherwise relates to a merger, acquisition, consolidation, sale or other disposition of all or substantially all of the assets of an issuer (collectively, the "Say-On-Pay Votes").

Time of Reporting

Under the proposed rules, covered institutional investment managers will generally be required to make reports on the Say-On-Pay Votes annually on Form N-PX no later than August 31 of each year for the most recent 12-month period ended June 30. For shareholder meetings that occur on or after January 21, 2011, and before June 30, 2011, the reports will be required to be filed not later than August 31, 2011.

Joint Reporting of Proxy Votes

Under the proposed rules, in order to prevent duplicative voting, a single institutional investment manager that shares voting power will be able to meet

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its reporting requirements by identifying and incorporating by reference to the Form N-PX filed by the institutional investment manager or fund that actually reports the voting results.

Form N-PX Changes and Proxy Voting Information

Cover Page and Summary Page. Under the proposed rules, Form N-PX would be amended to contain three parts: a cover page, summary page and required proxy voting information. The new cover page would include a section to report any amendments to previous filings and would identify whether the reporting person was a fund or an institutional investment manager. The summary page would be required in any Form N-PX report filed by a fund or institutional investment manager, other than a "notice" report.[1] The summary page must include the total number of, and list, the institutional investment managers, not including the reporting person, whose Say-On-Pay Votes are included in the report.

Proxy Voting Information. For each proxy vote that must be included on Form N-PX, the following information must be disclosed:

- the name of the issuer of the security;
- the exchange ticker symbol of the security;
- the Council on Uniform Securities Identification Procedures number for the security;
- the shareholder meeting date;
- a brief identification of the matter voted on;
- for reports filed by funds (but not by institutional investment managers), whether the matter was proposed by the issuer or by a security holder;
- the number of shares the reporting person was entitled to vote (for funds) or had or shared voting power over (for institutional investment managers);
- the number of shares that were voted;
- how the reporting person voted those shares (e.g., for or against proposal, or abstain; for or withhold regarding election of directors) and, if the votes are cast in multiple manners (e.g., for and against), the number of shares voted in each manner;
- whether the vote was for or against management's recommendation; and
- identification of each institutional investment manager on whose behalf the Form N-PX report is filed (other than the reporting person) and who had or shared voting power as to the securities voted by the number assigned to the institutional investment manager in the Summary Page.

Requests for Confidential Treatment

In general, information filed on Form N-PX will be publicly available. However, an institutional investment manager may request confidential treatment of such information. Under the proposed rules, the SEC remarked that confidential treatment of the information filed on Form N-PX would generally not be appropriate; however, it could be appropriate, "if at all," only in narrowly defined circumstances where the institutional investment manager has filed a confidential treatment request for information reported on Form 13F, and where confidential treatment of information on Form N-PX would be appropriate to protect information that is the subject of the Form 13F confidential treatment request.

[1] As a general matter, if none of an institutional investment manager's Section 13(f) securities are listed on a Form 13F (e.g., because all of such Section 13(f) securities are reported on someone else's Form 13F), the institutional investment manager must file a 13F Notice (or "notice" report). When filing a 13F Notice, the institutional investment manager submits only a cover page which includes the name(s) of other manager(s) reporting for it.

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Non-discrimination Rules for Medical Plans

On December 21, 2010, the IRS released Notice 2011-1, which delayed the requirements that all fully-insured group health plans comply with the non-discrimination requirements set forth in Section 105(h) of the Internal Revenue Code of 1986, as amended (the "Code").

Background

Under Section 105(h) of the Code, discrimination in favor of highly-compensated employees under a self-insured plan results in the taxation of benefits provided to such employees under such plan. Insured plans were not historically subject to these rules. However, the Patient Protection and Affordable Care Act (the "PPACA"), enacted on March 23, 2010, added new Section 2716 to the Public Health Service Act (the "PHS Act") which generally provides that group health plans (other than self-insured plans) must satisfy the non-discrimination requirements of Section 105(h) of the Code. More specifically, Section 2716 of the PHS Act provides that fully-insured plans must abide by prohibitions against discriminating in favor of highly-compensated employees as to eligibility to participate and benefits provided under such plans. For purposes of Section 2716, the term "highly compensated employee" shall have the same meaning as provided under Section 105(h)(5) of the Code, and shall generally include (i) one of the five highest paid officers, (ii) 10% shareholders and (iii) one of the highest paid 25% of all employees. These requirements for insured group health plans are effective for plan years beginning on or after September 23, 2010.

Insured group health plans with at least one individual enrolled on March 23, 2010 generally are "grandfathered" and not subject to Section 2716 of the PHS Act until such time as certain provisions of the plan or coverage are modified or until a replacement policy is issued by the current insurance provider or a new provider.

New Section 2716 provides that group health plans (or the sponsors thereof) that fail to satisfy non-discrimination requirements are subject to the taxes imposed under Section 4980D of the Code (generally applying an excise tax of $100 per day of noncompliance with respect to each individual to whom such failure relates).[1] In determining the application of such penalty, the Department of the Treasury and the Internal Revenue Service ("IRS") take the position that in determining the number of individuals to whom the failure relates, it is the number of non-highly compensated employees that are adversely affected against which the $100 per day penalty is applied (rather than applying such penalty against the number of highly-compensated employees who receive more favorable treatment). Thus, with respect to a discriminatory self-insured plan, highly compensated individuals lose a valuable tax benefit, and with respect to an insured group health plan, failure to comply results in the plan (or sponsor thereof) being subject to civil action to compel compliance as well as being subject to an excise tax of $100 per day per individual discriminated against.

Implications

The general rules requiring non-discriminatory benefits and eligibility are rather complex and technical. Included below are a few ways in which employers may inadvertently create violations of these rules.

- Employers that provide health coverage to a limited group of executives, or provide coverage on more favorable terms may have a discriminatory program.
- Employers that provide post-termination coverage under more favorable terms than provided to employees generally may have a discriminatory program.
- Insured programs that provide discriminatory benefits may no longer qualify for certain exceptions to the rules governing deferred compensation set forth in Section 409A of the Code.

Notice 2011-1

Given the requirement under Section 2716 of the PHS Act that insured group health

[1] An insured group health plan or its sponsor may also be subject to a civil action to enjoin noncompliance or for other appropriate equitable relief.

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plans satisfy "rules similar to the rules" contained in Section 105(h) of the Code, the Department of Treasury and the IRS have determined that compliance with Section 2716 should be delayed until such time as regulations or other administrative guidance have been issued thereunder. The Departments of Treasury, Labor and Health and Human Services have solicited comments with respect to Section 2716 of the PHS Act, which must be received by March 11, 2011.

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DOL Proposes Expanded ERISA "Fiduciary" Definition

The U.S. Department of Labor (the "DOL") has recently issued a proposed regulation (the "Proposed Regulation") to more broadly define the circumstances under which a person is considered to be a "fiduciary" under the U.S. Employee Retirement Income Security Act of 1974, as amended ("ERISA").

As discussed below, the Proposed Regulation, if implemented, would result in substantial changes to the established definition of fiduciary under ERISA (and under the analogous provisions of the U.S. Internal Revenue Code of 1986, as amended (the "Code")). Many service providers that are not currently being treated as fiduciaries under ERISA may become fiduciaries.

Background

Under Section 3(21)(A) of ERISA, a person is generally a "fiduciary" with respect to a plan to the extent that such person (i) exercises any discretionary authority or control over the management of such plan, or exercises any authority or control over the management or disposition of its assets, (ii) renders investment advice for a fee or other compensation, directly or indirectly, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) has any discretionary authority or responsibility in the administration of such plan.

In 1975, the DOL issued regulations interpreting when the offering of investment advice under clause (ii) of the definition noted above would result in fiduciary status. These regulations provided a five-part test (the "Current Test"), whereby in order to be deemed a fiduciary as a result of providing investment advice (for a fee or other compensation), an adviser who does not have discretionary authority or control with respect to the purchase or sale of securities or other property for a plan must satisfy each of the following five elements: (i) the adviser must render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property, (ii) the advice must be provided on a *regular basis*, (iii) the advice must be provided pursuant to a *mutual* agreement, arrangement or understanding with the plan, (iv) the advice must serve as a *primary basis* for investment decisions with respect to plan assets, and (v) the advice must be *individualized* based on the particular needs of the plan.

The Proposed Test

The Proposed Regulation would replace the existing five-part test discussed above with what essentially is a new two-part test (the "Proposed Test") that may apply to a broader group of services. Under the Proposed Test, a person who renders investment advice for a direct or indirect fee or other compensation will be deemed to be a fiduciary under ERISA to the extent that such person satisfies both of the following items:

(i) engages in one of the following three services to a plan, plan fiduciary, or a plan participant or beneficiary:

- Provides advice, or *appraisals or fairness opinion*, concerning the value of securities or other property,
- Makes recommendations as to the advisability of investing in, purchasing, holding or selling securities or other property, or
- Provides advice or makes recommendations as to the management of securities or other property; and

(ii) satisfies one of the following four conditions either directly or indirectly (e.g., through an affiliate):

- Represents or acknowledges that it is acting as a fiduciary,
- Acts as a fiduciary with respect to the plan within the meaning of Section 3(21)(A)(i) or (iii) of ERISA (i.e., it is a person that exercises discretionary authority or control over management of the plan, or management or disposition of its assets, or that has discretionary authority or responsibility in plan administration),
- Acts as an investment adviser within the meaning of Section 202(a)(11) of

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the Investment Advisers Act of 1940, or

- Provides advice or makes recommendations pursuant to an agreement, arrangement or understanding, written or otherwise, between such person and the plan, a plan fiduciary, or a plan participant or beneficiary, where the advice *may be considered* in connection with making investment or management decisions with respect to plan assets, and the advice will be *individualized* to the needs of the plan, a plan fiduciary, or a participant or beneficiary.

While the language of the Proposed Test is similar in a number of ways to certain language in the Current Test, the Proposed Test contains significant changes, including the following:

- Advice no longer needs to be offered on a *regular basis* (i.e., a service provider that provides investment advice even on a one-time basis could be a fiduciary).
- Advice no longer needs to be offered as part of a *mutual* understanding that the advice will serve as the *primary basis* for investment decisions (i.e., it would be sufficient if the understanding of the parties is that the advice *may be considered* in connection with making a decision relating to plan assets).
- The provision of *appraisals and fairness opinions* concerning the value of securities or other property is specifically included (i.e., this would supersede the DOL's current position that a valuation of closely-held employer securities would not constitute investment advice).
  - This change would not be limited to appraisals and fairness opinions concerning employer securities, and would also include, for example, real estate and other appraisals.
- The provision of advice and recommendations as to the *management* of securities or other property is specifically included.
  - This would include, for example, advice and recommendations as to the exercise of rights appurtenant to shares of stock (e.g., voting proxies) and as to the selection of persons to manage plan investments.
- The Proposed Test makes clear that fiduciary status may result from the provision of advice or recommendations not only to a plan fiduciary, but also to a plan participant or beneficiary.

Exceptions to Fiduciary Status

As discussed below, the Proposed Regulation provides for certain actions that will generally not result in fiduciary status, except to the extent that such actions are engaged in by a person who represents or acknowledges that it is acting as a fiduciary (which the Proposed Regulation generally considers dispositive of fiduciary status).

- Under the Proposed Regulation, a person will not be considered a fiduciary if such person can demonstrate that the recipient of the advice knows, or under the circumstances, reasonably should know, that (i) the person is providing the advice or making the recommendation in its capacity as a purchaser or seller of a security or other property, or as an agent of, or appraiser for, such a purchaser or seller, whose interests are adverse to the interests of the plan or its participants or beneficiaries, and (ii) the person is not undertaking to provide impartial investment advice.

In addition, the following actions in connection with an individual account plan (e.g., a 401(k) plan) will generally not, in and of themselves, be treated as the rendering of investment advice for purposes of the Proposed Test:

- Providing investment education information and materials within the scope of the existing DOL guidance on investment education (i.e., 29 CFR 2509.96-1(d));
- Marketing or making available investments through a platform or similar mechanism (without regard to the individualized needs of the plan, or its participants or beneficiaries), or providing general financial information and data to assist in selecting and monitoring those investments, provided that these actions are accompanied by a written disclosure that the party is not providing impartial investment advice; and
- Preparing a general report or statement that merely reflects the value of an investment of a plan, or its participants or beneficiaries and that are provided for purposes of complying with the applicable reporting and disclosure requirements under ERISA and the Code, unless such report involves assets for which there is not a generally recognized market and serves as a basis on which the plan may make

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distributions to plan participants and beneficiaries.

Definition of "Fee or Other Compensation"

The Proposed Regulation clarifies that rendering investment advice for a "fee or other compensation" includes any direct or indirect fees or other compensation received by the adviser or 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.

- Thus the term "fee or other compensation" includes, for example, brokerage, mutual fund sales and insurance sales commissions, as well as fees and commissions based on multiple transactions involving different parties.

Application to Parallel Code Provisions"

The provisions of Section 4975(e)(3)(B) of the Code defines the term "fiduciary" for purposes of the prohibited transaction provisions in Code Section 4975 and contains parallel provisions to Section 3(21)(A)(ii) of ERISA. The Proposed Regulation would conform the provisions of Code Section 4975(e)(3)(B) to the new definition of "fiduciary" under ERISA discussed above.

Public Comments and Effective Date

The DOL has proposed that the new rules will become effective 180 days after publication of the final regulations in the Federal Register, however it has solicited comments on whether such effective date should be adjusted. In addition, the DOL will be holding hearings on March 1, 2011 in relation to the finalization of the proposed regulation.

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