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DOL to Widen "Fiduciary" Net: Proposes the Most Significant Expansion of Its Regulatory Framework Since the Enactment of ERISA

On October 21, 2010, the U.S. Department of Labor (the "DOL") proposed to amend its regulations in a manner that would significantly broaden the circumstances under which a person providing services to an employee benefit plan, plan fiduciary or plan participants would be considered a fiduciary under Section 3(21) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA").[1] The Proposed Regulation represents the most significant expansion of the DOL's regulatory framework since the enactment of ERISA, an expansion not prompted by legislative change. The Proposed Regulation would substantially alter the business practices of virtually every entity that deals with plans subject to ERISA.

Among other consequences, the Proposed Regulation would impose fiduciary standards and potential liability on persons who render advice as to the management, valuation, or advisability of investing in, purchasing, holding or selling securities or other property, **even if**:

- such advice is not provided on a regular basis and does not form a primary basis for a plan's investment decisions;
- such advice is not individually tailored, if provided by an investment adviser; or
- such advice consists solely of appraisals or fairness opinions.

According to the DOL, applying the Current Regulation in today's market has had a "detrimental impact" on the allocation of its enforcement resources and litigation success with staff members "routinely devot[ing] disproportionate time and resources" to

[1] The current regulation, Definition of "Fiduciary," 29 CFR § 2510.3-21(c) (1975), has been in force since 1975 (the "Current Regulation"). If adopted, the proposed regulation, Definition of the Term ''Fiduciary,'' 75 Fed Reg. 65,263 (Oct. 22, 2010) (the "Proposed Regulation") would become effective 180 days after the publication of the final regulation in the Federal Register. The proposed amendments to the definition of the term "fiduciary" set forth in the Proposed Regulation would also apply for purposes of the application of Internal Revenue Code (the "Code") section 4975 with respect to any plan described in Code section 4975(e)(1), including individual retirement accounts ("IRAs").

establishing that such service providers are actually fiduciaries.[2] The DOL states that the Proposed Regulation would permit "EBSA investigators and attorneys to focus their efforts on the adviser's conduct rather than meeting the evidentiary requirements necessary to prove that all elements of the current regulation's five-part test [for fiduciary investment advice] are satisfied."[3] The relaxed evidentiary requirements in the Proposed Regulation would give the DOL and private plaintiffs wide latitude to bring lawsuits for alleged fiduciary breaches, creating significant uncertainty in the market and impeding the ability of plans to conduct transactions in an efficient manner.

As proposed, the DOL's result-oriented change to the long-standing definition of fiduciary would cast the fiduciary net over a much larger number of service providers. The DOL's proposal fails to consider or discuss the adequacy of the currently available penalties applicable to non-fiduciaries as well as the harmful consequences of turning many of today's service providers into ERISA fiduciaries.[4] If adopted, the Proposed Regulation would require a thorough review of the business practices of any person who deals with plans, including brokers, valuation agents, custodians, lawyers, accountants, and proxy advisory firms.[5] Extending fiduciary status to market participants not previously subject to ERISA's fiduciary rules would:

- significantly increase the risk of liability to any such person for conduct incidental to transactions involving plans, even when such person is not the decision maker or even a primary adviser;

- render unavailable numerous current exemptions for routine transactions, thereby injecting the DOL into the costly and time-consuming process of prescribing new detailed exemptions;[6]

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2 Preamble to the Proposed Regulation, 75 Fed Reg. 65,263, 65,272.

3 Preamble to the Proposed Regulation, 75 Fed Reg. 65,263, 65,272.

4 The statutory framework imposes significant penalties on non-fiduciary service providers who enter into prohibited transactions with plans but the DOL did not address the availability of such penalties as an alternative to an expanded definition of fiduciary. In general, both fiduciary and non-fiduciary service providers are subject to the extensive prohibited transaction rules of ERISA under which any person providing services to a plan cannot provide any other services or engage in any other transaction with the plan absent an exemption.

5 In what can only be called a gross understatement, the DOL severely underestimates the compliance costs associated with the Proposed Regulation, suggesting that "affected service providers will require on average 16 hours of legal professional time at a cost of approximately $119 per hour to perform the compliance review." *See* Preamble to the Proposed Regulation, 75 Fed Reg. 65,263, 65,274. We assume that these estimates were prepared in good faith, leading to the conclusion that the DOL does not appreciate the depth and breadth of the changes that would result from the Proposed Regulation.

6 While the DOL considers the enforcement cost savings from diluting the current test to determine whether a service provider is actually a fiduciary, it does not give adequate consideration to the additional costs that the DOL will incur from having to review numerous new prohibited transaction exemption applications. *See* note 11.

- significantly increase the costs to plans of obtaining quality services and decrease the number of providers willing to provide services to plans;[7] and

- give the DOL and private plaintiffs the ability to bring potentially tenuous lawsuits based on aggressive interpretations of the proposed definition of fiduciary, which would have a chilling effect on plans' access to quality services and investment products.

This memorandum highlights the key differences between the Current Regulation and the Proposed Regulation and considers the practical applications and consequences of the proposed changes. The comment period for the Proposed Regulation closes on **January 20, 2011**. The final regulation will be effective 180 days after its publication in the Federal Register.

I. Overview of ERISA Regulatory Framework and Likely Impact of the Proposed Regulation

Under ERISA, a person is a fiduciary with respect to a plan to the extent it "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."[8] For persons that do not have discretion with respect to the purchase or sale of securities or other property of the plan, the Current Regulation (issued shortly after the enactment of ERISA) defines "investment advice" as:

- advice as to the value of securities or other property, or recommendations as to the advisability of investing in, purchasing, or selling securities or other property, that is

- provided on a regular basis,

- pursuant to a mutual agreement that the advice serves

- as a primary basis for investment decisions with respect to plan assets, and

- is individualized based on the particular needs of the plan.

[7] Service providers who are not currently fiduciaries but who would be treated as such under the Proposed Regulation would also be subject to the increased disclosure requirements under the DOL's final interim regulations that define "reasonable contract or arrangement" for purposes of the statutory exemption contained in Section 408(b)(2) of ERISA for the provision of services. Under the new regulation, the disclosure obligations are greater for service providers that are fiduciaries within the meaning of Section 3(21) of ERISA.

[8] ERISA Section 3(21)(A)(ii).

As described in more detail below, the Proposed Regulation would gut the long-standing, sensible conditions that carefully delineate between those advisers who should be relied upon as fiduciaries and those other service providers who should not.

Applying this definition of "investment advice" to the advisory activities of service providers is critical since ERISA imposes stringent duties and liabilities on those who act as fiduciaries to plans.[9] Under ERISA, a fiduciary:

- Has the duty to act prudently for the exclusive purpose of providing plan benefits and defraying plan costs.

- Must not engage in conflict of interest transactions by:

  - dealing with the assets of the plan in its own interest or for its own account;

  - acting in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan, its participants or beneficiaries; or

  - receiving any consideration from a third party dealing with a plan in connection with a transaction involving plan assets.

- Must not cause a plan to engage in virtually any transaction with persons providing services to or otherwise related to a plan, unless an exemption is available.

- Is subject to co-fiduciary liability. Under Section 405 of ERISA, if a plan has more than one fiduciary, each fiduciary will be liable for a breach by a co-fiduciary if the fiduciary knowingly participates in or tries to conceal or fails to make a reasonable effort to remedy a co-fiduciary's breach of which it is aware, and also if, in failing to comply with the fiduciary responsibility rules in the administration of his specific fiduciary responsibilities, the fiduciary enables the other fiduciary to commit a breach.

In enacting ERISA, Congress recognized that the breadth of ERISA's restrictions would preclude many routine transactions that were necessary to the operation of plans. ERISA therefore includes numerous statutory exemptions for service providers. It also gives authority to the DOL to issue class and individual exemptions from the prohibited transaction restrictions, in the interest of plans and plan participants. The DOL exercised

[9] Some courts have characterized the degree of care with which a fiduciary is required to act as the "highest known to the law." *See Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8 (2d Cir. 1982), *cert. denied*, 459 U.S. 1069 (1982).

this authority promptly following enactment of ERISA and frequently thereafter, in order to facilitate the operation of plans which could not have functioned in the absence of many of those exemptions.

However, most of the exemptions for routine investment transactions depend on the service provider or plan counterparty (and certain of its affiliates) not being a fiduciary to the plan.[10] The breadth of the proposed fiduciary definition therefore undermines the availability of many of the exemptions so that numerous common transactions would become prohibited upon the adoption of the Proposed Regulation.[11] The process of obtaining new exemptions would be costly and time consuming for plan sponsors, service providers and the DOL.

Moreover, the DOL's approach in the Proposed Regulation contradicts the approach taken by Congress in the Pension Protection Act of 2006 (the "PPA"), which granted the "service provider exemption" under Section 408(b)(17) of ERISA. The enactment of the service provider exemption recognized the appropriateness of minimizing the costs and delay related to exemption requests for routine transactions involving service providers who were not fiduciaries. By expanding the categories of service providers that would be treated as fiduciaries under the Proposed Regulation, the DOL would effectively make the service provider exemption inapplicable to many of the transactions for which it was intended and is currently used.

II. **Overview of Proposed Changes**

The Current Regulation contains both a higher standard of conduct (e.g., there must be a mutual agreement that the individualized advice will be a primary basis of investment decisions) and a more functional test (based upon the relevant actions, rather than the mere status, of the service provider) for the determination of who is a fiduciary. The Proposed Regulation both lowers the bar for conduct that qualifies as "investment advice" and also provides that "investment adviser" status, not function, would trigger fiduciary duties. Under the Proposed Regulation, a service provider would be considered a fiduciary if the service provider both:

- provides the type of advice covered by the Proposed Regulation (any kind of advice in Column A); and

10 Such exemptions include Prohibited Transaction Exemption ("PTE") 2006-16, 94-20, 81-8, and 75-1 Parts I, II and V; the QPAM and INHAM exemptions (PTE 84-14 and 96-23); and the service provider and foreign exchange transaction exemptions under ERISA Sections 408(b)(17) and 408(b)(18), respectively.

11 In the preamble to the Proposed Regulation, the DOL acknowledges that new prohibited transaction exemptions would have to be granted and states simply that it is uncertain as to how many such exemptions would be necessary. *See* 75 Fed Reg. 65,263, 65,275. This acknowledgement is surprising given the enormous effects that the Proposed Regulation would have on the financial markets. This absence of analysis also calls into question the utility of the cost-benefit analysis provided by the DOL in conjunction with the Proposed Regulation.

- either directly or indirectly (e.g., through or together with any affiliates) has the kind of relationship with the plan, or plan fiduciary, participant or beneficiary covered by the Proposed Regulation (any type of relationship in Column B).

Proposed Regulation's Two Pronged Fiduciary Test: If a service provider satisfies **one** requirement from Column A and **one** requirement from Column B, such service provider will be a fiduciary under the Proposed Regulation.

Column A: Types of Advice Covered	**Column B: Types of Relationships Covered**

• Advice, or an appraisal or fairness opinion, concerning the value of securities or other property; OR
• Recommendations as to the advisability of investing in, purchasing, holding, or selling securities or other property; OR
• Advice or recommendations as to the management of securities or other property.
	Person rendering advice either directly or indirectly through or together with an affiliate:
	• Represents or acknowledges that it is acting as a fiduciary within the meaning of ERISA; OR
	• Exercises any discretionary authority or control with respect to the management of the plan or disposition of its assets, or has any discretionary authority or responsibility in the administration of the plan; OR
	• Is an investment adviser under the Investment Advisers Act of 1940 (the "<u>Advisers Act</u>"); OR
	• Provides advice or makes recommendations:
	    o pursuant to an agreement, arrangement or understanding, written or otherwise,
	    o that such advice may be considered in connection with making investment or management decisions with respect to plan assets, and
	    o that such advice will be individualized.

A. Types of Advice Covered

The types of advice covered by the Proposed Regulation both expand upon, and add to, the types of advice covered under the Current Regulation.

Types of Advice: Current and Proposed Regulation

Current Regulation	**Proposed Regulation (changes noted in bold)**
• Advice as to the value of securities or other property; OR • Recommendations as to the advisability of investing in, purchasing, or selling securities or other property.	• Advice, or an **appraisal or fairness opinion**, concerning the value of securities or other property; OR • Recommendations as to the advisability of investing in, purchasing, **holding**, or selling securities or other property; OR • Advice or recommendations as to the **management of securities or other property**. Advice may be rendered to a plan, or a plan fiduciary or a plan participant or beneficiary.

There are three key differences between the types of advice covered by the Current Regulation and the Proposed Regulation.

1. Appraisals and Fairness Opinions. While the Current Regulation covers advice as to the value of securities or other property, the DOL interpreted it to exclude valuations, even in the context where the valuation was used by a fiduciary to purchase securities in connection with the establishment of an employee stock ownership plan (ESOP).[12] The Proposed Regulation reverses this long-standing interpretation and includes the provision of all appraisals or fairness opinions, with the limited exception described below.

- The only appraisal or fairness opinion that would not be considered advice would be a “general report or statement that merely reflects the value of an investment of a plan or a participant or beneficiary,” provided for purposes of compliance with

[12] DOL Advisory Opinion 76-65A (1976).

Internal Revenue Service (the "IRS") and DOL reporting and disclosure requirements.[13]

- To come within this exception, any appraisal provided to a defined benefit plan would have to be legended that it could be used solely for purposes of IRS or DOL reporting or disclosure requirements. Any use for other purposes, such as asset allocation, would appear to render the exception unavailable. Such a requirement would be inconsistent with customary practice.

- Even if provided for DOL or IRS reporting or disclosure requirements, any appraisal or fairness opinion regarding an asset for which there is not a generally recognized market and that serves as a basis on which distributions to plan participants and beneficiaries are made would be treated as investment advice.

- Any appraisal or fairness opinion not used solely for DOL or IRS compliance or disclosure purposes would be in all cases considered investment advice under the Proposed Regulation. This treatment would apply to all assets, without regard to whether or not there is a generally recognized market for such assets.

- Imposing fiduciary standards on the valuation of assets in cases where there is no generally recognized market for such assets, such as periodic valuations to facilitate distributions from a plan at fair value, would effectively make it impossible for plans to obtain necessary valuations at a reasonable cost from credit-worthy firms.

  - We would expect many custodians to refuse to accept plan assets for which there is not a generally recognized market.

  - We suspect that the unintended impact of the rule will be less reliable valuations for plans.

  - We would also expect prime brokers to refuse to provide any valuations for illiquid assets.

- It is possible that a valuation provided by the manager of a hedge fund or a private equity fund to investors could be swept up in the breadth of this definition. Such an interpretation could subject the manager of the funds to fiduciary status. We assume that this result was not intended by the DOL, as it would wreak havoc on the well-settled plan asset rules as applied to hedge and private equity funds. However, given

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13 Proposed Regulation, 75 Fed Reg. 65,263, 65,277.

the enforcement focus in the preamble to the Proposed Regulation and the DOL's focus on private investment fund valuations, we cannot be sure. If covered by the Proposed Regulation, funds could be forced to appoint independent third parties to provide valuations, which would not necessarily be available or would significantly increase the fees borne by investors, including plans.

  - Given the increased liability risks associated with the Proposed Regulation, the current costs of obtaining a valuation could skyrocket.

- There are many circumstances where a counterparty provides valuations to plans. For example, the Dodd-Frank Wall Street Reform and Consumer Protection Act,[14] requires a security-based swap dealer to provide plans with a daily mark of their positions. Surely, the Proposed Regulation did not intend that the provision of a daily mark or any other provision of valuations by a plan's counterparty make that counterparty a fiduciary.[15]

2. Management of Securities or Other Property. Unlike the Current Regulation, the Proposed Regulation includes as "investment advice" advice regarding the "management" of securities and other property. As a result, under the Proposed Regulation, fiduciary obligations would apply to persons that provide:

- Advice and recommendations as to the exercise of rights incident to shares of stock.

  - Those who advise plans on the voting of proxies would be considered fiduciaries under the Proposed Regulation if the advice is individualized, whether or not it serves as a primary basis for the plans' voting decisions, or if such persons are investment advisers under the Advisers Act. Proxy advisory firms registered as investment advisers would clearly be subject to fiduciary standards under ERISA for providing generalized advice on proxy voting. As fiduciaries, such firms would need to ensure that they do not receive compensation (directly or through their affiliates) from issuers about whose securities they are advising plans.

- Advice and recommendations as to the selection of persons to manage plan investments.

  - On their face, ERISA and the Current Regulation only cover advice regarding the advisability of investing in, purchasing, or selling securities or other property. The Proposed Regulation expands the regulation to include advice

[14] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, P.L. 111-203 §764 (2010).

[15] The counterparty limitation described in Section D below may be applicable.

as to the selection of persons to manage plan investments. Accordingly, consultants that advise plans as to the selection of investment managers and that receive compensation for such advice would be treated as fiduciaries under the Proposed Regulation and would be subject to the accompanying ERISA fiduciary standards and liabilities.

3. Provision of Advice to Plan Participants and Beneficiaries. The Proposed Regulation explicitly covers the provision of advice or recommendations to plan participants or beneficiaries.

- The DOL has previously taken the position that, as a general matter, a recommendation to a plan participant to take an otherwise permissible plan distribution does not constitute investment advice.[16] In connection with the Proposed Regulation, the DOL has requested comments on whether and to what extent the final regulation should define the provision of investment advice to include recommendations related to taking permissible plan distributions. If this advice were considered to be fiduciary advice, then the Proposed Regulation would restrict the ability of the adviser to make available its products or the products of an affiliate for investment of the distributed amount.

This provision, if adopted in its current form, would dramatically affect the ability of plan participants and IRA holders to receive even minimal advice in connection with their holdings and would put tremendous pressure on the contours of DOL Interpretive Bulletin 96-1(relating to participant investment education)[17] and the yet to be finalized investment advice regulations under the PPA.[18]

B. Types of Relationships Covered

As shown in the table below, the Proposed Regulation's most extensive changes are in the section that governs the nature of the relationship between the adviser and the plan fiduciary, participant or beneficiary.

The second prong of the Proposed Regulation's definition sets forth four independent, alternative conditions. Satisfaction of any ***one*** of the conditions (directly or indirectly, including through or together with an affiliate) would result in fiduciary status being attributed to a person giving the type of advice covered by the Proposed Regulation.

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16 DOL Advisory Opinion 2005-23A (2005).

17 Interpretive Bulletin Relating to Participant Investment Education, 29 CFR 2509.96-1 (1996).

18 Investment Advice—Participants and Beneficiaries, 75 F.R. 9360 (proposed Mar. 2, 2010).

Types of Relationships: Current and Proposed Regulation

Current Regulation	**Proposed Regulation** **(changes noted in bold)**

Person rendering advice either directly or indirectly through or together with an affiliate:
• Has discretionary authority or control with respect to purchasing or selling securities or other property for the plan; OR
• Renders any advice:
  o on a regular basis to the plan,
  o pursuant to a mutual agreement, arrangement or understanding, written or otherwise, between such person and the plan or a fiduciary with respect to the plan, that
  o such services will serve as a primary basis for investment decisions with respect to plan assets, and
  o that such person will render individualized investment advice to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.
	Person rendering advice either directly or indirectly through or together with an affiliate:
	• **Represents or acknowledges that it is acting as a fiduciary** within the meaning of ERISA with respect to providing advice or making recommendations; OR
	• Exercises any discretionary authority or control with respect to the **management of** the plan or disposition of its assets, or has any discretionary authority or responsibility in the **administration of** the plan; OR
	• Is an **investment adviser** within the meaning of Section 202(a)(11) of the Advisers Act; OR
	• Provides advice or makes recommendations:
	  o pursuant to an agreement, arrangement or understanding (**even if not mutual**), written or otherwise, between such person and the plan, a plan fiduciary, or a plan participant or beneficiary
	  o that such advice **may be considered** in connection with making investment **or management** decisions with respect to plan assets, and
	  o will be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary.

1. Persons that represent or acknowledge that they are acting as fiduciaries within the meaning of ERISA.

- An acknowledgement of such status, either orally or in writing, in connection with the provision of advice for a fee, would result in fiduciary status.

- While this status-based characterization of a person as a fiduciary without regard to the functions performed by such person is at odds with the DOL's historic view that the fiduciary test is a functional test (e.g., the services actually rendered are determinative), it seems reasonable to treat as fiduciaries those service providers that hold themselves out as such. To avoid fiduciary status that could arise from alleged oral statements, a service provider should obtain from a plan or plan participant a written document, with a robust integration clause, that disclaims fiduciary status.

2. Persons that exercise any discretionary authority or control with respect to the management of the plan or disposition of its assets, or have any discretionary authority or responsibility in the administration of the plan.

- The Current Regulation only covers persons who have discretionary authority or control with respect to purchasing or selling securities or other property for the plan.

- The Proposed Regulation broadens the definition to also include persons who have any discretionary authority or control respecting the management of the plan or who have any discretionary authority or responsibility in the administration of the plan.[19]

3. Persons that are investment advisers within the meaning of Section 202(a)(11) of the Advisers Act.[20]

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[19] The Proposed Regulation references a person who is a fiduciary within the meaning of ERISA Section 3(21)(A)(i) or (iii).

[20] Subject to several important exceptions, Section 202(a)(11) generally defines an "investment adviser" as any person who, for compensation, engages in the business of advising others as to the value of securities or the advisability of investing in, purchasing, or selling securities, or who promulgates analyses or reports concerning securities. Among others, Section 202(a)(11) specifically excludes: (1) a bank, or any bank holding company as defined in the Bank Holding Company Act of 1956, which is not an investment company, except that the term "investment adviser" includes any bank or bank holding company to the extent that such bank or bank holding company serves or acts as an investment adviser to a registered investment company, but if such services or actions are performed through a separately identifiable department or division of a bank, the department or division, and not the bank itself, is deemed to be the investment adviser; (2) any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his or her profession; (3) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor; (4) the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation; and (5) any nationally recognized statistical rating organization, as that term is defined in Section 3(a)(62) of the Securities Exchange Act of 1934, unless such organization engages in issuing recommendations as to purchasing, selling, or holding securities or in managing assets, consisting in whole or in part of securities, on behalf of others.

The per se fiduciary treatment of any entity that is an investment adviser as defined under the Advisers Act, whether or not registered, raises a number of issues.

- The DOL states that persons excluded from the definition of investment adviser under Section 202(a)(11) would not be captured as "investment advisers" so as to make them per se fiduciaries. Nevertheless these excluded persons (such as, for example, lawyers and accountants) would be fiduciaries if they render investment advice that is "individualized" and "may be" considered by plans in connection with making investment or management decisions, as discussed below.
    - Banks are excluded from the definition of an investment adviser under the Advisers Act and are therefore not per se fiduciaries. We see no reason why investment advisers should be treated any differently.
- It is not clear how this regulation would be applied to an entity that is an investment adviser but that performs a range of services for plans, including services performed in a capacity other than that of investment adviser.
    - Registered investment advisers that send out generalized research reports about issuers or statements about the economy could be deemed to be fiduciaries under this provision. Presumably the DOL could not have intended this consequence.
    - Service providers may be registered both as investment advisers and broker-dealers. As broker-dealers, they may provide advice incidental to their activities as broker-dealers. Would such advice render the entities fiduciaries because they are also registered as investment advisers? The Proposed Regulation offers no guidance on how to resolve this question.

4. Persons that provide advice or recommendations pursuant to an agreement, arrangement or understanding, written or unwritten, that such advice may be considered in connection with making investment or management decisions, and will be individualized to the needs of the plan, or plan fiduciary, participant or beneficiary.

- Under the Proposed Regulation, the advice would not have to be provided on a *regular* basis, nor would there be any requirement that the parties have a *mutual* understanding that the advice will serve as a *primary* basis for plan investment decisions, each of which is a significant departure from the Current Regulation. According to the DOL, when a service provider is retained to render advice, the plan should be able to rely on the advice without regard to whether the parties intend it to be "a primary or lesser basis in the fiduciary's decision-making."[21] This part of the

[21] Preamble to the Proposed Regulation, 75 Fed Reg. 65,263, 65,267.

Proposed Regulation reverses the more sensible approach of the Current Regulation which clearly defines when a plan should reasonably expect a service provider to be acting in a fiduciary capacity. Certainly, when a plan and a service provider explicitly agree that the plan is not relying on the service provider's advice as a fiduciary, the service provider should ordinarily be entitled to rely on that agreement. The Proposed Regulation lacks a safe harbor that would protect the enforceability of such an agreement.

- This provision comes close to creating "same room liability" for the deepest pockets in the room, since any covered advice or recommendation that is *individualized* and that *may* be considered in connection with an investment would render the service provider a fiduciary.[22] Such liability would cause many current advisers to exit from the market, leaving plans with only judgment-proof or unqualified advisers.
    - A lawyer who advises as to whether or not a proposed transaction would give rise to unrelated business income or involve plan assets, for example, or an accountant who advises as to whether a particular synthetic guaranteed investment contract would be eligible for book value accounting, could each be viewed as fiduciaries under the Proposed Regulation, potentially subjecting both to direct and co-fiduciary liability under ERISA. This change has the potential to alter the standard of professional liability based on the nature of the client. It could also subject professional service providers to lawsuits related to deals that in retrospect are not successful based on a theory that the professional knew that the main fiduciary that is compensated for making the decision breached its fiduciary duty.
    - This provision would have a chilling effect on the ability of plans to hire professional advisers and would increase the costs of such professional advice. Service providers also would routinely attempt to ensure that plans confirm that the advice provided will not be considered in connection with decisions regarding plan assets.

C. Types of Fees and Compensation Covered

The Proposed Regulation clarifies that the "fee or other compensation" requirement under Section 3(21) of ERISA would be satisfied by any fee or compensation for the advice received by the person or by an affiliate from any source, and any fee or compensation received by the person or by an affiliate incident to the transaction in which the investment advice has been rendered or will be rendered. The term "fee or compensation" includes, for

[22] Phyllis C. Borzi, the assistant secretary of labor for the Employee Benefits Security Administration, specifically stated that the new definition of fiduciary in the Proposed Regulation will protect plan sponsors because it will more effectively pull in the advisers. She noted further that plan sponsors do not want to be the only fiduciary to be held responsible. *See* Andrea L. Ben-Yosef, *BNA Pension & Benefits Daily* (Nov. 5, 2010).

example, brokerage, mutual fund sales, and insurance sales commissions, as well as fees and commissions based on multiple transactions involving different parties. The provisions in this section are consistent with the DOL's prior position.

D. **Limitations in the Proposed Regulation**

While significantly broadening the definition of fiduciary, the Proposed Regulation also includes important carveouts.

1. Purchase and Sale of Securities or Other Property. Absent a representation to the contrary, a person would not be treated as a fiduciary if it could demonstrate that the plan receiving its advice knows, or reasonably should know, that the person is providing the advice or 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 that the person is not undertaking to provide impartial investment advice.

- The burden of proof would be on the person disputing the fiduciary classification, and such person would have to "demonstrate" knowledge or the reasonable expectation of knowledge by the plan.
  - Counterparties would seek to ensure that plans sign an acknowledgement that the service providers are not acting as fiduciaries. All materials provided would contain appropriate legends to that effect.
  - This part of the Proposed Regulation codifies the practice whereby broker-dealers request written representations from plans that, within the context of the Current Regulation, any advice provided by the broker-dealer will not be a primary basis for the plan's decision. As such, this part of the Proposed Regulation is a common sense approach that permits parties to characterize their status with respect to each other and to plan accordingly.
- While helpful, this limitation is too narrow, since it does not cover numerous other routine transactions with broker-dealers to which the same rationale should apply, such as acting as a broker for the plan or as a futures commission merchant for the plan (as opposed to an adverse party) in connection with a securities or futures trade.
  - For example, consider the situation where a plan approaches a broker-dealer for assistance in transitioning a portfolio of fixed income securities that the plan manager has decided to sell and replace with equity securities. Some of the fixed income securities may be sold to the broker-dealer as principal and some equity securities may be purchased on an exchange with the broker-dealer acting as agent. The manager may seek to change the plan's exposure immediately through the use of futures contracts. Would the broker-dealer

become a fiduciary only with respect to the agency trades? With respect to both the agent and the principal transactions? With respect to neither transaction? In this circumstance, the form of the transaction as broker or dealer should be irrelevant and the broker-dealer should not be treated as a fiduciary. At a minimum, advice regarding how to execute a transaction should not be viewed as providing advice with meaning of the Proposed Regulation.

  - If this limitation is not expanded to cover routine brokerage transactions, broker-dealers would have to comply with Prohibited Transaction Exemption 86-128 in order to act as agents in securities transactions and would not be able to effect futures transactions on behalf of plans absent an additional DOL exemption.

- The use of the phrase "securities or other property" in this section might seem inappropriately narrow and may appear to raise questions as to whether items such as swaps and derivatives are covered by this carveout. If "property" does not include commodity-based swaps and derivatives for purposes of this section, then commodity-based swaps and derivatives would not be covered by the Proposed Regulation at all, as the advice covered by the Proposed Regulation is also defined by reference to "securities or other property." We doubt that the DOL intended such a narrow interpretation in either the general scope of the Proposed Regulation or in the limitation.

- The DOL seems to have limited this section to the "purchase or sale" of securities or other property, even though the advice covered by the Proposed Regulation includes advice as to the valuation and management of securities or other property, and as to the advisability of investing in, purchasing, holding, or selling securities or other property.

  - Failure to clarify that this language expressly covers the holding of securities or other property, in addition to the purchase or sale of such securities or other property, would leave service providers uncertain as to whether this provision would apply to ongoing transactions such as extensions of credit under notes issued by the counterparty or derivative transactions that continue over a period of time.

2. **Individual Account Plans**. The Proposed Regulation sets forth several acts that, when performed in connection with individual account plans,[23] would not be treated as the rendering of investment advice for purposes of ERISA Section 3(21)(ii):

[23] An individual account plan is defined in Section 3(34) of ERISA to mean "a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's

- Provision of investment education information and materials within the meaning of DOL Interpretive Bulletin 96-1 (relating to participant investment education) to plan participants or beneficiaries. Read literally, Interpretive Bulletin 96-1 does not apply to IRAs.[24]

- So long as the person making available such investments discloses in writing to the plan fiduciary that the person is not undertaking to provide impartial investment advice:

    - Marketing or making available, without regard to the individualized needs of the plan, its participants, or beneficiaries, securities or other property from which a plan fiduciary may designate investment alternatives; and

    - The provision of general financial information and data to assist a plan fiduciary's selection or monitoring of such securities or other property as plan investment alternatives.

III. Next Steps to Consider

Service providers to plans should review the Proposed Regulation to determine the effects on their businesses and the effects on their plan clients. Plan sponsors should review the Proposed Regulation to determine whether it would significantly impede the ability of plans to obtain services or significantly increase the cost of such services. Both plan sponsors and service providers should immediately contact industry trade associations to ensure that any concerns are adequately expressed and understood by the DOL.

Service providers and plan sponsors also should start to sketch out the changes to their businesses that would be required should the Proposed Regulation be adopted in its current form. For many service providers, such changes would be very significant and would require long lead times to implement. Compliance will be required 180 days after the regulation is finalized.

Please call any of your regular contacts at the firm or any of the partners and counsel listed under Employee Benefits in the Practices section of our website (www.cgsh.com) if you have any questions.

CLEARY GOTTLIEB STEEN & HAMILTON LLP

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account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account."

24 29 CFR 2509.96-1(d)(1996).

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C. Description of the Proposed Interpretive Rule

The proposed interpretive rule would amend part 1450. Section 1450.1, Scope, would explain that part 1450 pertains to the Virginia Graeme Baker Pool and Spa Safety Act and that the statute is designed to prevent child drowning, drain entrapments, and eviscerations in pools and spas.

Section 1450.2, Definitions, would define "public accommodations facility" at paragraph (a) as "an inn, hotel, motel, or other place of lodging, including, but not limited to, rental units rented on a bi-weekly or weekly basis."

List of Subjects in 16 CFR Part 1450

Consumer protection, Infants and children, Law enforcement.

E. Conclusion

For the reasons stated above, the Commission proposes to amend part 1450 of title 16 of the Code of Federal Regulations as follows:

PART 1450—VIRGINIA GRAEME BAKER POOL AND SPA SAFETY ACT REGULATIONS

1. The authority citation for part 1450 continues to read as follows:

Authority: 15 U.S.C. 2051–2089, 86 Stat. 1207; 15 U.S.C. 8001–8008, 121 Stat. 1794.

2. Section 1450.1 is added to read as follows:

§ 1450.1 Scope.

This part pertains to the Virginia Graeme Baker Pool and Spa Safety Act, ("Act"), 15 U.S.C. 8001 *et seq.,* which is designed to prevent child drowning, drain entrapments and eviscerations in pools and spas.

3. Add paragraph (a) to § 1450.2 to read as follows:

§ 1450.2 Definitions.

(a) *Public accommodations facility* means an inn, hotel, motel, or other place of lodging, including, but not limited to, rental units rented on a bi-weekly or weekly basis.

* * * * *

Dated: October 15, 2010.

Todd A. Stevenson,

Secretary, Consumer Product Safety Commission.

[FR Doc. 2010–26520 Filed 10–19–10; 8:45 am]

BILLING CODE 6355–01–P

CONSUMER PRODUCT SAFETY COMMISSION

16 CFR Part 1450

Virginia Graeme Baker Pool and Spa Safety Act; Public Accommodation; Withdrawal of Proposed Rule

AGENCY: Consumer Product Safety Commission.

ACTION: Withdrawal of proposed rule.

SUMMARY: In the **Federal Register** of March 15, 2010, the Consumer Product Safety Commission ("CPSC" or "Commission") issued a proposed interpretive rule that would interpret the term "public accommodations facility" as used in the Virginia Graeme Baker Pool and Spa Safety Act ("VGB Act" or "Act") as "an inn, hotel, motel, or other place of lodging, except for an establishment located within a building that contains not more than five rooms for rent or hire and that is actually occupied by the proprietor of such establishment as the residence of such proprietor" (75 FR 12167). The Commission is withdrawing the March 15, 2010 proposed interpretive rule and, elsewhere in this issue of the **Federal Register**, is issuing a new proposed interpretive rule with a 60-day comment period which would interpret "public accommodations facility" as "an inn, hotel, motel, or other place of lodging, including but not limited to, rental units rented on a bi-weekly or weekly basis."

DATES: The proposed interpretive rule is withdrawn as of October 22, 2010.

FOR FURTHER INFORMATION CONTACT: Barbara E. Little, Office of the General Counsel, Consumer Product Safety Commission, 4330 East West Highway, Bethesda, Maryland 20814; e-mail *blittle@cpsc.gov.*

SUPPLEMENTARY INFORMATION: The Commission published a proposed interpretive rule on the definition of "public accommodations facility in the **Federal Register** of March 15, 2010 (75 FR 12167). The proposed interpretive rule would interpret "public accommodations facility" to mean: "An inn, hotel, motel, or other place of lodging, except for an establishment located within a building that contains not more than five rooms for rent or hire and that is actually occupied by the proprietor of such establishment as the residence of such proprietor."

CPSC staff prepared a draft final interpretative rule for the Commission's approval, but, on August 4, 2010, the Commission voted to withdraw the proposed interpretive rule and to direct CPSC staff to draft a new proposed interpretive rule with a 60-day comment period and interpreting "public accommodations facility" as "an inn, hotel, motel, or other place of lodging, including, but not limited to, rental units rented on a bi-weekly or weekly basis." The Commission preliminarily determined that the exception for an owner-occupied establishment located within a building that contains not more than five rooms for rent or hire is inappropriate in the context of pool and spa safety because the number of units for rent or hire has no bearing on the safety of the pool. In addition, the Commission wanted to make clear that a residential facility may become a "place of lodging" if the facility were to offer a significant number of short term stays.

Thus, the Commission, through this notice, is withdrawing the March 15, 2010 proposed interpretive rule. Elsewhere in this issue of the **Federal Register**, the Commission is issuing a new proposed interpretive rule to interpret "public accommodations facility" in the VGB Act as "an inn, hotel, motel, or other place of lodging, including, but not limited to, rental units rented on a bi-weekly or weekly basis."

Dated: October 15, 2010.

Todd A. Stevenson,

Secretary, Consumer Product Safety Commission.

[FR Doc. 2010–26521 Filed 10–21–10; 8:45 am]

BILLING CODE 6355–01–P

DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2510

RIN 1210–AB32

Definition of the Term "Fiduciary"

AGENCY: Employee Benefits Security Administration, Labor.

ACTION: Proposed rule.

SUMMARY: This document contains a proposed rule under the Employee Retirement Income Security Act (ERISA) that, upon adoption, would protect beneficiaries of pension plans and individual retirement accounts by more broadly defining the circumstances under which a person is considered to be a "fiduciary" by reason of giving investment advice to an employee benefit plan or a plan's participants. The proposal amends a thirty-five year old rule that may inappropriately limit the types of investment advice relationships that give rise to fiduciary duties on the

part of the investment advisor. The proposed rule takes account of significant changes in both the financial industry and the expectations of plan officials and participants who receive investment advice; it is designed to protect participants from conflicts of interest and self-dealing by giving a broader and clearer understanding of when persons providing such advice are subject to ERISA's fiduciary standards. For example, the proposed rule would define certain advisers as fiduciaries even if they do not provide advice on a "regular basis." Upon adoption, the proposed rule would affect sponsors, fiduciaries, participants, and beneficiaries of pension plans and individual retirement accounts, as well as providers of investment and investment advice related services to such plans and accounts.

DATES: Written comments on the proposed regulations should be submitted to the Department of Labor on or before January 20, 2011.

FOR FURTHER INFORMATION CONTACT: Fred Wong, Office of Regulations and Interpretations, Employee Benefits Security Administration (EBSA), (202) 693–8500. This is not a toll-free number.

ADDRESSES: To facilitate the receipt and processing of comment letters, the EBSA encourages interested persons to submit their comments electronically by e-mail to *e-ORI@dol.gov* (enter into subject line: Definition of Fiduciary Proposed Rule) or by using the Federal eRulemaking portal at *http://www.regulations.gov.* Persons submitting comments electronically are encouraged not to submit paper copies. Persons interested in submitting paper copies should send or deliver their comments to the Office of Regulations and Interpretations, Employee Benefits Security Administration, Attn: Definition of Fiduciary Proposed Rule, Room N–5655, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, DC 20210. All comments will be available to the public, without charge, online at *http://www.regulations.gov* and *http://www.dol.gov/ebsa* and at the Public Disclosure Room, N–1513, Employee Benefits Security Administration, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, DC 20210.

SUPPLEMENTARY INFORMATION:

A. Background

The Employee Retirement Income Security Act of 1974 (ERISA) is a comprehensive statute designed to promote the interests of participants in employee benefit plans and their beneficiaries by establishing standards of conduct, responsibility, and obligation for fiduciaries of those plans. ERISA imposes a number of stringent duties on those who act as plan fiduciaries, including a duty of undivided loyalty, a duty to act for the exclusive purposes of providing plan benefits and defraying reasonable expenses of administering the plan, and a stringent duty of care grounded in the prudent man standard from trust law.[1] Congress supplemented these general duties by categorically barring, subject to exemption, certain "prohibited" transactions.[2] Fiduciaries are personally liable for losses sustained by a plan that result from a violation of these rules.[3]

Section 3(21)(A) of ERISA provides in relevant part that a person is a fiduciary with respect to a plan to the extent (i) it exercises any discretionary authority or discretionary control with respect to management of such plan or exercises any authority or control with respect to management or disposition of its assets, (ii) it 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, or (iii) it has any discretionary authority or discretionary responsibility in the administration of such plan.[4] On its face, section 3(21)(A)(ii) sets out a simple two-part test for determining fiduciary status: A person renders investment advice with respect to any moneys or other property of a plan, or has any authority or responsibility to do so; and the person receives a fee or other compensation, direct or indirect, for doing so.

In 1975, shortly after ERISA was enacted, the Department issued a regulation, at 29 CFR 2510.3–21(c), that defines the circumstances under which a person renders "investment advice" to an employee benefit plan within the meaning of section 3(21)(A)(ii) of ERISA.[5] A person who renders "investment advice" under the regulation, and receives a fee or other compensation, direct or indirect, for doing so, is a fiduciary under section 3(21)(A)(ii). The current regulation provides in relevant part as follows:

(c) *Investment advice.* (1) A person shall be deemed to be rendering "investment advice" to an employee benefit plan, within the meaning of section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 (the Act) and this paragraph, only if:

(i) Such person renders advice to the plan as to the value of securities or other property, or makes recommendation as to the advisability of investing in, purchasing, or selling securities or other property; and

(ii) Such person either directly or indirectly (*e.g.,* through or together with any affiliate)—

(A) Has discretionary authority or control, whether or not pursuant to agreement, arrangement or understanding, with respect to purchasing or selling securities or other property for the plan; or

(B) Renders any advice described in paragraph (c)(1)(i) of this section on a regular basis to the plan pursuant to a mutual agreement, arrangement or understanding, written or otherwise, between such person and the plan or a fiduciary with respect to the plan, that such services will serve as a primary basis for investment decisions with respect to plan assets, and that such person will render individualized investment advice to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.

The regulation significantly narrows the plain language of section 3(21)(A)(ii), creating a 5-part test that must be satisfied in order for a person to be treated as a fiduciary by reason of rendering investment advice. For advice to constitute "investment advice," an adviser who does not have discretionary authority or control with respect to the purchase or sale of securities or other property for the plan must—

(1) 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

(2) On a regular basis

(3) Pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary, that

(4) The advice will serve as a primary basis for investment decisions with respect to plan assets, and that

(5) The advice will be individualized based on the particular needs of the plan.

The Department further limited the term "investment advice" in a 1976 advisory opinion. Under the facts described therein, the Department concluded that a valuation of closely-held employer securities that an employee stock ownership plan (ESOP)

[1] ERISA section 404(a).

[2] ERISA section 406.

[3] ERISA section 409.

[4] Section 4975(e)(3) of the Internal Revenue Code of 1986, as amended (Code) provides a similar definition of the term fiduciary for purposes of Code section 4975.

[5] 40 FR 50842 (Oct. 31, 1975). The Department of Treasury issued a virtually identical regulation, at 26 CFR 54.4975–9(c), that interprets Code section 4975(e)(3). 40 FR 50840 (Oct. 31, 1975). Under section 102 of Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 1 (1996), the authority of the Secretary of the Treasury to interpret section 4975 of the Code has been transferred, with certain exceptions not here relevant, to the Secretary of Labor. References in this document to sections of ERISA should be read to refer also to the corresponding sections of the Code.

would rely on in purchasing the securities would not constitute investment advice under the regulation.[6]

The current regulation has not been updated since its promulgation in 1975. Since that time, however, the retirement plan community has changed significantly, with a shift from defined benefit (DB) plans to defined contribution (DC) plans. The financial marketplace also has changed significantly, and the types and complexity of investment products and services available to plans have increased. With the resulting changes in plan investment practices, and relationships between advisers and their plan clients, the Department believes there is a need to re-examine the types of advisory relationships that should give rise to fiduciary duties on the part of those providing advisory services. In this regard, we note that recent Department enforcement initiatives indicate there are a variety of circumstances, outside those described in the current regulation, under which plan fiduciaries seek out impartial assistance and expertise of persons such as consultants, advisers and appraisers to advise them on investment-related matters.[7] These persons significantly influence the decisions of plan fiduciaries, and have a considerable impact on plan investments. However, if these advisers are not fiduciaries under ERISA, they may operate with conflicts of interest that they need not disclose to the plan fiduciaries who expect impartiality and often must rely on their expertise, and have limited liability under ERISA for the advice they provide. Recent testimony by the Government Accountability Office noted an association between pension consultants with undisclosed conflicts of interest and lower returns for their client plans.[8] The Department believes that amending the current regulation to establish additional circumstances where investment advice providers are subject to ERISA's fiduciary responsibilities would better protect the interests of plans and their participants and beneficiaries. As a consequence of the current regulation, the Department's investigations of investment advisers must focus on establishing each of the elements of the 5-part test rather than on the precise misconduct at issue in particular cases. Even if an adviser advises a plan about its investments for a fee, the plan relied upon the advice based upon reasonable belief that it was impartial, and the advice was wholly abusive, the Department must still prove each of the test's five elements in order to assert a fiduciary breach. The Department does not believe that this approach to fiduciary status is compelled by the statutory language. Nor does the Department believe the current framework represents the most effective means of distinguishing persons who should be held accountable as fiduciaries from those who should not. For these reasons, the Department believes it is appropriate to update the "investment advice" definition to better ensure that persons, in fact, providing investment advice to plan fiduciaries and/or plan participants and beneficiaries are subject to ERISA's standards of fiduciary conduct.

B. Overview of Proposal

1. Proposed Amendment to Regulation Under ERISA Section 3(21)(A)(ii)

In general, the proposal amends paragraph (c) of Sec. 2510.3–21 by striking the current paragraph (c)(1), redesignating the current paragraph (c)(2) as paragraph (c)(5), and adding new paragraphs (c)(1) through (c)(4). New paragraph (c)(1) sets out the general rule that a person renders "investment advice" for a fee or other compensation, direct or indirect, to an employee benefit plan, within the meaning of section 3(21)(A)(ii) of ERISA and the regulation, if the person provides advice or makes recommendations described in paragraph (c)(1)(i), directly or indirectly meets any of the conditions described in paragraph (c)(1)(ii), and receives a fee or other compensation, direct or indirect, for providing such advice or recommendations. New paragraph (c)(2) sets forth certain limitations in the application of paragraph (c). New paragraph (c)(3) provides guidance with respect to the meaning of the term "fee or other compensation, direct or indirect," as used in section 3(21)(A)(ii) of ERISA. New paragraph (c)(4) clarifies the proposed amendment would apply for purposes of Code section 4975.

a. Description of Advice

Under paragraph (c)(1)(i)(A) of the proposal, the types of advice and recommendations that may result in fiduciary status under ERISA section 3(21)(A)(ii) are: Advice, appraisals or fairness opinions concerning the value of securities or other property; recommendations as to the advisability of investing in, purchasing, holding, or selling securities or other property; or advice or recommendations as to the management of securities or other property.

This provision encompasses the same types of investment-related advice and recommendations as covered by paragraph (c)(1)(i) of the current regulation, except for the following modifications. First, the proposal specifically includes the provision of appraisals and fairness opinions. As discussed above, the Department concluded in AO 76–65A that a valuation of closely held employer securities that would be relied on in the purchase of the securities by an ESOP would not constitute investment advice under the current regulation. However, a common problem identified in the Department's recent ESOP national enforcement project involves the incorrect valuation of employer securities.[9] Among these are cases where plan fiduciaries have reasonably relied on faulty valuations prepared by professional appraisers. The Department believes that application of the proposal to appraisals and fairness opinions rendered in connection with plan transactions may directly or indirectly address these issues, and align the duties of persons who provide these opinions with those of fiduciaries who rely on them. Accordingly, paragraph (c)(1)(i)(A)(*1*) of the proposal specifically includes the provision of appraisals and fairness opinions concerning the value of securities or other property. This paragraph is intended to supersede the Department's conclusion in AO 76–65A, but is not limited to employer securities. Therefore, if a person is retained by a plan fiduciary to appraise real estate being offered to the plan for purchase, then the provision of the appraisal would fall within paragraph (c)(1)(i)(A)(*1*) of the proposal, and may result in fiduciary status under ERISA section 3(21)(A)(ii). The Department would expect a fiduciary appraiser's determination of value to be unbiased, fair, and objective, and to be made in good faith and based on a prudent investigation under the prevailing

[6] Advisory Opinion 76–65A (June 7, 1976) (AO 76–65A).

[7] The Department's Employee Benefits Security Administration (EBSA) maintains a national enforcement project designed to identify and correct violations of ERISA in connection with Employee Stock Ownership Plans. One of the most common violations found is the incorrect valuation of employer securities. Another project, the Consultant/Adviser project (CAP) focuses on ERISA violations that may occur in connection with the receipt of improper, undisclosed compensation by pension consultants and other investment advisers. Information on the EBSA's national enforcement projects can be found at *http://www.dol.gov/ebsa/erisa_enforcement.html.*

[8] *Conflicts of Interest Can Affect Defined Benefit and Defined Contribution Plans,* GAO 09–503T (Mar. 24, 2009).

[9] *See* footnote 7.

circumstances then known to the appraiser.

Second, the proposal at paragraph (c)(1)(i)(A)(*3*) makes specific reference to advice and recommendations as to the management of securities or other property. This would include, for instance, advice and recommendations as to the exercise of rights appurtenant to shares of stock (*e.g.,* voting proxies),[10] and as to the selection of persons to manage plan investments.

Finally, the proposal at paragraph (c)(1)(i)(B) makes clear that fiduciary status under section 3(21)(A)(ii) may result from the provision of advice or recommendations not only to a plan fiduciary, but also to a plan participant or beneficiary. This reflects the Department's long-standing interpretation of the current regulation.[11] The Department notes that it also has taken the position that, as a general matter, a recommendation to a plan participant to take an otherwise permissible plan distribution does not constitute investment advice within the meaning of the current regulation, even when that advice is combined with a recommendation as to how the distribution should be invested.[12] Concerns have been expressed that, as a result of this position, plan participants may not be adequately protected from advisers who provide distribution recommendations that subordinate participants' interests to the advisers' own interests. The Department, therefore, is requesting comment on whether and to what extent the final regulation should define the provision of investment advice to encompass recommendations related to taking a plan distribution. The Department is specifically interested in information on other laws that apply to the provision of these types of recommendations, whether and how those laws safeguard the interests of plan participants, and the costs and benefits associated with extending the regulation to these types of recommendations.

b. Conditions

Paragraph (c)(1)(ii) of the proposal sets forth alternative conditions, at paragraphs (c)(1)(ii)(A) through (D), at least one of which must be met by a person rendering advice described in paragraph (c)(1)(i) in order for the person to be considered rendering investment advice under the proposal. The conditions may be met by the person acting directly or indirectly, such as through or together with an affiliate. These alternative conditions generally relate to the degree of authority, control, responsibility or influence that is possessed, directly or indirectly, by the person rendering the advice, and the reasonable expectations of the persons receiving the advice. The conditions at paragraphs (c)(1)(ii)(B) and (D) of the proposal are based on paragraphs (c)(1)(ii)(A) and (B) of the current regulation (which include elements of the 5-part test described above), but with modifications to simplify their application and broaden their scope. The conditions at paragraphs (c)(1)(ii)(A) and (C) are new, and are intended to broaden the scope of the regulation based on readily-ascertainable criteria.

Paragraph (c)(1)(ii)(A) of the proposal includes persons providing advice or recommendations described in paragraph (c)(1)(i) that represent or acknowledge that they are acting as a fiduciary within the meaning of ERISA with respect to such advice or recommendations. The Department believes that explicitly claiming ERISA fiduciary status, orally or in writing, enhances the adviser's influence, and gives the advice recipient a reasonable expectation that the advice will be impartial and prudent. Therefore such a representation or acknowledgment in connection with provision of the advice or recommendations described in paragraph (c)(1)(i) is sufficient under the proposal to result in fiduciary status under section 3(21)(A)(ii) if provided for a fee or other compensation, direct or indirect.

Paragraph (c)(1)(ii)(B) of the proposal includes persons providing the types of investment-related advice or recommendations described in paragraph (c)(1)(i) that are fiduciaries with respect to the plan within the meaning of section 3(21)(A)(i) or (iii) of ERISA. This provision is based on the condition in paragraph (c)(1)(ii)(A) of the current regulation, which is met if the person rendering advice directly or indirectly has discretionary authority or control with respect to purchasing or selling securities or other property for the plan. However, the proposal broadens the scope of this condition by referencing a person who is a fiduciary within the meaning of section 3(21)(A)(i) or (iii) of ERISA, which is not limited to persons with authority or control relating to purchases or sales of investments for a plan. Specifically, section 3(21)(A)(i) and (iii) describe any person who exercises any discretionary authority or discretionary control with respect to management of the plan, exercises any authority or control with respect to management or disposition of its assets, or has any discretionary authority or discretionary responsibility in the administration of the plan.

Paragraph (c)(1)(ii)(C) includes persons providing advice or recommendations described in paragraph (c)(1)(i) that are investment advisers within the meaning of section 202(a)(11) of the Investment Advisers Act of 1940 (Advisers Act), 15 U.S.C. 80b–2(a)(11). This section generally defines an "investment adviser" as any person who, for compensation, engages in the business of advising others as to the value of securities or the advisability of investing in, purchasing, or selling securities, or who promulgates analyses or reports concerning securities. However, section 202(a)(11) specifically excludes the following: (1) A bank, or any bank holding company as defined in the Bank Holding Company Act of 1956, which is not an investment company, except that the term "investment adviser" includes any bank or bank holding company to the extent that such bank or bank holding company serves or acts as an investment adviser to a registered investment company, but if such services or actions are performed through a separately identifiable department or division of a bank, the department or division, and not the bank itself, is deemed to be the investment adviser; (2) any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his or her profession; (3) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor; (4) the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation; (5) any person whose advice, analyses, or reports relate to no securities other than securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States, or securities issued or guaranteed by corporations in which the United States has a direct or indirect interest which shall have been designated by the Secretary of the Treasury, pursuant to section 3(a)(12) of the Securities Exchange Act of 1934, as exempted securities for the purposes of that Act; (6) any nationally recognized statistical rating organization, as that term is defined in section 3(a)(62) of the Securities Exchange Act of 1934, unless such organization engages in issuing recommendations as to purchasing,

[10] The fiduciary act of managing plan assets that are shares of corporate stock include the management of voting rights appurtenant to those shares of stock. 29 CFR 2509.08–2.

[11] *See* 29 CFR 2509.96–1(c).

[12] Advisory Opinion 2005–23A (Dec. 7, 2005).

selling, or holding securities or in managing assets, consisting in whole or in part of securities, on behalf of others; or (7) such other persons designated by the Securities and Exchange Commission (SEC) by rules, regulations or orders.[13] Courts have determined that these investment advisers owe fiduciary duties to their clients under the Advisers Act.[14] In this regard, the SEC has stated: "the Investment Advisers Act imposes on investment advisers an affirmative duty to their clients of utmost good faith, full and fair disclosure of all material facts, and an obligation to employ reasonable care to avoid misleading their clients." [15] Thus, the Department proposes to include these persons under the regulation.

Paragraph (c)(1)(ii)(D) includes persons that provide advice or make recommendations described in paragraph (c)(1)(i) pursuant to an agreement, arrangement or understanding, written or otherwise, between such person(s) and the plan, a plan fiduciary, or a plan participant or beneficiary, that such advice may be considered in connection with making investment or management decisions with respect to plan assets, and will be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary.

Paragraph (c)(1)(ii)(D) of the proposal is based on the elements of the 5-part test contained in paragraph (c)(1)(ii)(B) of the current regulation which, as described above, requires that a person render advice on a regular basis to the plan pursuant to a mutual agreement, arrangement or understanding, written or otherwise, between such person and the plan or a fiduciary with respect to the plan, that such services will serve as a primary basis for investment decisions with respect to plan assets, and that such person will render individualized investment advice to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments. The Department notes several differences between the proposal and current paragraph (c)(1)(ii)(B). The proposal does not require the advice to be provided on a regular basis. The Department has observed that in those instances where a plan fiduciary retains a service provider such as a consultant or appraiser to render advice, it often involves discrete advice with respect to distinct investment transactions, such as a purchase of employer securities. The Department does not believe that the significance of the advice on a plan fiduciary's decisions diminishes merely because it is rendered only once, rather than on a *regular basis,* or that fiduciary status under section 3(21)(A)(ii) should depend on such a distinction. For example, a fiduciary may retain a person to provide advice on a particular real estate investment in the plan's portfolio, and never have a reason to use this adviser again. Nevertheless, such advice may be critical to an important investment decision and the plan's agreement with the adviser may give the plan every expectation that the adviser is competent and has no conflicts of interest. The Department also believes that removal of the regular basis requirement will help address uncertainty under the current regulation by eliminating difficult factual questions relating to what constitutes a regular basis, and when it begins and ends, and by making clear that fiduciary status applies to each instance advice is rendered.

The proposal also does not require that the parties have a mutual understanding that the advice will serve as a primary basis for plan investment decisions. Nothing in ERISA compels conditioning fiduciary status on a requirement that an adviser and plan fiduciary have a mutual understanding as to the primacy of the advice given, in relation to other advice or information that the fiduciary may consider in making a decision. The Department believes that when a service provider is retained to render advice, the plan should generally be able to rely on the advice without regard to whether the parties intend it be a primary or lesser basis in the fiduciary's decision-making. For example, in a complex investment decision, a plan fiduciary may need to consult advisers with different areas of investment expertise in order to make a prudent decision. The relative importance of the different kinds of advice that the plan fiduciary obtains may be impossible to discern, and should not affect the question of whether the adviser is a fiduciary. Accordingly, under the proposal it is sufficient if the understanding of the parties is that the advice will be considered in connection with making a decision relating to plan assets. The Department also believes this modification will simplify this condition by eliminating difficult factual issues surrounding the primacy of the advice rendered. Other changes are editorial in nature and intended to improve the readability of the provision.

It is important to note generally that paragraphs (c)(1)(ii)(A), (B), (C) and (D) are independent, alternative conditions. Satisfaction of any one of these alternative conditions may result in fiduciary investment advice under the proposal if paragraph (c)(1)(i) also is satisfied. For example, a bank or a broker dealer that provides investment advice or recommendations described in paragraph (c)(1)(i) might fall within an exclusion from the definition of "investment adviser" in section 202(a)(11) of the Advisers Act, and therefore might not meet paragraph (c)(1)(ii)(C) of the proposal. Notwithstanding this exclusion, if the bank or broker dealer meets the requirements of paragraphs (c)(1)(ii)(A), (B) or (D), it would nevertheless be considered to render investment advice under the proposal.

c. Limitations

Paragraphs (c)(2) of the proposal sets forth certain limitations with respect to the application of paragraph (c)(1).

Paragraph (c)(2)(i) provides that a person shall not be considered to be a person described in paragraph (c)(1) with respect to the provision of advice or recommendations if, with respect to a person other than a person described in paragraph (c)(1)(ii)(A), such person can demonstrate that the recipient of the advice knows or, under the circumstances, reasonably should know, that 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 that the person is not undertaking to provide impartial investment advice. This provision reflects the Department's understanding that, in the context of selling investments to a purchaser, a seller's communications with the purchaser may involve advice or recommendations, within paragraph (c)(1)(i) of the proposal, concerning the investments offered. The Department has determined that such communications ordinarily should not result in fiduciary status under the proposal if the purchaser knows of the person's status as a seller whose interests are adverse to those of the purchaser, and that the person is not undertaking to provide impartial investment advice. However, the Department believes there is an inherent expectation of impartial investment advice from a person described in

[13] *See* Advisers Act section 202(a)(11)(A)–(G), 15 U.S.C. 80b–2(a)(11)(A)–(G).

[14] *SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180 (1963).

[15] SEC Advisers Act Rel. No. 1393 (Nov. 29, 1993).

paragraph (c)(1)(ii)(A) (involving representations or acknowledgment of ERISA fiduciary status with respect to providing advice or recommendations). Accordingly, paragraph (c)(2)(i) does not apply to such a person.

As an example, if a person selling securities to a plan is a fiduciary of the plan under section 3(21)(A)(i) or (iii) of ERISA (and therefore in paragraph (c)(1)(ii)(B) of the proposal),[16] or is an investment adviser as defined in the Advisers Act (and therefore in paragraph (c)(1)(ii)(C) of the proposal),[17] then the person may seek to utilize paragraph (c)(2)(i) to avoid fiduciary status under the proposal in connection with the sale. However, if the person also makes a representation of ERISA fiduciary status in connection with the sale, orally or in writing, then paragraph (c)(2)(i) would not be available. The Department intends that a person seeking to avoid fiduciary status under the proposal by reason of the application of paragraph (c)(2)(i) must demonstrate compliance with all applicable requirements of the limitation.

Paragraph (c)(2)(ii) describes certain activities taken in connection with individual account plans that will not, in and of themselves, be treated as rendering investment advice for purposes of ERISA section 3(21)(A)(ii). Paragraph (c)(2)(ii)(A) clarifies that the provision of investment education information and materials described in 29 CFR 2509.96–1(d) will not constitute the rendering of investment advice under section 3(21)(A)(ii) of ERISA. In 29 CFR 2509.96–1(d), the Department identified four specific categories of information and materials which, if furnished, alone or on combination, to plan participants or beneficiaries would not result in the rendering of investment advice under the current regulation. The Department reasoned that these categories of information and materials—plan information, general financial and investment information, asset allocation models, and interactive materials—would not involve advice or recommendations within the meaning of paragraph (c)(1)(i) of the current regulation.[18] The proposed modifications to the advice and recommendations described in paragraph (c)(1)(i) would not change this conclusion. This is reflected in paragraph (c)(2)(ii)(A). The Department notes that the information and materials described in 29 CFR 2509.96–1(d) merely represent examples of the type of information and materials that may be furnished to a participant or beneficiary without being considered the rendering of investment advice under the proposal.

Paragraphs (c)(2)(ii)(B) and (c)(2)(ii)(C) address certain common practices that have developed with the growth of participant-directed DC plans. Service providers such as recordkeepers and third party administrators sometimes make available a menu of investments from which a plan fiduciary selects a more limited menu that will be available under the plan for participant or beneficiary investment. The provider may simply offer a "platform" of investments from which the plan fiduciary selects those appropriate for the plan, or the provider may select, or assist the plan fiduciary in selecting the investments that will be available under the plan. The service provider also sometimes retains the ability to later make changes to the plan's investment menu, subject to advance approval by the plan fiduciary. In some instances, the provider and the plan fiduciary clearly understand that the provider is offering investments as to which the provider has financial or other relationships, and is not purporting to provide impartial investment advice regarding construction of the plan's investment menu. In other instances, the plan fiduciary is relying on the provider's impartial expertise in selecting an investment menu for the plan. Also, to assist in the plan fiduciary's selection or monitoring of investments from those made available, such a service provider also might provide to the fiduciary general financial information and data regarding matters such as historic performance of asset classes and of the investments available through the provider.

To help address any uncertainty as to how these arrangements are treated under the proposal, the Department is clarifying at paragraph (c)(2)(ii)(B) that, with respect to an individual account plan, the marketing or making available (*e.g.,* through a platform or similar mechanism), without regard to the individualized needs of the plan, its participants, or beneficiaries, securities or other property from which a plan fiduciary may designate investment alternatives into which plan participants or beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts, will not, by itself, be treated as the rendering of investment advice within the meaning of section 3(21)(A)(ii) of ERISA if the person making available such investments discloses in writing to the plan fiduciary that the person is not undertaking to provide impartial investment advice.[19] Paragraph (c)(2)(ii)(C) of the proposal further clarifies that, in connection with the activities described in paragraph (c)(2)(ii)(B), the provision of certain information and data to assist a plan fiduciary's selection or monitoring of such plan investment alternatives will not be treated as rendering investment advice if the person providing such information or data discloses in writing to the plan fiduciary that the person is not undertaking to provide impartial investment advice.

The Department recognizes that compliance with a number of ERISA's reporting and disclosure provisions requires information on the value of plan assets. The Department does not intend, as a general matter, for such information provided solely for compliance purposes to fall within the type of advice described under that proposal. Paragraph (c)(2)(iii) provides that advice described in paragraph (c)(1)(i)(A)(*1*) does not encompass the preparation of a general report or statement that merely reflects the value of an investment of a plan or a participant or beneficiary, provided for purposes of compliance with the reporting and disclosure requirements of the Act, the Internal Revenue Code, and the regulations, forms and schedules issued thereunder, unless such report involves assets for which there is not a generally recognized market and serves as a basis on which a plan may make distributions to plan participants and beneficiaries.

[16] The Department notes that, because such a fiduciary would be a party in interest to the plan under section 3(14)(A) of ERISA, such a transaction would be prohibited by section 406(a) of ERISA unless exempt pursuant to an available statutory or administrative prohibited transaction exemption.

[17] The Department is not addressing any issues under the Advisers Act related to such a transaction.

[18] *See generally* 29 CFR 2509.96–1(d).

[19] The Department notes, however, that such a service provider's substitution or deletion of investment options selected by a plan fiduciary may, depending on the surrounding facts and circumstances, constitute an exercise of "authority or control respecting management or disposition of [a plan's] assets" within the meaning of section 3(21)(A)(i) of ERISA. *See* Advisory Opinion 97–16A (May 22, 1997).

d. Fee Requirement

A necessary element of fiduciary status under section 3(21)(A)(ii) of ERISA is that a person must render investment advice for a fee or other compensation, direct or indirect. Paragraph (c)(3) provides that purposes of section 3(21)(A)(ii), a fee or other compensation, direct or indirect, received by a person for rendering investment means 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. For example, the term fee or compensation includes, but is not limited to, brokerage, mutual fund sales, and insurance sales commissions. It includes fees and commissions based on multiple transactions involving different parties.

e. Application Under Code Section 4975

Code section 4975(e)(3) contains a provision that is parallel to ERISA section 3(21)(A)(ii) and defines the term "fiduciary" for purposes of the prohibited transaction excise tax provisions in Code section 4975. In 1975, the Department of the Treasury issued a regulation under Code section 4975(e)(3), found at 26 CFR 54.4975–9(c), that parallels 29 CFR 2510.3–21(c). Under section 102 of Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 1 (1996), the authority of the Secretary of the Treasury to interpret section 4975 of the Code has been transferred, with certain exceptions not here relevant, to the Secretary of Labor. Paragraph (c)(4) clarifies that the proposed amendments to the definition of the term "fiduciary" in 29 CFR 2510.3–21(c) also apply for purposes of the application of Code section 4975 with respect to any plan described in Code section 4975(e)(1), regardless of whether such plan is an employee benefit plan.

C. Effective Date

The Department proposes that the regulations contained in this document will be effective 180 days after publication of the final regulations in the **Federal Register**. The Department invites comments on whether the final regulations should be made effective on a different date.

D. Request for Comment

The Department invites comments from interested persons on the proposed rule. To facilitate the receipt and processing of comment letters, the EBSA encourages interested persons to submit their comments electronically by e-mail to *e-ORI@dol.gov* (enter into subject line: Definition of Fiduciary Proposed Rule) or by using the Federal eRulemaking portal at *http://www.regulations.gov*. Persons submitting comments electronically are encouraged not to submit paper copies. Persons interested in submitting paper copies should send or deliver their comments to the Office of Regulations and Interpretations, Employee Benefits Security Administration, Attn: Definition of Fiduciary Proposed Rule, Room N–5655, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, DC 20210. All comments will be available to the public, without charge, online at *http://www.regulations.gov* and *http://www.dol.gov/ebsa* and at the Public Disclosure Room, N–1513, Employee Benefits Security Administration, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, DC 20210.

The comment period for the proposed regulations will end 90 days after publication of the proposed rule in the **Federal Register**. The Department believes that this period of time will afford interested persons an adequate amount of time to analyze the proposal and submit comments. Written comments on the proposed rule should be submitted to the Department on or before January 20, 2011.

E. Regulatory Impact Analysis

1. Executive Order 12866 Statement

Under Executive Order 12866 (58 FR 51735), the Department must determine whether a regulatory action is "significant" and therefore subject to review by the Office of Management and Budget (OMB). Section 3(f) of the Executive Order defines a "significant regulatory action" as an action that is likely to result in a rule (1) having an annual effect on the economy of $100 million or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or Tribal governments or communities (also referred to as "economically significant"); (2) creating a serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order. OMB has determined that this rule is economically significant within the meaning of section 3(f)(1) of the Executive Order, because it is likely to have an effect on the economy of $100 million in any one year. Accordingly, OMB has reviewed the rule pursuant to the Executive Order. The Department performed a comprehensive, unified analysis to estimate the costs and, to the extent feasible, provide a qualitative assessment of benefits attributable to the proposed rule for purposes of compliance with Executive Order 12866 and the Regulatory Flexibility Act. The analysis is summarized in Table 1, below.

TABLE 1—ACCOUNTING TABLE

Benefits				
Annualized Monetized ($millions/year)—Not Quantified.				
Qualitative: The proposed regulation's new definition of when a person is considered a "fiduciary" of a pension plan by reason of providing investment advice will discourage harmful conflicts of interest, improve service value, and enhance the Department's ability to redress abuses and more effectively and efficiently allocate its enforcement resources. The proposed regulation also should help plans by giving them a means to seek recoupment of losses and disgorgement of ill-gotten gains from those newly-considered fiduciaries who engage in misconduct. While most of the recoupment will be transfers, they are welfare improving, because they return money to plans that would not have been taken from them if the service provider had been acting in the best interest of the plan and its participants and beneficiaries as required by ERISA. Given the magnitude of plan assets that may be affected, even a small service value improvement by a moderate number of plans could yield economically significant benefits.				
Costs	Estimate	Year dollar	Discount rate	Period covered
Annualized Monetized ($millions/year) for service provider compliance review and implementation costs	2.1 1.9	2010 2010	7% 3%	2011–2020 2011–2020
Annualized Monetized ($millions/year) for higher costs of doing business for service providers not previously covered by the fiduciary definition—Not Quantified.				
Qualitative: An increased number of service providers could become fiduciaries to the plans to whom they provide services. These service providers could experience higher costs of doing business due to increased liability. To the extent costs and liabilities rise, the plan service provider market could become compressed if plan service providers leave the market. As more service providers become fiduciaries, more transactions could violate ERISA prohibited transaction rules. Absent applicable prohibited transaction exemptions, service providers would have to restructure transactions and/or modify business practices.				

2. Background and Need for Regulatory Action

As stated earlier in this preamble, section 3(21)(A)(ii) of ERISA defines a fiduciary as a person that renders investment advice to a plan 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. In 1975, shortly after ERISA was enacted, the Department adopted a regulation[20] that significantly limited the broad statutory language. The current regulation provides that a person provides "investment advice" for purposes of section 3(21)(A)(ii) of ERISA only if it renders advice as to the purchase, sale, or value of securities or other property and either has discretionary authority or control with respect to the purchase of property for the plan, or, in the alternative, the person (1) renders advice as to the purchase, sale, or value of securities or other property, (2) on a regular basis, (3) pursuant to a mutual agreement, arrangement or understanding, written or otherwise, between such person and the plan or a plan fiduciary, that (4) the advice will serve as a primary basis for investment decisions with respect to plan assets, and that (5) the advice will be individualized based on the particular needs of the plan (hereinafter referred to as the "five-part test").[21] Under the current regulation, a plan service provider must satisfy each element of the five-part test in order to be considered a fiduciary under ERISA section 3(21)(A)(ii) unless the service provider renders advice and has discretionary authority or control with respect to purchasing or selling securities or other property for the plan.

The current regulation has not been updated since it was promulgated in 1975. Since that time, the design and operation of employee benefit plans has changed significantly. One of the most dramatic changes has been the growth of defined contribution (DC) plans, specifically, 401(k) plans, which did not exist when the current regulation was promulgated. Department of Labor data show that from 1975 through 2007, the percentage of active participants covered by DC plans grew from 29% to 78% and 90% of these active DC plan participants were covered by 401(k) plans.[22] Importantly, about 89% of 401(k) plans covering 95% of all active 401(k) plan participants are participant-directed, which means that participants make investment decisions regarding the investment of assets held in their individual accounts by choosing from a diverse menu of designated investment alternatives selected by plan sponsors.

In 2009, the Government Accountability Office (GAO) found that many opportunities exist in the 401(k) marketplace for plans to hire service providers that have business arrangements that could give rise to conflicts of interest.[23] For example, the GAO noted that plans often hire consultants and other advisers to provide advice regarding investment options and products that should be offered under the plan and to monitor the performance of the selected investments. In some cases, consultants receive compensation from the investment companies whose products they recommend to the plan, which could lead them to steer the plans toward products for which they receive additional compensation. These arrangements can be harmful to plan

[20] 29 CFR 2510.3–21(c).

[21] The scope of the regulation was further limited by the Department in a 1976 advisory opinion (AO 76–65), in which it concluded that, under the facts described therein, a valuation of closely held employer securities that would be relied on in the purchase of the securities by an employee stock ownership plan (ESOP) would not constitute investment advice under the regulation.

[22] *See* U.S. Department of Labor, Employee Benefits Security Administration, "Private Pension Plan Bulletin Historical Tables and Graphs," January 2010, p. 1. This document can be found at *http://www.dol.gov/ebsa/pdf/1975-2007historicaltables.pdf.* Please note that the number of active participants in 1975 and 2007 are not directly comparable because of adjustments in the definition of a participant. This adjustment is explained in detail in the historical tables and graphs.

[23] *See,* GAO, *Conflicts of Interest Can Affect Defined Benefit and Defined Contribution Plans,* GAO–09–503T, Testimony Before the Subcommittee on Health, Employment, Labor and Pensions, Education and Labor Committee, House of Representatives (March 24, 2009), accessible at *http://www.gao.gov/new.items/d09503t.pdf.*

participants, because the plan may pay excessive fees for the provided services, which could lower returns. Participants in participant-directed 401(k) plans are especially vulnerable in these situations, because they must rely on the assets in their individual accounts to meet their retirement income needs.

There also is a greater potential for conflicts of interest to exist in the defined benefit pension plan service provider market than when the current regulation was promulgated. Due to the increased complexity of investment opportunities available to defined benefit plans, plan sponsors often seek investment advice from a broad range of service providers. Some of these service providers have business arrangements that can give rise to conflicts of interest. For example, in a May 2005 study,[24] the Securities and Exchange Commission (SEC) staff found that 13 of the 24 pension consultants examined or their affiliates had undisclosed conflicts of interest, because they provided products and services to pension plan advisory clients, money managers, and mutual funds on an ongoing basis without adequately disclosing these conflicts. The SEC staff also found that the majority of examined pension consultants had business relationships with broker-dealers that raised a number of concerns about potential harm to pension plans.

The current regulation's narrow approach to fiduciary status sharply limits the Department's ability to protect plans and their participants and beneficiaries from conflicts of interest that may arise from the diverse and complex fee practices existing in today's retirement plan services market and to devise effective remedies for misconduct when it occurs. In recent years, non-fiduciary service providers—such as consultants, appraisers, and other advisers—have abused their relationships with plans by recommending investments in exchange for undisclosed kickbacks from investment providers, engaging in bid-rigging, misleading plan fiduciaries about the nature and risks associated with plans investments, and by giving biased,[25] incompetent, and unreliable valuation opinions. Yet, no matter how egregious the abuse, plan consultants and advisers have no fiduciary liability under ERISA, unless they meet every element of the five-part test.

In instances where a plan has relied upon abusive investment advice from a self-dealing consultant concerning an investment product on a single occasion, the Department would be unable to bring an action for fiduciary breach against the consultant, because the "regular basis" element of the current regulation's five-part test would not be satisfied. The consultant would be absolved of liability regardless of the severity of the abuse or the extent of the plan's reliance. This is true even if the consultant engaged in precisely the same conduct that would have been *per se* illegal if committed by an equally culpable consultant that met the current regulation's "regular basis" test.

For example, a plan's purchase of annuity contracts is a major transaction, but it may occur only in connection with the plan's termination. As a result, the Department could not pursue a civil enforcement action against an insurance brokerage company for accepting kickbacks from an annuity carrier while advising plans for a fee regarding the selection of annuity contracts. Even where the brokerage company's recommendation was the primary basis for the plan's choice of annuity providers, the brokers could not be held accountable as fiduciaries because the advice would not have been offered on a regular basis.

Another anomaly associated with the current regulation is that the five-part test applies even to persons who represent themselves to the plan as fiduciaries in rendering investment advice. For example, a consultant could hold itself out as a plan fiduciary in a written contract with the plan, render investment advice for a fee, and still evade fiduciary status by showing that its advice was insufficiently "regular," did not serve as a "primary basis" for the decision, or otherwise failed to meet each element of the five-part test. The current test also makes it easy for consultants to structure their actions to avoid fiduciary status. The SEC found evidence of this practice in its pension consultants examination and made the following statement regarding this issue in its report: "Many pension consultants believe they have taken appropriate actions to insulate themselves from being considered a 'fiduciary' under ERISA. As a result, it appears that many consultants believe they do not have any fiduciary relationships with their advisory clients * * *."[26]

An adviser's recommendation may involve significant sums and matters of specialized expertise, and it may include professions of impartiality. However, unless the advice meets each element of the current regulation's 5-part test, ERISA's remedies for lack of due diligence and disloyalty are unavailable to the plan.

In contrast, when a fiduciary uses its position of trust to enrich itself by engaging in self-dealing and subordinating the plans' interests to its own, it violates numerous provisions of ERISA, including its duty of loyalty provided in section 404 of ERISA and the prohibitions on self-dealing provided in section 406(b) of ERISA. Such a fiduciary also exposes itself to the broadest possible range of remedies under ERISA.

Applying the current regulation in today's service provider market has had a detrimental impact on EBSA's allocation of its enforcement resources. EBSA seeks to focus its enforcement resources on areas that have the greatest impact on the protection of plan assets and participants' benefits. To accomplish this goal, EBSA requires its field offices to place particular emphasis on certain national enforcement projects. The determination of fiduciary status is particularly important to two national enforcement projects: The Employee Stock Ownership Plan (ESOP) Project and the Consultant/Adviser Project (CAP).

The ESOP project is designed to identify and correct violations of ERISA in connection with ESOPs, which are designed to invest primarily in employer securities. CAP focuses on the receipt of improper or undisclosed compensation by employee benefit plan consultants and other investment advisers. EBSA's investigations seek to determine whether the receipt of such compensation, even when disclosed, violates ERISA because the adviser/consultant leveraged its position with a benefit plan to generate additional fees for itself or its affiliates. When ERISA violations are uncovered, EBSA will seek corrective action for past violations as well as prospective relief to deter future violations.

One of the most critical elements in bringing enforcement actions under the ESOP and CAP initiatives is establishing

[24] *See* U.S. Securities and Exchange Commission, Office of Compliance Inspections and Examinations, Staff Report Concerning Examination of Select Pension Consultants (Washington, DC: May 16, 2005.). The report's findings were based on a 2002 to 2003 examination of 24 pension consultants. The report can be accessed at *http://www.sec.gov/news/studies/pensionexamstudy.pdf.*

[25] The GAO found that DB pension plans using consultants with SEC-identified undisclosed conflicts earned returns 130 basis points lower than the others, which implies that bias may taint consultants' advice. *See e.g.,* GAO, *Conflicts of Interest Involving High Risk of Terminated Plans Pose Enforcement Challenges,* Defined Benefit Pension Report (June 2007), at *http://www.gao.gov/new.items/d07703.pdf.*

[26] *See* U.S. Securities and Exchange Commission, Office of Compliance Inspections and Examinations, Staff Report Concerning Examination of Select Pension Consultants, p. 6 (Washington, DC: May 16, 2005).

that a service provider is a fiduciary. In order to make this determination, investigators must gather evidence to support a finding for each element of the five-part test. In all cases, the analysis necessary to determine fiduciary status is very fact-intensive and requires extensive review of plan documents and contracts, client files, e-mails, investment documentation, accounting records, and interview statements to be obtained from service providers and their affiliates. Consequently, EBSA investigators routinely devote disproportionate time and resources establishing all elements of the five-part test, rather than focusing on the precise misconduct at issue in particular cases.

Based on the foregoing, the Department has determined that regulatory action is necessary to adopt a definition of the term "fiduciary" that more closely reflects the broad statutory definition of the term, recognizes the diverse and complex fee practices that exist in today's service provider market and their potential conflicts, accounts for the shift from DB to DC plans, expands the scope of fiduciary protections for plans and their participants and beneficiaries, and permits EBSA investigators and attorneys to focus their efforts on the adviser's conduct rather than meeting the evidentiary requirements necessary to prove that all elements of the current regulation's five-part test are satisfied. As discussed in further detail below, the Department believes that amending the current regulation by broadening the scope of service providers that would be considered fiduciaries would enhance the Department's ability to redress service provider abuses that currently exist in the market, such as undisclosed fees, misrepresentation of compensation arrangements, and biased appraisals of the value of employer securities and other plan investments.

4. Affected Entities

The Department used data from the Schedule C of the 2007 Form 5500, the latest available complete data, to estimate the universe of plan service providers that would be affected by the proposed rule. Generally, plans with 100 or more participants are required to report on Schedule C persons who rendered services to or who had transactions with the plan during the reporting year if the person received, directly or indirectly, $5,000 or more in reportable compensation in connection with services rendered or their position with the plan. The type of services provided by each service provider also must be reported. Based on the Schedule C service codes, the Department estimates that 5,300 unique service providers most likely provide investment- and valuation-related services covered under the proposed rule that could cause them to be considered fiduciaries. In order to provide a reasonable estimate, service providers reporting service codes corresponding to brokerage (real estate), brokerage (stocks, bonds, commodities), consulting (general), insurance agents and brokers, valuation services (appraisals, asset valuation, *etc.*) and investment evaluations were assumed to provide covered services. Note that the code for investment advisory services was omitted, because we assume that such service providers are ERISA fiduciaries.

The Department acknowledges that its estimate may be imprecise. Although some small plans file Schedule C, small plans generally are not required to complete Schedule C. Therefore, there would be an underestimate of covered services providers to small plans if a substantial number of the service providers only service small plans. The Department, however, believes that its estimated number of covered service providers is reasonable, because most small plans use the same service providers as large plans.[27] The Department invites comments regarding this estimate.

5. Benefits

The Department expects that amending its current regulation defining the circumstances under which a person is a fiduciary under ERISA as a result of providing investment advice will discourage harmful conflicts, improve service value, and enhance the Department's ability to redress abuses and more effectively and efficiently allocate its enforcement resources. Although the Department is unable to quantify these benefits, the Department tentatively concludes they would justify their cost.

a. Discouraging Harmful Conflicts

Harmful arrangements generally are those that are tainted by unmitigated conflicts. These arrangements occur when a plan's service providers strike deals that profit one another at the plan's expense or subordinate the plan's interest to someone else's. As mentioned earlier, in a 2005 report,[28] SEC staff identified certain undisclosed arrangements in the business practices of pension consultants that can give rise to conflicts of interest. The SEC found that the objectivity of advice provided by the examined pension consultants was called into question, because many pension consultants provided services both to pension plans who are their clients and money managers. In the report, the SEC stated that this raises concerns that pension consultants may steer clients to certain money managers and other vendors based on the consultant's other business relationships and receipt of fees from these firms, rather than because selecting the money manager or other vendor was in the best interest of the plan and its participants and beneficiaries.

Also, as noted earlier in this Regulatory Impact Analysis, a recent GAO study links undisclosed conflicts with 130 basis points of underperformance in defined benefit pension plans.[29] A variety of academic studies further support the hypothesis that conflicts often erode the value provided to defined contribution pension plans by mutual funds and their distribution channels.[30]

Beneficial arrangements generally are those in which a plan's service providers, in competition to provide the best value to the plan, deliver high quality services to the plan at the lowest cost, and act solely in the interest of their plan clients and the plan's participants and beneficiaries. According fiduciary status to certain service providers that provide investment advice and valuation services to plans and their participants, and subjecting them to the full extent of remedies under ERISA, would discourage harmful conflicts and create

[27] While in general small plans are not required to file a Schedule C, some voluntarily file. Looking at Schedule C filings by small plans, the Department verified that most small plans reporting data on Schedule C used the same group of service providers as larger plans.

[28] *See* U.S. Securities and Exchange Commission, Office of Compliance Inspections and Examinations, Staff Report Concerning Examination of Select Pension Consultants, p. 5 (Washington, DC: May 16, 2005).

[29] *See,* GAO, *Conflicts of Interest Can Affect Defined Benefit and Defined Contribution Plans,* GAO–09–503T, Testimony Before the Subcommittee on Health, Employment, Labor and Pensions, Education and Labor Committee, House of Representatives (March 24, 2009), accessible at *http://www.gao.gov/new.items/d09503t.pdf.*

[30] Examples include: Daniel B. Bergstresser *et al.,* Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry, Social Science Research Network Abstract 616981 (Sept. 2007). Mercer Bullard *et al.,* Investor Timing and Fund Distribution Channels, Social Science Research Network Abstract 1070545 (Dec. 2007). Xinge Zhao, The Role of Brokers and Financial Advisors Behind Investment Into Load Funds, China Europe International Business School Working Paper (Dec. 2005), at *http://www.ceibs.edu/faculty/zxinge/brokerrole-zhao.pdf.*

more beneficial arrangements in the pension plan service provider market by deterring service providers from engaging in self-dealing, acting imprudently, and subordinating their plan clients' interests to other interests due to the liability exposure and negative publicity that would result from being sued for a fiduciary breach under ERISA.

b. Improved Service Value

Under the proposal, certain service providers that are not fiduciaries under the Department's current regulation would be determined to be fiduciaries under ERISA. Based on this change, the Department expects that affected service providers will modify their business practices to ensure that they act solely in the interests of their employee benefit plan clients and the plans' participants and beneficiaries as required by section 404 of ERISA. Therefore, plans should receive better value for the service fees they pay. Advisers are more likely to act in accordance with ERISA's high fiduciary standards if they know that they may be held to them. Where a plan suffers a loss because of an investment adviser's imprudence or actions contrary to the plan's interests, the plan will have remedies under ERISA to recoup its losses and disgorge the adviser's ill-gotten gains. This should provide the ancillary benefit of improved returns on plan assets and larger account balances for participants and beneficiaries of individual account plans.

While the improvement in service value that may result from the proposed rule is difficult to quantify, the Department believes that it has the potential to be very large. If just 10 percent of plans realize a one basis point (0.01 percent of plan assets) service value improvement, it would be worth approximately $399 million over ten years using a seven percent discount rate and reporting in 2010 dollars. In addition, GAO's study linking undisclosed conflicts with 130 basis points of underperformance suggests that value can be improved via service quality as well as price.[31] Viewed in this context, the Department is confident that service value improvement could be substantial as a result of the proposed rule and may be economically significant (*i.e.,* exceed $100 million annually).

c. Improve Department's Ability To Redress Abuse and Improve Enforcement Resource Allocation

Amending the Department's current regulation by broadening the scope of service providers that would be considered fiduciaries would enhance the Department's ability to redress service provider abuses that currently exist in the market, such as undisclosed fees, misrepresentation of compensation arrangements, and biased appraisals of the value of employer securities and other plan investments.[32] It also would allow the Department to more effectively and efficiently allocate its enforcement resources, which would directly benefit plans and their participants and beneficiaries by providing greater protections than are available under the current regulation.

Specifically, the proposed rule would improve the Department's ability to redress abuse, provide additional protection to plans and their participants and beneficiaries, and allocate its enforcement resources by:

• Including as fiduciary investment advice appraisals and fairness opinions concerning value of securities or other property;

• According fiduciary status to persons who render investment advice for a fee to a plan, its participants or beneficiaries and directly or indirectly represent or acknowledge that they are acting as a fiduciary within the meaning of ERISA in rendering the advice; and

• Expediting the resolution of difficult factual questions and enforcement challenges by removing the requirements in the current regulation's five-part test that investment advice must be provided on a regular basis based on the parties' mutual understanding and that the advice will serve as a primary basis for plan investment decisions.

These benefits are discussed in more detail below.

Appraisals and Valuation Opinions: As discussed earlier in this preamble, EBSA's national ESOP enforcement project is focused on identifying and correcting violations of ERISA in connection with ESOPs, which are designed to invest primarily in employer securities. A common violation found in the ESOP national enforcement project arises in cases where plan fiduciaries have reasonably relied on faulty valuations of securities prepared by professional appraisers. The proposed rule, which would supersede AO 76–65A, and therefore would apply to appraisals and fairness opinions rendered in connection with plan investment transactions would align the duties of persons who provide appraisals with those of fiduciaries who rely on these appraisals. As noted above, the provision in the proposed rule is not limited to employer securities.

Persons Holding Themselves Out as Fiduciaries: The proposed rule provides that a person is a fiduciary if it (1) renders investment advice described in the proposal to a plan, plan fiduciary, or plan participant or beneficiary for a fee or other compensation and (2) directly or indirectly represents or acknowledges that it is acting as a fiduciary within the meaning of ERISA with respect to the plan in rendering the advice. Many pension plans rely heavily on the expert guidance provided by consultants and other advisers in managing the investment of plan assets. The Department believes that claiming ERISA fiduciary status enhances the adviser's influence, and gives the advice recipient a reasonable expectation that the advice will be impartial and prudent. Therefore, the proposed rule provides that such a representation or acknowledgment in connection with advice is sufficient to constitute investment advice under the proposal which, if rendered for a direct or indirect fee or other compensation, would result in fiduciary status under section 3(21)(A)(ii) of ERISA.

Simplifying Current Rule's Five-Part Test: As stated earlier in this preamble, EBSA's CAP project focuses on the receipt of improper, undisclosed compensation by pension consultants and other investment advisers, and whether the receipt of such compensation violates ERISA, because the adviser/consultant used its position with a benefit plan to generate additional fees for itself or its affiliates. One of the most substantial impediments confronting CAP investigators when bringing enforcement actions under the CAP program is proving that all elements of the current rule's five-part test are met. As stated earlier, CAP investigators spend an inordinate amount of time gathering evidence to satisfy all elements of the five-part test rather than focusing on the misconduct involved in a particular case.

The proposed rule would remove this impediment by eliminating the

[31] *See,* GAO, *Conflicts of Interest Can Affect Defined Benefit and Defined Contribution Plans,* GAO–09–503T, Testimony Before the Subcommittee on Health, Employment, Labor and Pensions, Education and Labor Committee, House of Representatives (March 24, 2009), accessible at *http://www.gao.gov/new.items/d09503t.pdf.*

[32] Please note that Department's proposal also would benefit participants and beneficiaries of ERISA-covered plans, because section 502(a)(2) of ERISA allows them to assert a private right of action against plan fiduciaries who breach any of the responsibilities, obligations, or duties imposed on fiduciaries under Title I of ERISA.

requirement that advice must be provided on a "regular basis." This condition bears no necessary relationship to the importance of the advice to the plan or the culpability of the adviser. The proposal also does not require the parties to have a mutual understanding that the advice will serve as a "primary basis" for plan investment decisions. This should allow EBSA to more efficiently allocate its enforcement resources, because investigators no longer would need to devote disproportionate time to prove that these elements of the five-part test are met.

6. Costs

The Department estimated the costs for the proposal over the ten-year time frame for purposes of this analysis and used information from the quantitative characterization of the service provider market presented above as a basis for these cost estimates. This characterization did not account for all service providers, but it does provide information on the segments of the service provider industry that are likely to be most affected by the proposal (*i.e.*, those who provide investment- and valuation-related services to employee benefit plans).

Most of the cost of the rule would be imposed on affected plan service providers. These service providers would need to review the proposed rule and determine whether their current service provider contracts and arrangements with plans, or activities carried out pursuant to them, would make them fiduciaries under the proposal.

For purposes of this analysis, the Department assumes that all affected service providers will incur these initial compliance review costs. The Department believes that service providers will need to review their entire book of business, not each individual transaction or a plan-by-plan review, to determine whether they are fiduciaries, because service providers will enter into agreements with plans to provide similar types of services. The Department assumes that affected service providers will require on average 16 hours of legal professional time at a cost of approximately $119 per hour to perform the compliance review. Based on the foregoing, this cost is estimated to be approximately $10.1 million in the first year.

The Department also has estimated the initial compliance review and implementation costs for service providers newly entering the market ("new service providers") to provide services to plans (either for the first time or by re-entry) beginning in 2012 and each year thereafter. The Department assumes that about eight percent of all service providers will be new in each year subsequent to 2011,[33] and that these service providers will incur the same compliance review and implementation costs as existing service providers. Based on the foregoing, the Department estimates that new service providers will incur costs of approximately $845,000 in 2012 and thereafter. Estimates of the cost of the rule over the first ten years are reported in Table 2, below.

The Department's estimate regarding the time required for service providers to complete the compliance review to determine whether they are fiduciaries under the proposal as a result of providing investment advice to a plan or a plan participant or beneficiary is based on an average cost for large and small service providers to conduct the review. In developing this estimate, the Department has accounted for the fact that large service providers may require more time than small service providers to complete the compliance review due to the wide range of services they provide and the complexity of their business arrangements and affiliate relationships. The Department believes that the burden for service providers to complete the compliance review is mitigated by the fact that the proposal sets forth discrete types of advice and recommendations that constitute investment advice for purposes of ERISA section 3(21)(A)(ii). The Department welcomes public comments regarding this estimate.

TABLE 2—MONETIZED COSTS OF RULE (2010 DOLLARS)

Year	Cost of legal review undiscounted (A)	Total 3% discounting	Total 7% discounting
2011	$10,138,000	$10,138,000	$10,138,000
2012	845,000	820,000	790,000
2013	845,000	796,000	738,000
2014	845,000	773,000	690,000
2015	845,000	751,000	644,000
2016	845,000	729,000	602,000
2017	845,000	708,000	563,000
2018	845,000	687,000	526,000
2019	845,000	667,000	492,000
2020	845,000	647,000	460,000
Total	17,741,000	16,715,000	15,642,000

Note: The displayed numbers are rounded to the nearest thousand and therefore may not add up to the totals.

7. Regulatory Alternatives

As discussed elsewhere in the preamble to the proposal, plan service providers that fall within the Department's rule might experience increased costs and liability exposure associated with ERISA fiduciary status. Consequently, these service providers might charge higher fees to plan clients, or limit or discontinue the availability of their services or products to ERISA plans. As further discussed below, the Department considered but rejected two regulatory alternatives, because these alternatives could lead to higher fees for plans and a compression of the plan service provider market.

[33] Estimate based on the Department's comparison of data reported on the 2005 and 2006 Form 5500.

In developing this proposal, the Department sought to broaden the scope of the persons treated as ERISA fiduciaries, without creating an overly-broad or ambiguous standard that might unnecessarily disadvantage plans. As an alternative, the Department considered a proposal that would replace the current regulatory definition with the language of section 3(21)(A)(ii) of ERISA, which provides simply that a person is a fiduciary if it renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of a plan, or has any authority or responsibility to do so. However, the Department believes this approach would not provide sufficient clarity for persons to determine whether they are ERISA fiduciaries. Without a sufficiently clear standard, a broad range of plan service providers, in order to mitigate or avoid any potential risks, might simply presume fiduciary status and charge higher fees to plan clients, or limit or discontinue the availability of their services or products to ERISA plans. The Department rejected this alternative. The Department's proposal attempts to identify fiduciaries based on readily-ascertainable criteria related to their degree of authority, control, responsibility or influence and the expectations of the parties involved.

The Department considered another alternative that would not have included in the proposal an explicit limitation applicable to service providers that offer of a "platform" of investment options. Defined contribution plans that permit participants to direct the investment of assets allocated to their accounts have become increasingly popular. Often, the service provider offering a platform, as an incidental part of its overall services, also provides the plan sponsor with general information and assistance in assessing the investments available for inclusion in the plan's platform. The Department rejected this alternative, because if the proposal does not provide sufficient clarity as to whether their activities related to offering an investment platform would result in fiduciary status, these service providers might increase their fees, limit the types of investment-related information made available to plan sponsors, or cease offering their services to plans. In order to provide clarity, the Department's proposal attempts to describe the circumstances under which merely offering a platform of investment options, and certain incidental services, will not cause a person to become an ERISA fiduciary.

8. Uncertainty

The Department's estimates of the effects of this proposed rule are subject to uncertainty. The Department is confident that adopting a new definition of the term "fiduciary" should discourage harmful conflicts of interest, improve service value, and enhance the Department's ability to redress abuses and more effectively and efficiently allocate its enforcement resources. However, it is uncertain about the magnitude of these benefits and potential costs. It is possible this rule could have a large market impact.

For example, the Department is uncertain regarding whether, and to what extent, service provider costs would increase due to the proposed rule, and if so, whether the increased cost would be passed on to plans. The Department expects that more service providers would be determined to be fiduciaries under the proposed rule than under the current regulation. These service providers could experience higher costs of doing business due to the increased liability exposure that is associated with ERISA fiduciary status, such as fiduciary liability insurance costs, which could result in higher fees for their plan clients. The Department also is uncertain whether the service provider market will shrink because some service providers would view the increased costs and liability exposure associated with ERISA fiduciary status as outweighing the benefit of continuing to service the ERISA plan market. The Department does not have enough information to provide a specific number. However, it is possible that many plans currently employ service providers who would be considered fiduciaries for the first time under the proposal.

Also, if more service providers are fiduciaries, more transactions would violate the self-dealing prohibitions contained in ERISA section 406(b). In order to avoid committing prohibited transactions, affected service providers would have to identify transactions that would be prohibited because they involve self-dealing, restructure these transactions, and modify their business practices in the absence of an applicable statutory, class, or individual prohibited transaction exemption. The Department is uncertain regarding the number of transactions that would have to be restructured, whether an applicable prohibited transaction exemption would be available for such transactions, and if not, the number of prohibited transactions exemption applications the Department could expect to receive regarding the transactions. The Department welcomes public comments regarding this issue.

The Department believes its assumptions are reasonable based on the available information and tentatively concludes that the proposed regulation's benefits would justify its costs. The Department invites comments that will help it assess the impact of areas where it is uncertain.

9. Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) (RFA) imposes certain requirements with respect to Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act (5 U.S.C. 551 *et seq.*) and which are likely to have a significant economic impact on a substantial number of small entities. Unless an agency determines that a proposal is not likely to have a significant economic impact on a substantial number of small entities, section 603 of the RFA requires the agency to present an initial regulatory flexibility analysis (IRFA) of the proposed rule. The Department's IRFA of the proposed rule is provided below.

a. Need for and Objectives of the Rule

The Department has determined that regulatory action is necessary to adopt a definition of the term "fiduciary" that more closely reflects the broad statutory definition of the term, recognizes the diverse and complex fee practices that exist in today's plan service provider market and their potential conflicts, accounts for the shift from DB to DC plans, expands the scope of fiduciary protections for plans and their participants and beneficiaries, and permits EBSA investigators and attorneys to focus their efforts on the adviser's conduct rather than meeting the evidentiary requirements necessary to prove that all elements of the current regulation's five-part test are satisfied. As discussed in further detail in the regulatory impact analysis above, the Department believes that amending the current regulation by broadening the scope of service providers, regardless of size, that would be considered fiduciaries would enhance the Department's ability to redress service provider abuses that currently exist in the plan service provider market, such as undisclosed fees, misrepresentation of compensation arrangements, and biased appraisals of the value of employer securities and other plan investments.

b. Affected Small Entities

The Department is unable to estimate the number of small service providers that would be affected by the proposal. These service providers generally consist of professional service enterprises that provide a wide range of services to plans, such as investment management or advisory services for plans or plan participants, and appraisal, consulting, brokerage, pension insurance advisory services, investment evaluations, or valuation services. Many of these service providers have special education, training, and/or formal credentials in fields such as ERISA and benefits administration, employee compensation, taxation, actuarial science, or finance.

The Small Business Administration considers service providers with annual revenues of less than $7 million to be small entities. Using data from Schedule C of the Department's 2007 Form 5500, which generally is used by plans with over 100 participants to report service providers that rendered services to or had transactions with the plan and received $5,000 or more in total direct or indirect compensation, the Department estimates that about 130 of the 5,300 affected service providers have total revenues reported on the Schedule C of over $7 million. Based on the foregoing, there would be 5,170 service providers with revenues of less than $7 million; however, this estimate overstates the total number of small entities that would be affected by the proposal, because it does not include revenues from the nearly 626,000 small plans that are not required to file the Schedule C and revenues from other sources.

c. Impact of the Proposal

Small entities that are determined to be fiduciaries under the Department's proposal will be required to act solely in the interest of their plan clients and participants and beneficiaries in connection with covered services. The Department believes that amending the current regulation to reflect additional circumstances where an investment advice provider is in a position of authority, control, responsibility, or influence with respect to a plan and its investment decisions is a critical component of protecting the interest of plans and the retirement income security of participants and beneficiaries.

The Department also is unable to estimate the increased business costs small entities would incur if they were determined to be fiduciaries under the proposal. Such costs would include the expense of purchasing fiduciary liability insurance due to the increased liability exposure that is associated with ERISA fiduciary status. The Department estimates that, on average, affected service providers would incur a cost of $1,900 to determine whether a service provider's contracts and arrangement with plans, or activities carried out pursuant to them, would make the service provider a fiduciary under the proposed rule.

It is possible that some small service providers may find that the increased costs associated with ERISA fiduciary status outweigh the benefit of continuing to service the ERISA plan market; however, the Department does not have sufficient information to determine the extent to which this will occur. It is possible that the economic impact of the rule on small entities would not be as significant as it would be for large entities, because generally, small entities do not have as many business arrangements that give rise to conflicts of interest. Therefore, they would not be confronted with significant costs to restructure transactions that would be faced by large entities.

The Department invites comments regarding all aspects of this IRFA.

10. Paperwork Reduction Act

The proposed rule is not subject to the requirements of the Paperwork Reduction Act of 1995 (PRA 95) (44 U.S.C. section 3501 *et seq.*), because it does not contain a collection of information as defined in 44 U.S.C. section 3502(3).

11. Congressional Review Act

The proposed rule is subject to the Congressional Review Act provisions of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801 *et seq.*) and, if finalized, will be transmitted to Congress and the Comptroller General for review. The proposed rule is a "major rule" as that term is defined in 5 U.S.C. 804, because it is likely to result in an annual effect on the economy of $100 million or more.

12. Unfunded Mandates Reform Act

For purposes of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104–4), as well as Executive Order 12875, the proposed rule does not include any Federal mandate that may result in expenditures by State, local, or Tribal governments in the aggregate of more than $100 million, adjusted for inflation, or increase expenditures by the private sector of more than $100 million, adjusted for inflation.

13. Federalism Statement

Executive Order 13132 (August 4, 1999) outlines fundamental principles of federalism, and requires the adherence to specific criteria by Federal agencies in the process of their formulation and implementation of policies that have substantial direct effects on the States, the relationship between the national government and States, or on the distribution of power and responsibilities among the various levels of government. This proposed rule does not have federalism implications, because it has no substantial direct effect on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Section 514 of ERISA provides, with certain exceptions specifically enumerated, that the provisions of Titles I and IV of ERISA supersede any and all laws of the States as they relate to any employee benefit plan covered under ERISA. The requirements implemented in the proposed rule have no implications for the States or the relationship or distribution of power between the national government and the States.

Statutory Authority

This regulation is proposed pursuant to the authority in section 505 of ERISA (Pub. L. 93–406, 88 Stat. 894; 29 U.S.C. 1135) and section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978), effective December 31, 1978 (44 FR 1065, January 3, 1979), 3 CFR 1978 Comp. 332, and under Secretary of Labor's Order No. 1–2003, 68 FR 5374 (Feb. 3, 2003).

List of Subjects in 29 CFR Part 2510

Employee benefit plans, Employee Retirement Income Security Act, Pensions, Plan assets.

For the reasons set forth in the preamble, Chapter XXV, subchapter F, part 2510 of Title 29 of the Code of Federal Regulations is proposed to be amended as follows:

PART 2510—DEFINITION OF TERMS USED IN SUBCHAPTERS C, D, E, F, AND G OF THIS CHAPTER

1. The authority citation for part 2510 is revised to read as follows:

Authority: 29 U.S.C. 1002(2), 1002(21), 1002(37), 1002(38), 1002(40), 1031, and 1135; Secretary of Labor's Order 1–2003, 68 FR 5374; Secs. 2510.3–101 and 2510.3–102 also issued under sec. 102 of Reorganization Plan

No. 4 of 1978, 43 FR 47713, 3 CFR, 1978 Comp., p. 332 and E.O. 12108, 44 FR 1065, 3 CFR, 1978 Comp., p. 275, and 29 U.S.C. 1135 note. Section 2510.3–38 also issued under Sec. 1, Pub. L. 105–72, 111 Stat. 1457.

2. In § 2510.3–21, revise paragraph (c) to read as follows:

§ 2510.3–21 Definition of "Fiduciary."

* * * * *

(c) *Investment advice for a fee.* (1) *General.* Except as provided in paragraph (c)(2) of this section, a person renders "investment advice" for a fee or other compensation, direct or indirect, to an employee benefit plan, within the meaning of section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 (the Act) and this paragraph, if:

(i) Such person—

(A)(*1*) Provides advice, or an appraisal or fairness opinion, concerning the value of securities or other property,

(*2*) Makes recommendations as to the advisability of investing in, purchasing, holding, or selling securities or other property, or

(*3*) Provides advice or makes recommendations as to the management of securities or other property,

(B) To a plan, a plan fiduciary or a plan participant or beneficiary;

(ii) Such person either directly or indirectly (*e.g.*, through or together with any affiliate)—

(A) Represents or acknowledges that it is acting as a fiduciary within the meaning of the Act with respect to providing advice or making recommendations described in paragraph (c)(1)(i) of this section;

(B) Is a fiduciary with respect to the plan within the meaning of section 3(21)(A)(i) or (iii) of the Act;

(C) Is an investment adviser within the meaning of section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)(11)); or

(D) Provides advice or makes recommendations described in paragraph (c)(1)(i) of this section 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 that such advice may be considered in connection with making investment or management decisions with respect to plan assets, and will be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary.

(2) *Limitations.* (i) For purposes of this paragraph (c), a person shall not be considered to be a person described in paragraph (c)(1) of this section with respect to the provision of advice or recommendations if, with respect to a person other than a person described in paragraph (c)(1)(ii)(A), such person can demonstrate that the recipient of the advice knows or, under the circumstances, reasonably should know, that 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 that the person is not undertaking to provide impartial investment advice.

(ii) For purposes of this paragraph (c), the following acts in connection with an individual account plan (as defined in section 3(34) of the Act) shall not, in and of themselves, be treated as the rendering of investment advice for purposes of section 3(21)(A)(ii):

(A) Provision of investment education information and materials within the meaning of 29 CFR 2509.96–1(d);

(B) Marketing or making available (*e.g.,* through a platform or similar mechanism), without regard to the individualized needs of the plan, its participants, or beneficiaries, securities or other property from which a plan fiduciary may designate investment alternatives into which plan participants or beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts, if the person making available such investments discloses in writing to the plan fiduciary that the person is not undertaking to provide impartial investment advice;

(C) In connection with the activities described in paragraph (c)(2)(ii)(B), the provision of general financial information and data to assist a plan fiduciary's selection or monitoring of such securities or other property as plan investment alternatives, if the person providing such information or data discloses in writing to the plan fiduciary that the person is not undertaking to provide impartial investment advice.

(iii) For purposes of paragraph (c)(1)(i) of this section, the term "advice, or appraisal or fairness opinion" shall not include the preparation of a general report or statement that merely reflects the value of an investment of a plan or a participant or beneficiary, provided for purposes of compliance with the reporting and disclosure requirements of the Act, the Internal Revenue Code, and the regulations, forms and schedules issued thereunder, unless such report involves assets for which there is not a generally recognized market and serves as a basis on which a plan may make distributions to plan participants and beneficiaries.

(3) *Fee or other compensation.* For purposes of this paragraph (c) and section 3(21)(A)(ii) of the Act, a fee or other compensation, direct or indirect, received by a person for rendering investment advice means 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. The term fee or compensation includes, for example, brokerage, mutual fund sales, and insurance sales commissions. It includes fees and commissions based on multiple transactions involving different parties.

(4) *Internal Revenue Code.* Section 4975(e)(3)(B) of the Internal Revenue Code of 1986 (Code) contains provisions parallel to section 3(21)(A)(ii) of the Act which define the term "fiduciary" for purposes of the prohibited transaction provisions in Code section 4975. Effective December 31, 1978, section 102 of the Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 214 (2000 ed.) transferred the authority of the Secretary of the Treasury to promulgate regulations of the type published herein to the Secretary of Labor. All references herein to section 3(21)(A)(ii) of the Act should be read to include reference to the parallel provisions of section 4975(e)(3)(B) of the Code. Furthermore, the provisions of this paragraph (c) shall apply for purposes of the application of Code section 4975 with respect to any plan described in Code section 4975(e)(1).

(5) A person who is a fiduciary with respect to a plan by reason of rendering investment advice (as defined in paragraph (c)(1) of this section) for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or having any authority or responsibility to do so, shall not be deemed to be a fiduciary regarding any assets of the plan with respect to which such person does not have any discretionary authority, discretionary control or discretionary responsibility, does not exercise any authority or control, does not render investment advice (as defined in paragraph (c)(1) of this section) for a fee or other compensation, and does not have any authority or responsibility to render such investment advice, provided that nothing in this paragraph shall be deemed to:

(i) Exempt such person from the provisions of section 405(a) of the Act concerning liability for fiduciary breaches by other fiduciaries with respect to any assets of the plan; or

(ii) Exclude such person from the definition of the term "party in interest" (as set forth in section 3(14)(B) of the Act) with respect to any assets of the plan.

* * * * *

Signed at Washington, DC, this 13th day of October 2010.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

[FR Doc. 2010–26236 Filed 10–21–10; 8:45 am]

BILLING CODE 4510–29–P

DEPARTMENT OF DEFENSE

Corps of Engineers, Department of the Army

33 CFR Part 334

Pamlico Sound and Adjacent Waters, NC; Danger Zones for Marine Corps Operations

AGENCY: U.S. Army Corps of Engineers, DoD.

ACTION: Notice of proposed rulemaking and request for comments.

SUMMARY: The U.S. Army Corps of Engineers (Corps) is proposing to amend its regulations to establish one new danger zone in Pamlico Sound near Marine Corps Air Station Cherry Point, North Carolina. Establishment of this danger zone will enable the Marine Corps to control access and movement of persons, vessels, and objects within the danger zone during live fire training exercises.

DATES: Written comments must be received by November 22, 2010.

ADDRESSES: You may submit comments, identified by docket number COE–2010–0037, by any of the following methods:

Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

E-mail: david.b.olson@usace.army.mil. Include the docket number COE–2010–0037 in the subject line of the message.

Mail: U.S. Army Corps of Engineers, Attn: CECW–CO (David B. Olson), 441 G Street, NW., Washington, DC 20314–1000.

Hand Delivery/Courier: Due to security requirements, we cannot receive comments by hand delivery or courier.

Instructions: Direct your comments to docket number COE–2010–0037. All comments received will be included in the public docket without change and may be made available on-line at *http://regulations.gov,* including any personal information provided, unless the commenter indicates that the comment includes information claimed to be Confidential Business Information (CBI) or other information whose disclosure is restricted by statute. Do not submit information that you consider to be CBI, or otherwise protected, through regulations.gov or e-mail. The regulations.gov Web site is an anonymous access system, which means we will not know your identity or contact information unless you provide it in the body of your comment. If you send an e-mail directly to the Corps without going through regulations.gov, your e-mail address will be automatically captured and included as part of the comment that is placed in the public docket and made available on the Internet. If you submit an electronic comment, we recommend that you include your name and other contact information in the body of your comment and with any disk or CD–ROM you submit. If we cannot read your comment because of technical difficulties and cannot contact you for clarification, we may not be able to consider your comment. Electronic comments should avoid the use of any special characters, any form of encryption, and be free of any defects or viruses.

Docket: For access to the docket to read background documents or comments received, go to *http://www.regulations.gov.* All documents in the docket are listed. Although listed in the index, some information is not publicly available, such as CBI or other information whose disclosure is restricted by statute. Certain other material, such as copyrighted material, is not placed on the Internet and will be publicly available only in hard copy form.

FOR FURTHER INFORMATION CONTACT: Mr. David Olson, Headquarters, Operations and Regulatory Community of Practice, Washington, DC at 202–761–4922 or Richard K. Spencer, U.S. Army Corps of Engineers, Wilmington District, at 910–251–4172.

SUPPLEMENTARY INFORMATION: Pursuant to its authorities in Section 7 of the Rivers and Harbors Act of 1917 (40 Stat. 266; 33 U.S.C. 1) and Chapter XIX of the Army Appropriations Act of 1919 (40 Stat. 892; 33 U.S.C. 3), the Corps proposes to amend the regulations in 33 CFR part 334 by adding § 334.420 (b)(1)(v) to establish an Intermittent Danger Zone abutting the existing 1.8 mile Danger Zone [as described in § 334.420(b)(1)(i)] in the Pamlico Sound and adjacent waters in Carteret County, North Carolina. The public is currently restricted from accessing the existing 1.8 mile radius circular area and has limited access to three additional 0.5 mile radius circular danger zones described at §§ 334.420(b)(1)(ii), (iii), and (iv), but has unrestricted access to the surrounding waters. To better protect the public from potentially hazardous conditions during scheduled live fire training, Marine Corps Air Station Cherry Point has requested that the Corps establish the Intermittent Danger Zone that will enable the Marine Corps to ensure security and safety for the public.

The current military training mission requires enhanced public safety and protection of vessels that operate in the vicinity of the Bombing Target-11 range. This proposed amendment to the current danger zone regulation at 33 CFR 334.420 includes the addition of a danger zone in Pamlico Sound that abuts the existing 1.8 mile radius danger zone and extends out to 2.5 miles from the common center point. Establishment of this additional danger zone will allow the Marine Corps to minimize the public safety hazard resulting from the increased use of .50 caliber weapons firing from rotary-wing aircraft and small boats during training exercises at Bombing Target-11 Range. The new danger zone will optimize public safety and military training, and protect any vessels that operate in the vicinity of Bombing Target-11 Range.

Procedural Requirements

a. *Review Under Executive Order 12866.* This proposed rule is issued with respect to a military function of the Defense Department and the provisions of Executive Order 12866 do not apply.

b. *Review Under the Regulatory Flexibility Act.* This proposed rule has been reviewed under the Regulatory Flexibility Act (Pub. L. 96–354) which requires the preparation of a regulatory flexibility analysis for any regulation that will have a significant economic impact on a substantial number of small entities (*i.e.,* small businesses and small governments). The Corps has determined that revising this proposed rule would have practically no economic impact on the public, or result in no anticipated navigational hazard or interference with existing waterway traffic. This proposed rule will have no significant economic impact on small entities.

c. *Review Under the National Environmental Policy Act.* The Corps expects that the proposed rule will not have a significant impact to the quality of the human environment and,