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DOL Lets New Definition of ERISA Fiduciary Take Effect June 9, 2017; Some Private Investment Funds May Require Prompt Action

Private investment fund managers who are not ERISA fiduciaries today may want to review, and if necessary tweak, their investor communications and the ERISA-related representations in their subscription books for ERISA and IRA investments made after June 9, to avoid inadvertently becoming an ERISA fiduciary under a soon-to-be-effective expanded definition of ERISA fiduciary.

Background

The Department of Labor's controversial ERISA fiduciary rule is still under governmental review, and also under attack from several quarters; conceivably the rule could be significantly modified or repealed before January 1, 2018, when its major provisions are scheduled to take effect. However, in the May 23 *Wall Street Journal*, Secretary of Labor Alexander Acosta announced that DOL will not delay the June 9 effective date of the rule's new definition of ERISA fiduciary.

The new fiduciary rule itself might be regarded as a consumer protection measure, largely aimed at thwarting conflicted investment advice by commission-paid brokers and salesmen for retail financial retirement products. When the rule becomes effective, many brokers and salesmen who were not treated as ERISA fiduciaries under the old rule will be treated as ERISA fiduciaries under the new rule, if their communications to clients or potential clients are in the nature of **advice** or **recommendations** about the advisability of acquiring, holding or disposing of specific investments in their retirement accounts.

Given its consumer protection focus, the new rule should be largely irrelevant to private equity and hedge fund managers (unless they are marketing to small ERISA plans and IRAs). Nonetheless, because the new fiduciary definition can make someone an ERISA fiduciary who did not expect to be one, even private investment fund managers with mostly an institutional clientele will want to ensure that their investors are not expecting an ERISA fiduciary relationship.

The New Definition of Fiduciary

The new definition provides that:

- under the regulation's general rule, a fiduciary relationship will not arise between a private investment fund manager and an investor if the manager is not giving advice or recommendations as to whether the investor should make or maintain its investment in the fund; or

- under a safe harbor rule, even if the private investment fund manager is giving advice or recommendations, a fiduciary relationship will not arise solely as a result of giving such advice or recommendations if (A) the investor is **expertly managed** by an independent fiduciary with financial experience, (B) the investment fund manager receives no compensation for the provision of investment advice with respect to the investor's decision to invest in the fund, (C) the manager has advised the investor that it is not undertaking to provide impartial investment advice or give advice in a fiduciary capacity and (D) the fund manager has fairly disclosed its financial interests to the investor.[1]

The manager's benefit from using the safe harbor is that it avoids the need to explore the sometimes murky area where fund marketing stops and investment recommendations begin; and for private investment funds with mostly institutional clientele, the safe harbor is relatively easy to achieve. Private investment funds that want to rely on the safe harbor may want to make sure that their subscription agreement includes all of the representations needed to evaluate the safe harbor's applicability. In our experience, the marketing practices and offering materials of many private equity and hedge funds already have all (or almost all) of the ingredients that they need for the manager to feel free from inadvertent ERISA fiduciary status even without regard to the safe harbor. For funds not relying exclusively on the safe harbor, care will have to be taken that the fund's marketing materials, investor communications and conversations, periodic reports, etc. are crafted so as to be understood as not giving any advice or recommendations to a prospective (or current) investor to invest in (or continue an investment in) the manager's funds; and the investor should be fairly informed that the fund manager is not acting as an ERISA fiduciary.

The new rule should not apply with respect to decisions by investors in committed funds that were closed by June 9. Even so, perhaps all funds may want to consider adding a legend to regular investor communications declaring that these communications should not be construed as ERISA fiduciary investment advice or recommendations, and educating their investor-facing personnel to avoid communications with investors that could be considered to be investment advice or recommendations.

IRAs

Although many private fund managers have historically allowed IRAs to invest in their fund products, some fund managers with a mostly institutional clientele may decide not to permit new investments by non-expertly managed IRAs following the effective date of the new rule, reflecting a decision to rely

1 For these purposes, an ERISA plan or IRA is "expertly managed" if it is advised by a fiduciary (independent of the private fund manager) that is either (A) a qualified U.S. bank, (B) an insurance carrier, (C) a registered investment adviser, (D) a registered broker-dealer, or (E) an independent fiduciary that has at least $50 million in total assets under management or control. In addition, the private fund manager must have a reasonable basis to believe that the independent fiduciary can evaluate investment risks independently.

exclusively on the safe harbor. For funds that want to accept non-expertly managed IRAs, special care should be taken to fairly inform the investor that no advice is being given to make or maintain the investment. With respect to IRA investors whose investment in a fund predates the effective date of the new rule, a legend on future investor communications could make clear that no information being provided to such investors should be viewed as a recommendation as to whether to remain invested in the fund manager's products.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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