# Fiduciary Hot Topics

THIRD QUARTER 2018

## DOL Fiduciary Rule Now Dead in the Water

The Department of Labor elected not to appeal to the Supreme Court from the Fifth Circuit of the U.S. Court of Appeal's March decision vacating the new Fiduciary Rule (the Rule) in its entirety. Several parties, including AARP and several states' attorney generals, attempted to join this law suit in order to continue a defense of the Rule. The Fifth Circuit did not grant these requests.

The primary elements of the Rule and prohibited transaction exemptions are that any person making investment recommendations to plans, their participants or IRA holders, is acting as a fiduciary and may only make recommendations

est interests of the client" and to broaden the scope of the Department of Labor's jurisdiction. The rule is gulation runs 176 pages) and generated much controversy.

ators have argued that this decision does not apply outside the Fifth Circuit (parts of Texas, Louisiana and Mississippi) in light of a decision by the Tenth Circuit upholding the Rule. However, others have taken the position that it does. The Department appears to concede this point in a bulletin regarding enforcement relief issued following the Fifth

n. In any event, in light of the Department's decision not to appeal, it seems that under the Trump here will be no serious enforcement efforts.

This notwithstanding, the Rule may have a lasting impact. Many broker-dealers, including some of the largest players in the business, have adopted policies and procedures reflecting the standards in the Rule. Many of these firms have stated they intend to leave these policies and procedures in place. Also, the Securities and Exchange Commission's recent decision to beef up its own standards for brokers seems to have been prompted by the Department of Labor's foray into this area.

## Securities and Exchange Commission Picks Up the Ball

In April, the Securities and Exchange Commission issued a package of proposed advice standards. Sharing the Department of Labor's tendency to be somewhat verbose, the package runs to about 1,000 pages. It includes a "Regulation of Best Interest." Comments on these proposed standards were due to the Commission by August 7th. It is important to note that even with the issuance of this package the SEC was split internally in regards to support for the package.

In its essence, this regulation will require brokers to put their clients' needs ahead of their own desire to maximize revenue when making a recommendation. This is a much higher bar than the current long standing rule that requires brokers to make only recommendations that are "suitable" to the client's investor profile, but does not address fees. That the Commission is taking this step is not surprising. It has always led the way among government agencies in regulating the financial services industry and it has, on more the one occasion, stated it believes the Department of Labor was stepping onto its turf in promulgating a rule governing the actions of brokers and advisors. Earlier this year Jay Clayton, chairman of the Commission, stated that a fiduciary rule was at the top of the Commission's agenda for 2018.

Broker-dealers will be required to establish policies and procedures designed to identify and disclose conflicts of interest that may result from financial incentives. Significantly, where conflicts are identified, broker-dealers must take steps to mitigate the conflict.

## Due To Their Low Costs, CITs Continue to Grow in Popularity

Collective investment trusts (generally known as CITs) long used by defined benefit plans, are now the fastest growing investment vehicle in 401(k) plans. As of the end of 2015, over $2 trillion in assets were invested in CITs and over 70% of 401(k) plans now include at least one CIT in their investment lineup.

Like mutual funds, CITs are designed to facilitate investment management by pooling investors' assets into a single portfolio, thereby reducing costs through economies of scale and giving investors exposure to strategies they cannot access individually.

The chief advantage CITs have over mutual funds is lower costs. This is due primarily to the fact that CITs are not subject to the expensive process of registering with and reporting to the Securities and Exchange Commission. For this reason, flexPATH is offered through CITs and by utilizing CITs, and NFP is able to give clients access, at significant savings, to top performing investment managers in major asset classes.

There are some important differences between CITs and mutual funds:

- CITs are sponsored by banks and are regulated by the Office of the Comptroller of the Currency and state banking authorities, mutual funds are regulated by the Securities and Exchange Commission
- Because CITs are subject to ERISA, they are also regulated by the Department of Labor and must file an annual return (form 5500), mutual funds are exempt from ERISA

n only be offered to retirement plans, mutual funds are open to all investors

advantage of CITs is that when compared to mutual funds, less information about CITs is publically e via use of ticker symbols, but plans that utilize them have the same fund fact sheets available on their websites for CITs as they do for mutual funds

### Pension Benefit Guaranty Corporation's Multiemployer Program Looks to be in a Tail Spin

The Pension Benefit Guaranty Corporation's (the PBGC) is a government insurance program that guarantees all private defined benefit pensions. There is no comparable insurance for defined contribution plans. The PBGC now pays benefits to almost a million participants covered by 4,800 failed pension plans and is responsible for future payments to another half a million individuals.

The PBGC's program for multiemployer plans now has liabilities for benefit payments that exceed assets by $65 billion. This program is on track to run out of cash in 2025.[1] Senator Sherrod Brown of Ohio has proposed a legislative fix, known as the Butch Lewis Act. It will prop up the PBGC by establishing a legacy fund within the PBGC. This will be funded by closing "tax loopholes that allow the wealthiest Americans to avoid paying their fair share of taxes."

Congress began looking at pension funding after Studebaker Motors failed in 1963 and left 4,000 employees with little or no pension benefits. This ultimately led to the enactment of ERISA in 1974. A key component of ERISA was the creation of the PBGC.

When the sponsor of a pension plan becomes insolvent and goes into bankruptcy, the PBGC is required to assume responsibility for the plan going forward. The Agency takes control of plan assets and assumes responsibility for future benefit payments. Companies that go through a reorganization in bankruptcy court are sometimes permitted to terminate their pension plans, thereby forcing the PBGC to assume responsibility. The record to date is the United Airlines bankruptcy in 2005. The bankruptcy court allowed United to dump $7.5 billion in unfunded pension liabilities onto the PBGC.

The PBGC is funded primarily through a per participant annual premium paid by pension plans. These premiums have grown significantly over the years and are now a major detractor to establishing or maintaining a pension plan. For single employer plans, the premium varies depending upon the amount of underfunding. For 2018, the premium can run as high as $597 per participant.[2] This compares to a 50 cent premium when ERISA was enacted in 1974.[3]

[1]*Pension Benefit Guaranty Corporation. PBCG Fiscal Year 2017 Annual Report. https://www.pbgc.gov/news/press/releases/pr17-10*
[2]*Pension Benefit Guaranty Corporation. Premium Rates. https://www.pbgc.gov/prac/prem/premium-rates*
[3]*Pension Benefit Guaranty Corporation. MPRA Report. https://www.pbgc.gov/documents/MPRA-Report.pdfPension*

## LITIGATION UPDATE

### The Dust has Largely Settled Around Stable Value Lawsuits, Plaintiffs Have Experienced Little Success

It is ironic that one of the most conservative investment offerings in 401(k) plans has been a flash point of class action litigation.

Stable value funds are relatively low risk investments intended to protect against interest rate volatility. The primary objective is preserving capital. These funds are often the most conservative offering in the investment lineups of 401(k) plans. While the returns for stable value funds are low, they tend be higher than money market and short-term bond funds.

olving stable value products have generally fallen into one of three categories:  the portfolio was either too servative resulting in anemic returns; the declared interest rate on insurance products was too low; and the sponsor to include a stable value option in the plan's investment lineup.

By and large, plaintiffs have not fared well. Some of the allegations made in the complaints give the impression that the attorneys bringing the suit did not fully understand stable value investments. True to past decisions involving ERISA and retirement plans, the courts tended to favor the defendants where the plaintiffs challenged widely accepted industry practices.

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an - Settled parties agreed to $75 million settlement. One of the plaintiffs' allegations was that the use of e-backed securities was too risky. It is notable that at the outset of this law suit, JPMorgan announced it would no longer include mortgage-backed securities in its stable value portfolios.

Portfolio too risky:

- JPMorgan - Settled parties agreed to $75 million settlement. One of the plaintiffs' allegations was that the use of mortgage-backed securities was too risky. It is notable that at the outset of this law suit, JPMorgan announced it would no longer include mortgage-backed securities in its stable value portfolios.

Portfolio too conservative:

- Fidelity - *Dismissed* - Upheld on appeal. Court noted preservation of capital is a key concern.
- CVS - *Dismissed* - Court noted that a portfolio must meet its stated objectives and does not have to conform to industry averages.
- Union Bond & Trust – *Dismissed* - No opinion accompanied the dismissal order. At one point in the proceedings, the judge noted that the named plaintiff stood to gain less than one cent if the suit succeeded.

Failure to offer stable value option

- Chevron - *Dismissed* - Court stated that the plaintiffs' allegations were too broad and not tied sufficiently to any facts.
- Anthem - *Dismissed* - Court noted that ERISA does not require that fiduciaries offer any particular type of investment.
- Insperity - *Dismissed* - Court noted that plaintiffs' allegations were based entirely on hindsight.

Declared interest rate too low

- Prudential - Class action status denied.
- Principal - *Dismissed* - No opinion accompanied the dismissal order