Dealing with Retirement Plan and IRA Investors under DOL Fiduciary Rule: Practical Tips for Private Fund Managers

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I. Overview of Fiduciary Rule and Impact on Private Funds

Overview of Fiduciary Rule

- On April 6, 2016, the Department of Labor issued final regulations expanding the definition of a **fiduciary** to employee benefit plans and IRAs for purposes of ERISA and similar provisions under the Internal Revenue Code

Statutory Definition of Fiduciary
▪ Under the statutory text of ERISA and Section 4975 of the Internal Revenue Code, a person is a **fiduciary** with respect to a plan or IRA if he or she ▪ Exercises any discretion over the management or investment of the assets of the plan or IRA ▪ **Renders investment advice for a fee or other compensation**, **direct or indirect**, **with respect to any moneys or other property of the plan or IRA**, **or has any authority or responsibility to do so** or ▪ Has any discretion over the administration of the plan or IRA

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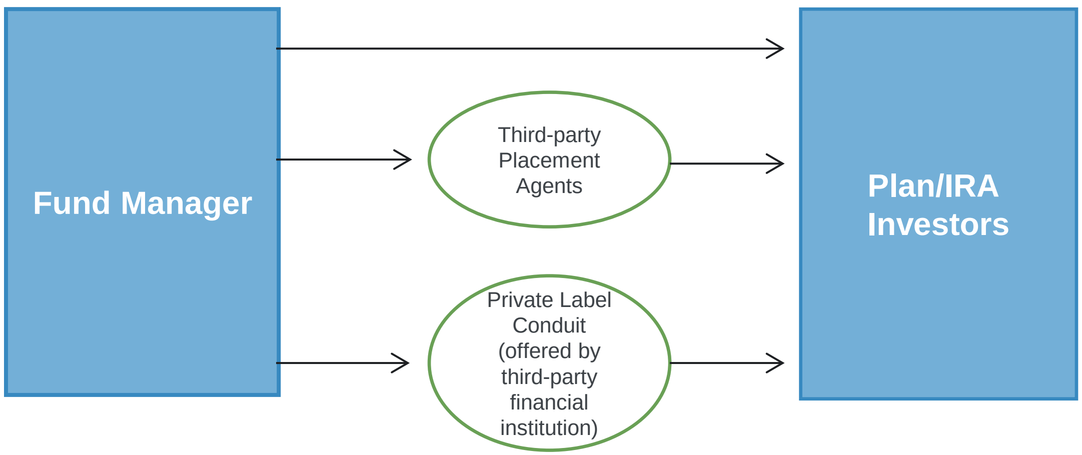
Overview of Fiduciary Rule (cont.)

- The regulatory package (commonly known as the **fiduciary rule**) has three interconnected parts:

New Definition of Investment Advice Fiduciary	Significantly **expands** the scope of communications with plans and IRAs that constitute **investment advice** and give rise to **fiduciary** status ▪ Fiduciaries are subject to the prohibited transaction provisions of ERISA and the Internal Revenue Code and their ability to receive fees and other compensation is severely limited ▪ Expanded definition has been in effect since **June 9, 2017** ▪ For private funds, this is the most relevant part of the rule
New Exemptions	Introduces two new prohibited transaction class exemptions (including the Best Interest Contract Exemption), which can be relied on by persons who become fiduciaries under the expanded definition ▪ Not relevant to private funds
Amended Exemptions	Amends several existing prohibited transaction exemptions that are commonly relied on in the financial sector and imposes additional conditions on the use of these exemptions ▪ Not relevant to private funds

Impact on Private Funds

- Limited impact on the operation of a fund
  - Fund manager that has investment discretion over an ERISA fund will continue to be an ERISA fiduciary to the fund
  - Fund manager of a non-ERISA fund (because the fund operates as a VCOC/REOC or under the 25% exception) will continue not to be an ERISA fiduciary to the fund



- Will impact how fund managers and other relevant parties **communicate and interact** with plan and IRA investors and will require them to **exercise care** so as to avoid having any communication rise to the level of **investment advice** under the expanded definition

Comparison of Old and New Definitions

Prior Five-Part Test

A person who

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

4. That the advice will serve as a **primary basis** for investment decisions with respect to plan assets **and**

5. That the advice will be **individualized** to the particular needs of the plan

New Two-Part Test

1. A person who
   - represents or acknowledges fiduciary status
   - renders individualized advice by making a recommendation pursuant to a written agreement or verbal understanding **or**
   - **directs advice or recommendation to a specific recipient**

2. Is deemed to be a **fiduciary** where such person makes a **recommendation** relating to
   - the advisability of acquiring, holding, disposing of, or exchanging securities or other investment property
   - how investment property should be invested after it is rolled over, transferred or distributed from a plan or IRA
   - the management of investment property **or**
   - rollovers, transfers, or distributions from a plan or IRA, including recommendations as to the amount, form or destination of such rollover

   Recommendation is any communication that would reasonably viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action

II. Dealing with Sophisticated Retirement Investors

Sophisticated Investor Exception

- One important exception under the rule is the so-called **sophisticated investor** exception, under which communications with a plan or IRA investor will not constitute investment advice if the communications are made to a **sophisticated independent fiduciary** of the plan or IRA
- Before relying on this exception, fund manager must **know or reasonably believe** that the independent fiduciary is:

- One of the following:
  - U.S. bank
  - U.S. insurance carrier
  - Registered investment adviser
  - Registered broker-dealer
  - Independent fiduciary that holds, or has under management or control, total assets of at least $50 million

- Capable of evaluating investment risk independently, both in general and with regard to particular transactions and investment strategies
- Acting as an independent fiduciary to the plan or IRA and is responsible for exercising independent judgment in evaluating the communications and related transactions

Sophisticated Investor Exception (cont.)

Additional Requirements of the Exception

- In addition, fund manager must:
  - Not receive any fee or other compensation directly from the plan or IRA or the independent fiduciary for the information or advice provided in the communication (as opposed to other services)
  - Inform the independent fiduciary that the manager is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity
  - Inform the independent fiduciary of the existence and nature of the manager's financial interests (i.e., fees and other compensation from managing the fund)

- Most large pension plan investors should be represented by sophisticated independent fiduciaries that meet these requirements (some IRA investors may as well)
- IRA owners **cannot** qualify as sophisticated independent fiduciaries of their own IRAs, regardless of their wealth and sophistication

III. Dealing with Retail Retirement Investors

Communications with Retail Retirement Investors

- These are small pension plans and IRAs that are not represented by sophisticated independent fiduciaries
- No exception under the rule is available for communications with these investors, other than the **general communications** exception

Examples of General Communications	
▪ General circulation letters ▪ Remarks and presentations from widely attended speeches and conferences ▪ Research or news reports for general distribution	▪ General marketing materials ▪ Performance reports and reports of general market data ▪ Prospectuses

- Fund managers should ensure that their communications with these investors are general communications or communications that do not otherwise rise to the level of investment advice
- Fund managers to train fund employees who may interact with these investors
- In light of the risks raised by communications with these investors, fund managers to consider alternatives in dealing with these investors

Practical Tips for Communicating with Retail Retirement Investors

- Issues and risks posed by:
  - Offering materials and general marketing materials
  - Performance reports and other periodic reports
  - One-on-one and other targeted communications

IV. Documentation Updates

Documents to Be Updated

- Offering materials and general marketing materials
- Performance reports and other reports
- Emails and other targeted written communications
- Subscription booklet
  - Flexible approach (allowing both sophisticated and retail retirement investors)
  - Limiting approach (allowing only sophisticated retirement investors)

V. Current Status and Future of Fiduciary Rule

Current Status and Future of Fiduciary Rule

- Expanded definition of investment advice fiduciary has been in effect since **June 9, 2017**
- Be aware of reports of **delay**
  - Delay only applies to the exemptions related to the rule (but not to the expanded definition)
  - Full requirements of the exemptions are currently scheduled to become applicable on January 1, 2018 and now proposed to be delayed until July 1, 2019
- Enforcement moratorium from the Department Labor and Internal Revenue Service during the transition period
- Presidential memorandum and the Department of Labor’s ongoing re-examination of the rule
- Prediction of the rule’s future
- Follow developments of the rule at www.finregreform.com

VI. Questions and Answers