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Dear Members,

With the Brussels’ conference almost upon us, I bring to you a taste of the debate, discussion and analysis that is to come.

This issue of the Journal can be aptly encapsulated by the theme “Pension plan design and reform”. As an overarching statement the articles focus on fiduciary obligation and the allocation risk.

At the plan design level the increasing prevalence in Canada of target benefit plans, which permit plan sponsors and plan members to share in the allocation of risk, is assessed and explored.

At the obligation level the concept of a fiduciary is under review in the United States. Significant issues with a proposed definition of “fiduciary” in the ERISA context are uncovered, with potential for impact on how services are provided and compensation is received from pension plans.

The Australian article takes the focus of fiduciary obligation into the retirement phase, exploring the idea of the development of a pre-selected “comprehensive income product for retirement” to provide members with a regular and stable income stream in retirement. The implication drawn is that although this is an exciting potential development, directors will need to do their best to keep up with all of the complex issues and guide and monitor the design and implementation of such retirement products.

Our many thanks to the authors and country representative for their time and effort to contribute to the International Pension Lawyer and join the pensions law debate.

Safe travels to everyone heading to Brussels and I look forward to seeing as many of you as possible there.

Kind regards

Lisa

Dr Lisa Butler Beatty
Senior Legal Counsel
Commonwealth Bank (Lisa.Butler.Beatty@cba.com.au)
Dear Colleagues,

It is hard to believe that it has already been two years since we last gathered at an IPEBLA Biennial Conference. Though we had the opportunity to see some of you at the Global Pension and Employee Benefits Lawyers Conference – Benefits Without Borders in Chicago last June, presented in partnership with the CBA and the ABA, we hope to see most of you in Brussels at IPEBLA’s 15th International Conference, and that looks to be the case. We are on par with registration for the Rome Conference and expect to see 150 delegates in attendance. I look forward to meeting for three days on the topic of “Changing Times, Changing Benefits” and to catching up with each of you once again.

In my last update, I reported on the changes to the IPEBLA website, which have now gone live. With the support of the Website Committee, we have redesigned our logo and introduced a more modern look and feel to the Association, including a new layout and colours. Next steps will be for the Steering Committee to consider how we can increase online networking for members in between conferences. As always, we welcome the feedback from our members.

I am also pleased to report that our membership has continued to stay strong. With some turnover over the last two years, our membership still remains at approximately 250 members from over 30 countries. We welcome new members having joined our network recently, and we thank renewing members for their support over many years, which enhances not only your own professional development and practice, but also the entire profession globally. To celebrate our past, the History of IPEBLA has now been finalized and posted to the IPEBLA website. This will remain a living document, and we continue to welcome your contributions.

I would like to thank our volunteers for their involvement over the past two years on the Steering, Teleconference, Website and Membership Committees, as well as the Conference Committee, led by Chair Jana Steele. As a friendly reminder, should you be interested in a leadership position within the organization, nominations for the 2015-17 Steering Committee are now open. Please send your nominations or any inquiries to contactIPEBLA@managingmatters.com. We will also be sharing more information about committee involvement at the Brussels Conference.

The next opportunity that the organization as a whole will have to meet in person will be June 2016, in St. John’s, Canada, in partnership with the International Actuarial Association. More information on this conference will be available soon.

I am looking forward to seeing you all in Brussels. Best wishes for an engaging conference experience.

Regards,

Mitch

Mitch Frazer
Chair, IPEBLA Steering Committee
Partner, Torys LLP
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New Challenges for Australian Superannuation Fund Directors in the Retirement Phase

Jeremy Cooper

Australia

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OECD Roadmap

In June 2012, the Organisation of Economic Cooperation and Development Working Party on Private Pensions issued a 10-point roadmap for the good design of defined contribution pension (that is, superannuation) plans. Australia scored about 6 or 7 out of 10 on these measures, with the key deficiencies being in the retirement phase. What this meant at that time is that the Australian superannuation system had a way to go in its evolution. As a compulsory system, there is a very high onus on both policy makers and industry participants to meet world’s best practice or have a good reason for not doing so. In 2012, Australia was part way down the track of turning a lump sum defined contribution savings system into a retirement income system. Further change was inevitable.

At the end of 2013, the Federal Treasurer initiated a broad-ranging inquiry into Australia’s financial system called the Financial System Inquiry (FSI). The FSI issued its final report in December 2014 and it devoted more attention than might have been expected to superannuation and, particularly, the retirement phase. It looked like Australia was going to transform its retirement savings system into a retirement income system. It still could. The Australian Government has not yet formally responded to the FSI’s final report.

This article looks at the principal recommendation made in relation to the retirement phase and the implications that could be in store for directors of superannuation funds if the recommendation is implemented.

The comprehensive income product for retirement

Recommendation 11 of the final report of the FSI recommended that all large Australian superannuation funds be required to ‘pre-select’ a comprehensive income product for retirement June 2012.

(called a ‘CIPR’ in the final report) that addressed the need for retirees to have:

- a regular and stable income stream;
- longevity risk management; and
- flexibility.

It was suggested that this requirement is likely to be satisfied by using a combination of products, starting with the well-known account-based pension (ABP). This was illustrated in figure 9 of the FSI’s final report as follows:²

Desired features of retirement income products

Other comments suggested that a CIPR could include:

- a flexible transition from the accumulation phase;
- a cooling off period;
- diminishing return of capital on death.

The recommendation was written at a relatively high level and there will be quite a lot of detail required to be thought through prior to its implementation.

Who would administer the CIPR regime?

Each fund and its directors (in consultation with suitably qualified experts where necessary) would have to consider what was the appropriate CIPR design (or designs) for their members, but this should be done within a framework administered by the Australian Prudential Regulation Authority (APRA) and supported by legislation.

As a prudential supervisor, APRA has the power,³ to make prudential standards that apply to APRA-regulated superannuation entities. Prudential standards provide additional detail and clarity on relevant legislation. Standards are a flexible tool for making industry-specific rules after consultation with participants and other stakeholders. Standards are treated as ‘legislative instruments’ and are disallowable by the Senate, subject to scrutiny by the Standing Committee on Regulations and Ordinances.

APRA would therefore be the appropriate agency to administer the CIPR regime. It can be given a broad, principles-based mandate in legislation and then use its prudential standard-making power to make the regime work in practice. This would give APRA the flexibility necessary to make CIPRs work for the benefit of retirees, while allowing for innovation and different circumstances from fund to fund.

Trustee governance

Under this approach, APRA could develop a prudential standard that provided guidance and direction to trustees and their directors in designing and implementing a CIPR. This approach could be similar to that adopted in respect of the provision of insurance within superannuation. APRA’s recently issued prudential standard on risk management for regulated institutions is a rich source of ideas for helping super funds develop an appropriate strategy for managing the risks faced by their retired members in a CIPR.


³ Section 34C of the Superannuation Industry (Supervision) Act 1993.
The idea would be to spell out the issues within the prudential standard that trustees and their directors would have to consider. That way, the CIPR concept would have some real impact, but the parameters would be both flexible and transparent. Importantly, setting the CIPR prudential standard would involve consultation with stakeholders in the normal way that APRA uses its standards-making power. The standard and its administration by APRA could be focused principally on trustee governance; aimed at making sure that the directors had made the appropriate inquiries and were following certain basic procedures in designing and implementing the fund’s CIPR.

Trustees should be aware of the inherent financial risks that their members face in retirement. The CIPR should lower the residual risks for retired members to a level consistent with the risk appetite that the trustees set for them (or a particular cohort of them), remembering that members may always choose another arrangement.

For example, the prudential standard might require certain preparatory work to be undertaken to ascertain what member needs and wants are in retirement. Subject to the outcome of such work, trustees could then be obliged to consider and have a strategy for dealing with the following risks and features of a CIPR:

- Longevity risk
- Inflation risk
- Investment strategy
- Net investment returns
- Market volatility
- Sequencing risk
- Income flows
- Liquidity
- Access to capital
- Late stage cognitive decline

The relative importance of each component should be considered and is likely to differ from fund to fund, but APRA might also set some guidelines or benchmarks in its CIPR standard. Trustees, through their directors, would be free to adjust various features in order to deliver a different approach relevant to their members.

Moving to an income stream focus

The FSI clearly enunciated the need for the Australian superannuation system to move towards income streams through several of its recommendations. The CIPR proposal is an important step forward in moving the system from wealth accumulation to a focus on providing income in retirement.

The real significance of this is that funds effectively operate in a wholesale environment in the accumulation phase. This is because members are not very active, contributions are paid by employers and funds think mostly at the macro-level in the accumulation phase. This is because they are investing a large amount of money for a relatively indefinite period. Accumulating members are not asking for regular income to be paid to them and they are not, in the main, seeking regular contact with the fund. The explanation for this is reasonably obvious. They have a job. That’s where their income comes from. Their superannuation fund is very much in the background. In retirement, this will change dramatically. Suddenly, apart from their means-tested Age Pension entitlement, their superannuation fund might be their main source of income.

Forcing funds to design and offer a composite product that deals with the particular risks in retirement pushes those funds into a position where they really have to engage with the member as a customer. The reality is that this is
going to be a very new experience for most funds.

What does this mean for trustee directors?

While the FSI panel was at pains to clarify that CIPRs were not intended to be a default product, there are some significant issues for directors arising out of the framing of the CIPR as the ‘pre-selected’ retirement option.

It is reasonably well accepted that a product that is singled out in any way carries the implication that it is inherently good for the customer. It effectively constitutes an implicit recommendation about its suitability. This carries with it an element of moral hazard which needs to be addressed. The question arises: should trustee directors simply be ‘on the hook’ for this or should there be a conditional ‘safe harbour’ like the QDIA regime under the US Pension Protection Act 2006?

A safe harbour was not mentioned in the FSI’s final report, but it might be worth considering, given some of the complexities around applying a relatively standard product to the individual circumstances of specific retirees over a lengthy period. There is also the potential for cognitive decline of retirees to consider.

There is a difference between default products for accumulating members who are relatively generic on the one hand, and retirees, who have far more specific requirements on the other. Retirement is a highly individualised experience.

Superannuation fund directors’ duties

Section 52A(2) of the Superannuation Industry (Supervision) Act 1993 (SIS Act) set up a unique code of duties for directors of superannuation funds, which has applied since 2012. The standard of care imposed is that of a prudent ‘superannuation entity director’. A superannuation entity director is a person whose profession, business or employment is or includes acting as a trustee of a superannuation entity and investing money on behalf of beneficiaries of the super entity. This has not yet been tested in the courts, but is considered to be a material increase from the pre-2012 position where the prudent ‘ordinary person’ standard applied. The effect of this is that the bar has clearly been raised for directors.

The liability of directors has also been made more direct in that loss or damage arising from a breach is recoverable against any person responsible or involved in the contravention. As a shield against frivolous or vexatious claims against directors, an applicant must first seek leave of the court to bring an action. The court must consider whether the applicant is acting in good faith and whether there is a serious question to be tried. These seem like relatively low hurdles to clear for a bona fide litigant.

The most important defence to a liability arising out of a CIPR is likely to be reasonable reliance on external advisers. The ‘Centro’ case: ASIC v Healey & Ors [2011] FCA 717 is an important Australian decision on the responsibilities of directors and their ability to rely on external advisers, in that case the auditors. In essence, the court found that there is a core, irreducible standard of care and need for financial literacy, relevantly, to assess and consider external advice that is given. In simple terms, a director cannot blindly rely on advice from a third party. They have to be part of the process.

In the context of complex financial products intended to mitigate longevity risk under the CIPR regime, this will impose an obligation on directors to be satisfied that they understand the products and their implications for members. If the advice of actuaries and lawyers is provided in connection with such products, directors will need to read and understand what is presented. They will have to ask questions and guide and monitor the design and implementation of a CIPR.
Conclusion

If the Australian government adopts and implements the CIPR recommendation, it will be an important and positive step for the superannuation system and for retirees. It will have important implications for directors of funds that introduce a CIPR because there is a range of relatively unfamiliar and complex issues to grapple with. Directors will be required to consider various models for providing advice to retirees, new products, such as pooled longevity schemes, and complex actuarial issues around life expectancies and cash flow models. This is not bad news by any means. It is an exciting opportunity to take the industry to the next level; possibly to the top of the world rankings for pension systems. But, there will be challenges as well. Directors will need to do their best to keep up with all the complex issues and guide and monitor the design and implementation of any proposed CIPR.
Introduction
In recent years, the conversation in the Canadian pension industry has focused on the need for pension reform, and within that discussion, the need for plan designs that offer more compromise than the standard defined benefit (“DB”) or defined contribution (“DC”) model. At the heart of it, the allocation of risk is often seen as being one-sided in the traditional DB and DC plan models. In a traditional DB plan, the burden of financing the plan’s promised benefits largely rests with a plan’s sponsor, which is responsible for funding ongoing service costs, as well as past deficits. Members in a DB plan may be required to contribute to ongoing service costs, but their contributions are known in advance and capped at predetermined levels.

In a DC model, the plan members bear the burden of risk, which is that the member (and plan sponsor) contributions plus investment returns will not result in a sufficient retirement income.

In some jurisdictions in Canada, plan sponsors and plan members are now able to share the allocation of risk in a target benefit plan (“TBP”) model. In this article, we describe the key features of a TBP and its prevalence in Canada, and briefly consider whether this model will be the solution to some of the concerns faced by the parties to a pension promise.

What is a Target Benefit Plan?
The term “target benefit plan” does not have the same meaning in every Canadian jurisdiction. However, generally, a TBP model incorporates some of the key elements of a DC plan and a DB Plan. In a TBP, similar to a DC plan, the employer’s contributions to the plan are fixed (or capped), whether by collective agreement or otherwise (for example, $ per hour worked, or % of earnings). In other words, the employer’s obligation to contribute is limited to the agreed-upon amount or range. Members may or may not contribute. Similar to a DB plan, there is a benefit formula that allows the accrued retirement benefit to be calculated in advance of retirement. However, one of the key differences between a DB plan and the TBP model is that a TBP provides a “target benefit” rather than a guaranteed benefit. In a TBP, all accrued and future benefits can be reduced if the plan’s assets are not sufficient to provide the target benefits. The employer is not required to contribute additional money to pay the difference between the benefit that can be funded by the plan’s assets and the target benefit.

At its basic level, the framework for TBPs allocates risk between plan sponsors and members by limiting a plan sponsor’s financial exposure and creating some certainty for plan
members in their retirement. However, how the risks between these two parties is allocated will largely be determined by the legislative requirements of the jurisdiction in which the TBP is registered. In Canada, minimum pension standards vary across 11 jurisdictions, and not all jurisdictions have taken steps to amend their legislation to allow for the implementation of TBPs broadly.\(^1\) We review in greater detail some of the features and issues emerging under minimum pension standards legislation in Canada and how they balance or affect risk.

**Plan Design**

For the purposes of this article, one of the key questions of plan design relates to how a TBP may be established. These limitations may be prescribed by legislation, or in some jurisdictions, there may be a range of acceptable design options. For example, when converting an existing DB plan to a TBP, whether and to what extent the DB benefits accrued up to the date of conversion can be converted to a TBP model (and therefore subject to reduction under the TBP model), will greatly affect how members of a TBP view the allocation of risk.

Where legislation permits both the conversion of accrued DB benefits to TBP benefits, and the subsequent reduction of those TBP benefits,\(^2\) plan sponsors may view the conversion favourably as it may be possible to reduce and/or eliminate unfunded liabilities accrued under the DB plan by way of a reduction of TBP benefits post-conversion. Conversely, members with DB benefits whose plan is being converted to a TBP under such a legislative scheme may see the conversion as increasing the level of risk associated with having DB-like benefits and particularly, as a possible means to reducing the benefits they accrued prior to the conversion.

Another question of plan design is the level of protection to be given to benefits under a TBP model. In Canada, TBPs may have two classes of benefits: base pension benefits and ancillary benefits. Base pension benefits receive more “protection” or guarantee of payment than ancillary benefits, and are only reduced after the removal or reduction of ancillary benefits does not achieve the goals set out in a funding recovering plan, or otherwise improve the funded status of the plan to a specified level.\(^3\) The ancillary benefits that may be offered under a TBP are varied (for example, bridge benefits or indexation increases), and if they are made available, are subject to reduction in the event of underfunding prior to the reduction of base pension benefits.

How a TBP plan member views the dual level of protection given to benefits under the plan will vary considerably, depending on the value given to the ancillary benefits. Where ancillary benefits are highly valued by a member, that member may view the conversion as allocating a disproportionate amount of risk to members by putting their benefits “at risk” based on the plan’s funding, with minimal risk faced by plan sponsors.

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1. In Canada, registered pension plans, which include TBPs, are governed by the *Income Tax Act* (Canada), RSC 1985, c 1 (5th Supp) (“ITA”), from a tax perspective, regardless of the jurisdiction in which the TBPs is registered. This paper does not comment on the ITA’s impact on the allocation of risk in a TBP.

2. See, for example, sections 100.52 and 100.53 of the *Pension Benefits Act* (New Brunswick), SNB 1987, c P-5.1 (“NB PBA”), which permit the conversion of a pension plan to a “shared risk plan”, a form of TBP (as defined in the NB PBA) and the reduction of benefits in the “shared risk plan” despite any contract or trust, including a document that creates or supports a pension plan or pension fund.

3. See, for example, section 11 of the *Shared Risk Plans Regulation*, NB Reg 2012-75 passed pursuant to the *Pension Benefits Act* (New Brunswick), SNB 1987, c P-5.1.
In addition to the ability of a TBP model to reduce ancillary and/or base pension benefits, the contributions of a plan sponsor and plan members may increase or decrease within a specified range. Thus, in years of higher-than-expected returns and positive plan experience, it is possible for members and sponsors to benefit from decreased contributions, as well as securing the payment of ancillary benefits. Increased contributions and the reduction or removal of ancillary benefits are also possible in the event of negative plan experience, and it is the individual risk tolerance of plan members that determines whether this allocation of risk to plan members is seen as acceptable.

**Plan Administration**

A common feature of TBP plan administration is the use of a joint governance model. Plan governance is shared between plan sponsor representatives and representatives from active members, and possibly, retired members and other plan beneficiaries, as well as trade unions that represent members. By providing parties other than plan sponsors with input on decisions that affect the governance of a TBP, it is thought that their increased participation in the plan’s administration will be seen as an offset to the risk associated with the ability to reduce accrued and future benefits in a TBP. The plan sponsor, while perhaps giving up sole control of the plan’s operation, gains less financial volatility and more cost predictability in exchange.

The administration and governance of a TBP may vary depending on whether the TBP is offered in a union or non-union workplace, if it is available to single-employer plans and/or multiple-employer plans, and whether TBPs can be used in the public and/or private sector. In at least one jurisdiction in Canada, the pension legislation permitting TBP models is intended to cover workplaces with or without a union, but the governance of the TBP may differ depending on whether a union is involved. In other jurisdictions, TBPs may be permitted in legislation covering private sector plans, but not public sector plans. Multiple-employer TBP plans may be permitted, however, their administrative framework requires some modifications.

In a multiple-employer TBP, it is possible that members of any particular employer or that employer itself are not represented on the board of trustees that administers the plan, or the joint governance committee, as the case may be. This may also be the case in a TBP provided to members of a number of different trade unions. Nevertheless, the flexibility afforded by a TBP may be a welcome change for all plan sponsors and plan members who would otherwise be faced with volatile funding obligations and/or the risk of a plan wind-up.

TBPs are to be funded, at a minimum, in accordance with the plan’s applicable pension legislation, and typically, in accordance with the individual plan’s funding deficit recovery plan and funding surplus utilization plan. The first, a funding deficit recovery plan, addresses the corrective actions that will be taken once a funding trigger is met. This could include, for example, the reduction of an ancillary benefit, or an increase in contributions for the plan sponsor and/or plan members. The trigger may be prescribed in the legislation, or may be set out in the funding deficit recovery plan. A funding

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4 See, for example, the Consultation Paper released by the federal Department of Finance Canada entitled “Pension Innovation for Canadians: The Target Benefit Plan”, dated April 2014, where the proposed TBP framework in the federal jurisdiction is intended to cover union and non-union workplaces.

5 In Alberta, the Employment Pension Plans Act (Alberta), SA 2012, c E-8.1 permits the use of TBPs; however, amendments to the Public Sector Pension Plans Act, RSA 2000, c P-41 that were introduced to permit the conversion of public sector plans in Alberta to TBPs were not passed by the Legislative Assembly.
surplus utilization plan provides a guideline for the use of surplus, such as the reduction or elimination of contributions or increases in benefits. The use of funding policies that are developed jointly by plan sponsors and plan members may increase the comfort of both the members and the employer with converting to a TBP, since it will be known in advance how increases and decreases in contributions and benefit improvements and reductions will be triggered, providing sponsors and members with certainty in the event a plan performs below or above its financial expectations.

The limitations placed on the types of plans that are able to convert to a TBP will determine the frequency and types of funding valuations required of the TBP. For example, single-employer non-collectively bargained plans, where the risk of wind-up may be perceived to be greater, may require more frequent valuations and valuations on a going-concern and solvency basis. A multiple-employer collectively bargained plan may be seen as less likely to be wound up and therefore subject to funding on a going-concern basis only. These factors, along with all others discussed above, must be considered when evaluating whether a TBP sufficiently allocates the risk between the parties that participate in the administration of a sustainable plan.

Why are TBPs Relevant?

The need for pension innovation in Canada, as in other countries, is at the forefront of discussion for governments, plan sponsors and plan members. It is no longer possible to expect pension plans to fall within the narrow categories of providing DB benefits or DC benefits, since these plans are now being viewed by governments and others as failing at allocating risk between sponsors and members, tipping the “risk-factor” in favour of one party over the other. TBPs are not only relevant in today’s discussion about the sustainability of pension plans, but they may be necessary to the future success of workplace pension plans in an environment of economic volatility and increasing plan member longevity.

In Canada, several jurisdictions across the country have taken steps to ensure the long-term sustainability of pension plans. Reform initiatives are ongoing and we expect further significant changes over the coming years. The following is a summary of some of the more significant changes that have been made to date.

New Brunswick Shared Risk Plan

The most highly publicized change was the introduction of the shared risk plans (“SRPs”) in New Brunswick. A SRP is essentially a form of a TBP. An SRP provides base (core) benefits, and ancillary benefits such as indexing/cost-of-living adjustments (“COLA”), bridge benefits and early retirement subsidies. These two different types of benefits (base and ancillary) have different levels of protection, with base benefits having a higher level of protection than ancillary benefits. Ancillary benefits are only provided if there are sufficient funds in the plan to provide such benefits. Sophisticated actuarial modelling/testing is done to ensure that there is a very high probability that there will be sufficient assets in the plan to provide the base benefits. However, all benefits under a SRP (past and future base and ancillary benefits) may be reduced if there are insufficient funds.

The legislation requires that the administrator of a SRP must be a trustee, a board of trustees or a not for profit corporation; there is no requirement for joint governance on a board of

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6 See section 100.51 of the Pension Benefits Act (New Brunswick), SNB 1987, c P-5.1 for a list of ancillary benefits that may be provided in an SRP.

7 Base benefits and ancillary benefits may also be increased. See subsection 100.53(b) and (c) of the Pension Benefits Act (New Brunswick), SNB 1987, c P-5.1.
trustees. However, to date all of the SRPs have implemented a joint governance model. If a DB plan is converted to a SRP all accrued benefits for both active and retired members become base benefits in the SRP.\(^8\) There is no consent requirement for the conversion of accrued benefits.

This model is not without controversy. A group of retirees affected by the conversion to a SRP commenced a legal action alleging, among other things, that the removal of their accrued guaranteed indexation benefits violates their rights under the *Canadian Charter of Rights and Freedoms*\(^9\) (section 7) by putting the security of their person at risk in their old age.\(^10\) The legal action demonstrates that despite efforts to balance and allocate risk between the government of New Brunswick and its employees, the affected employees are of the view that the new SRP does not provide sufficient incentive against the possibility that their accrued benefits may be reduced.\(^11\)

**Private Sector Target Benefit Plans in Alberta**

The *Employment Pension Plans Act*\(^12\) came into effect September 1, 2014 permitting the use of target benefit plans in the private sector. TBPs in Alberta are described as a plan that “establishes a formula by which the amount of the pension that is intended to be payable to a member is to be determined” and “provides that the actual benefit under the plan may be reduced below the intended benefit”.\(^13\) The reduction of benefits is not subject to the Superintendent’s prior approval.

In Alberta, TBPs are required to have a written governance policy and a written funding policy. The latter must include information on the mechanics for a benefit reduction and the use actuarial surplus.\(^14\)

As enacted, the *Employment Pension Plans Act* does not permit the conversion of past service benefits in a plan to TBP benefits. The Government of Alberta introduced legislation in April, 2014 that would have allowed the conversion of a past service benefits into a TBP retroactively\(^15\) (similar to the New Brunswick model), however the bill died on the order paper when the Alberta legislature prorogued September 16, 2014. The Government of Alberta announced that the amendments would not be re-introduced when the Legislative Assembly resumes.

**Federal Consultation Paper on Target Benefit Plans**

On April 24, 2014 the federal Minister of Finance released a consultation paper, *Pension Innovation for Canadians: The Target Benefit Plan*,\(^16\) which contains proposals on all aspects of a TBP’s design for federally-regulated employers. The deadline for making submissions on the consultation paper has

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\(^8\) See subsections 100.52(3.1) and (3.2) of the *Pension Benefits Act* (New Brunswick), SNB 1987, c P-5.1.


\(^11\) This litigation is in its preliminary stages and there have been no decisions on the merits released to date.


\(^14\) See section 55 of the *Employment Pension Plans Regulation*, Alta Reg 154/2014 passed pursuant to the *Employment Pension Plans Act*, S.A. 2012, c. E-8.1 for a list of other information that is required to be included in the funding policy.

\(^15\) See Bill 10, *Employment Pension (Private Sector) Plans Amendment Act, 2014*.

passed, however, draft legislation has not yet been released.

Under the consultation paper, the federal TBP would be open to new plans or existing DC or DB plans where the parties agree to convert to a TBP. The governance framework would require a Board of Trustees or similar body which allows for the participation of plan members and beneficiaries.

Contributions to a TBP may be based on either fixed or variable contributions that are to be established in the plan text. If the variable contribution model is chosen, the variability would be capped. Under the proposed TBP framework, there would be two classes of benefits with a varying level of benefit protection: base benefits could be reduced in cases where a funding deficit arises, but would have a high level of protection and would only be reduced as a last resort; and ancillary benefits would have a lower but reasonable level of protection and would be reduced before base benefits are reduced and could also be increased when the plan is in a surplus situation.

A funding deficit recovery plan is required and would incorporate: the trigger for deficit recovery measures and timelines for implementing the measures; the description of all possible measures and order of priority; the minimum funding level to be reached through the measures; and the approval process. A surplus utilization plan would be required to include the trigger for surplus utilization measures, and timelines for implementing the measures; the description of all possible measures and order of priority; any cap on surplus utilization; and the approval process.

The consultation paper proposes that termination provisions be included in the legislation to ensure that DB plans do not seek to convert to a TBP so as to terminate under TBP rules and avoid DB solvency funding requirements upon wind-up.

**Collectively Bargained Target Benefit Plans in Ontario**

In October, 2010, the government of Ontario introduced provisions in the *Pension Benefits Act* permitting the use of TBPs in unionized workplaces. The provisions are not yet operative and require the introduction of supporting Regulations to prescribe the details relating to governance, administration, funding and the establishment of, or the conversion to, a TBP.

What is known is that in order to qualify as a TBP in Ontario, the following requirements must be met: the benefits in the TBP are not DC benefits; the plan sponsor’s obligation to contribute to the TBP is limited to a fixed amount set out in one or more collective agreements; the TBP administrator is authorized in the plan documents to reduce benefits, deferred pensions or pensions accrued under the plan, both while the plan is ongoing and upon wind up (as long as the reduction is not otherwise prohibited by a collective agreement or applicable pension legislation); and any other criteria that may be prescribed in the Regulations.

In the 2014 Ontario Budget, the government stated that it intends to consult on the regulatory framework for multiple-employer TBPs. Feedback from these consultations would be used in subsequently developing a framework for single-employer TBPs.

**Pulp and Paper Sector Target Benefit Plans in Quebec**

On November 30, 2012, Bill 15, *An Act to provide for the establishment of target-benefit pension plans in certain pulp and paper sector enterprises*, was introduced by the government.

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of Quebec. Bill 15 permitted the establishment of TBPs in certain enterprises in the pulp and paper sector in Quebec, and was assented to on December 7, 2012. Regulations passed pursuant to the Supplemental Pension Plans Act\textsuperscript{19} provide that TBPs may be established if a plan sponsor is in the pulp and paper sector and has entered into an agreement with a trade union to establish a TBP while that employer was subject to an order under the federal Companies' Creditors' Arrangement Act.\textsuperscript{20}

While the Regulations were retroactive to December 31, 2010, TBPs are only permitted in these limited circumstances and the Regulations are temporary in nature.

**Have TBPs been Successful in Canada?**

It is too early to determine how well TBPs have been or will be received in Canada. At the federal level, the legislation is only in the consultative phase, and in Ontario, supporting Regulations are required in order to permit the use of the TBP model. In Alberta, the ability to include TBP provisions in a plan was only recently introduced in September 1, 2014, and in Quebec, the TBP model was only available in limited circumstances. In New Brunswick, the Shared Risk Plan model is in use, but as noted above, a legal action challenging it has been brought by affected retirees.

As other jurisdictions move towards the use of alternative plan designs, it remains to be seen whether Canada will see a harmonization in the legislative framework governing the use of TBPs, or whether significant differences in plan design and plan administration – and the perceived allocation of risks associated with those features – will continue to exist between jurisdictions.

\textsuperscript{19} Regulation respecting target-benefit pension plans in certain pulp and paper sector enterprises, CQLR c R-15.1, r 6.1.01 passed pursuant to the Supplemental Pension Plans Act, CQLR c R-15.1.

\textsuperscript{20} Companies' Creditors Arrangement Act, RSC 1985, c C-36.
DOL Proposes Major Changes to Fiduciary Duty Rules for Pension Plans

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Introduction

On April 14, 2015, the U.S. Department of Labor (“DOL”) issued a long-awaited re-proposed regulation (the “2015 Proposed Regulation”) on the definition of “fiduciary” under the Employee Retirement Income Security Act (“ERISA”), the labor law that imposes duties on pension and welfare plan fiduciaries.

Overview of the Current Fiduciary Definition and Proposed Revisions

The changes proposed by the DOL do not expand fiduciary duties so much as they expand the universe of individuals and entities viewed as investment advice fiduciaries to ERISA retirement plans and IRAs. While the proposal includes some helpful exceptions to the application of the new fiduciary definition, these exceptions are relatively narrow. As a result, certain sales activities, and consulting, recordkeeping, participant education and valuation services for plans that do not currently give rise to fiduciary status, would do so under the proposal.

Under current guidance, the DOL provides a 5-part test to determine whether a person will be acting as a fiduciary adviser (29 CFR sec. 2510.3-21(c)) (the “Current Rule”). Specifically, a person may provide investment advice if the person: (1) renders advice to a plan as to the value of securities or other property, or makes 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 understanding; (4) that such advice will be a primary basis for investment decisions; and that (5) the advice will be individualized to the plan.

The DOL initially proposed to expand the fiduciary advice definition in 2010 (the “2010 Proposed Regulation”) but withdrew the proposal in 2011 in the face of strong opposition from the retirement services community and members of Congress from both parties. The 2015 Proposed Regulation, like the 2010 Proposed Regulation, seeks to eliminate the current five part test and subject a person to ERISA’s fiduciary standards if, for a fee or other compensation, the person:
provides one of four types of advice directly to a plan, plan fiduciary, participant or beneficiary, IRA or IRA Holder (“Covered Advice”); and

either directly or indirectly (e.g., through or together with an affiliate):

represents or acknowledges fiduciary status, or

provides the advice under an agreement, arrangement or understanding that the advice is individualized to, or specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to securities or other property.

The 2015 Proposed Regulation defines the four different types of Covered Advice that could subject a person to fiduciary status as follows:

• recommendations as to the advisability of acquiring, holding, disposing or exchanging securities or other property, including recommendations to receive a distribution of benefits or roll over assets from a plan or IRA;

• recommendations as to the management of securities or other property, including recommendations as to the management of assets to be rolled over to or distributed from an IRA;

• appraisals or fairness opinions concerning the value of securities or other property if made in connection with a specific transaction involving the plan or IRA; and

• recommendations of a person who will also receive a fee or other compensation for providing any of the three Covered Advice categories listed above.

A. Observations

Not unexpectedly, the 2015 Proposed Regulation specifically applies to advice and recommendations regarding distributions from pension plans to be “rolled over” to an Individual Retirement Account (“IRA”). This is a reversal of the DOL’s position dating to 2005 on distribution-related advice - that a recommendation to a plan participant to take an otherwise permissible pension plan distribution does not constitute “investment advice.” Somewhat more surprising is that IRAs are defined to include Health Savings Accounts (“HSAs”) that hold funds accumulated for health care expenses, and that Covered Advice also includes recommendations regarding advice with respect to distributions from plans and IRAs that to not involve rollovers, such as the form of distribution in installments or an annuity. The proposal does not appear to require an investment recommendation to accompany the distribution advice.

The 2015 Proposed Regulation also includes other significant changes from the Current Rule. For instance, under the proposal, advice would not be required to be provided on a “regular basis” or pursuant to a “mutual understanding” that the advice will serve as a “primary basis” for an investment decision. While the advice must be either “individualized” or “specifically directed to” the advice recipient, the only “understanding” required (although not necessarily mutual) is that the advice will be “for consideration” by the recipient. And where the advice provider or an affiliate has represented or acknowledged that it is acting as a fiduciary with respect to the advice provided, the advice is Covered Advice without regard to any of the other requirements. The 2015 Proposed Regulation also affirms DOL’s position that recommendations regarding investment managers (not just securities) give rise to fiduciary status. These changes will certainly make it easier for many in the retirement services industry to be found to be acting in a fiduciary capacity — including for one-time advice or recommendations where the provider has no expectations that the advice will be relied upon.
Notably, the 2015 Proposed Regulation differs from the 2010 Proposed Regulation in that it does not automatically require that an adviser registered under the Investment Advisers Act of 1940, as amended, be a fiduciary under ERISA. However, as discussed below, a person providing Covered Advice will not be eligible for any of the proposed carve-outs from fiduciary status discussed below if it has represented or acknowledged that it is a fiduciary in providing Covered Advice. Under many existing service contracts, a person may acknowledge that it is a fiduciary, but only to the extent that it meets the requirements of ERISA’s fiduciary definition. It is not yet clear whether such a contract term would render the provider ineligible for any of the proposed carve-outs, discussed below.

B. Exceptions to Fiduciary Status

Notwithstanding the broad swaths of activities that the DOL seeks to include as fiduciary investment advice under the 2015 Proposed Regulation, the DOL also proposed several carve-outs that allow persons who may otherwise be deemed investment advice fiduciaries escape fiduciary status. These carve-outs are discussed in more detail below.

1. Counterparty Exceptions

The first “carve-out” category included in 2015 Proposed Regulation is referred to as the “Counterparty Exceptions.” These sales exceptions – which are only available for sales to certain plans or plan fiduciary and are thus unavailable for sales to individual participants, IRAs or IRA holders - allow a person, acting as or on behalf of a counterparty, to provide Covered Advice to an independent plan fiduciary in an arm’s-length sale, purchase, loan or bilateral contract or proposal for such a transaction if certain other conditions are met, as follows.

a. Plan Fiduciary Qualifications and Representations

To meet one Counterparty Exception, with respect to transactions with plans represented by a fiduciary with responsibility for managing at least $100 million in employee benefit plan assets, the advisor/counterparty must confirm the fiduciary’s “size” qualification either by relying on the plan’s most recently filed annual information return (Form 5500) or by obtaining a written representation from the fiduciary regarding its assets under management. For transactions with plans represented by fiduciaries having less than $100 million in assets under management, the advisor/counterparty must obtain a written representation from the plan fiduciary that:

- It exercises authority and control with respect to the management and disposition of plan assets;
- The plan has 100 or more participants; and,
- The fiduciary will not rely on the person to act in the best interest of the plan, to provide impartial investment advice, or to give advice in a fiduciary capacity.

b. Required Disclosures by Advisor/Counterparty

For any transaction to be covered by a Counterparty Exception, the advisor/counterparty must: fairly inform the fiduciary representing the plan that the advisor/counterparty is not undertaking to provide impartial investment advice. Further, the advisor/counterparty may not receive any fee or other compensation directly from the plan or plan fiduciary for the provision of investment advice in connection with the transaction. Notably, it appears this requirement would not preclude the counterparty advisor from receiving compensation from the plan or plan fiduciary for other services rendered in connection with the transaction.

c. Swaps Based Carve-Outs
In recognition that swaps and other security based swaps transactions are already regulated under the Commodity and Exchange Act ("CEA") and the Securities Exchange Act ("Exchange Act") under Dodd-Frank, the 2015 Proposed Regulation provides a carve-out for swap dealers, security-based swap dealers, major swap participants and security-based major swap participants who make recommendations to plans to avoid providing investment advice under ERISA.

First, the swap dealer may not act as an “advisor” to the ERISA plan in the swap transaction. This suggests that a recommendation not “tailored to the particular needs or characteristics” of the ERISA plan does not amount to a covered recommendation. It also suggests the need for greater reliance on a second safe harbor (CFTC Regulation 23.440(b)(2)), which would require the ERISA plan to be represented by a “qualified independent representative,” within the meaning of CFTC Regulation 23.450. Second, the plan fiduciary must be “independent” of the swap dealer, and third, prior to making any recommendations, the swap dealer must obtain a written representation from the plan fiduciary that the fiduciary will not rely on such recommendation.

This swaps-based carve-out, therefore, appears to hinge on how tailored the recommendation is to the ERISA plan. CFTC guidance indicates that certain recommendations can be individualized to an ERISA plan without subjecting the swap dealer to “advisor” status. Whether the recommendation would render the swap dealer an “advisor” to the ERISA plan, as set forth in CFTC Regulation 23.440, is a critical initial determination.

2. Employee Carve-Out

The 2015 Proposed Regulation also carves-out from the scope of fiduciary investment advice any employee of a sponsoring employer or employee organization provided that he or she receives no fee or other compensation in connection with the advice beyond the employee’s normal compensation for work performed for the employer or employee organization. While this carve-out should be useful to help prevent in-house personnel that routinely assist the plan fiduciary, such as by evaluating investments, from becoming fiduciaries themselves, contracts for those persons may need to be amended to reflect that no additional compensation is paid to the employee as a result of services performed to assist the plan fiduciary.

3. Platform Provider and Selection and Monitoring Assistance Carve-Outs

The 2015 Proposed Regulation carves-out from fiduciary status those who market and make available platforms for a plan fiduciary to select and monitor investment alternatives that are offered to participants and beneficiaries provided that the person acknowledges in writing that they are not providing investment advice to the plan. Moreover, in connection with those platform provider services, a platform provider may avoid fiduciary status if the person “merely identifies investment alternatives that meet objective criteria specified by the plan fiduciary (e.g., stated parameters concerning expense ratios, size of fund, type of asset, credit quality); or “merely provides objective financial data and comparisons with independent benchmarks to the plan fiduciary.”

It is uncertain whether this rule will severely affect the types of services that service providers are willing to offer plans or their fiduciaries. It is also unclear whether, as currently drafted, investment advisers may provide routine performance monitoring metrics and data to plan fiduciaries without incurring fiduciary status under ERISA. The DOL also specifically declined to extend these platform and monitoring assistance carve-outs to those providing services to IRA Holders.
4. Appraisal Carve-Out

While including appraisals or fairness opinions as Covered Advice that may cause a service provider to become an investment advice fiduciary, the DOL also carves-out certain types of appraisals from fiduciary status. In particular, a person furnishing an appraisal or fairness opinion will not be deemed a fiduciary provided that the appraisal was rendered for (1) an employee stock ownership plan (“ESOP”, a type of ERISA pension plan that is permitted to invest in certain employer stock without a requirement of diversification of assets); (2) an investment fund which holds the assets of more than one unaffiliated plan; or (3) for purposes of complying with ERISA’s reporting or disclosure requirements. The DOL cautioned, however, that appraisals rendered to ESOPs would be subject to separate future regulatory guidance.

5. Investment Education Carve-Out

Lastly, the DOL also attempted to exclude from the definition of fiduciary advice the provision of investment education (“Investment Education”). This carve-out would supersede and replace commonly relied upon current Investment Bulletin 96-1 (“IB 96-1”). IB 96-1 generally permits the furnishing of (1) plan information, (2) general financial, investment and retirement information, (3) asset allocation models, and (4) interactive investment material by as plan sponsor to its participants (but has been widely understood to apply more broadly to other persons). While the DOL’s Investment Education carve-out largely mirrors the provisions IB 96-1, the DOL added several new conditions that will need to be worked through in the upcoming days and months.

For example, DOL added a new condition that the information and materials provided not include advice or recommendations regarding specific investment products, specific investment managers or the value of particular securities or other property. The carve-out also specifically permits the furnishing of information to help participants assess their retirement needs past retirement and risks.

Most notably, however, and in a stark deviation from current practice under IB 96-1, investment allocation models may not refer to a specific investment product available under the plan or IRA. This is a departure from current guidance that would allow asset allocation models to be populated with specific investment choices. This approach would require any asset allocation model to be populated with asset classes and not specific investment choices regardless of whether a disclaimer is included that specifically highlights that other investment options are available under the plan. Also, the proposal does not address how to demonstrate that providing information about distributions or rollover may be education rather than advice.

6. Brokerage Services Carve-Out

The DOL also retained the provisions of the Current Rule that pertain to the effecting of securities transactions by broker-dealers at the direction of plan clients or other unrelated parties, but expanded the provision to also apply to IRAs. Thus, those relying on the exception should be permitted to continue their current practices without incurring fiduciary status under ERISA.

Accompanying Changes to Prohibited Transaction Exemptions

In addition to imposing duties on fiduciaries to pension plans, ERISA also prohibits many related party transactions per se, subject to class or individual exemptions granted by the DOL from time to time. Over the years, many industry practices with respect to retirement plans have developed to be consistent with those published exemptions. The 2010 Proposed Regulation was roundly criticized for, among other things, not addressing needed prohibited transaction relief for dealing with the conflicts that would have resulted from re-characterizing many non-fiduciary activities as
fiduciary in nature. The DOL has responded to this in conjunction with promulgating the 2015 Proposed Regulation by also proposing new prohibited transaction class exemptions and amendments to existing class exemptions would require significant changes to the current service delivery and compensation models of many registered investment advisers, brokers, banks, insurance companies and consultants. Many current compensation practices will simply not work under the modifications to the current class exemptions and limitations of the newly proposed class exemptions. Where current compensation practices can be preserved, the ability to receive such compensation will be accompanied by taking on significant contractual, recordkeeping, and reporting obligations not currently required.

In particular, the DOL has drafted a new class exemption designed for use by any person providing non-discretionary investment advice to so-called “Retirement Investors” (individual ERISA plan participants, IRAs or the plan sponsor of a non-participant-directed plan with under 100 participants) who wishes to receive and retain third-party compensation in connection with its fiduciary recommendations. All other fiduciary advisers in need of relief will be required to rely on some other exemption. In this regard, the DOL has also proposed a new exemption for the purchase and sale of certain debt securities and amendments to six existing class exemptions.

However, recognizing that plan participants, IRAs and small plan sponsors may be in need of special protections, the DOL crafted an exemption with safeguards designed especially for them. In general, any person providing non-discretionary investment advice to Retirement Investors who wishes to receive and retain third-party compensation in connection with its fiduciary recommendations will be required to comply with the new “Best Interest Contract Exemption” (or an existing individual or statutory exemption); all other fiduciary advisers in need of relief will be required to rely on some other exemption. Also proposed are a “Pre-Existing Transaction Exemption” and an “Insurance and Annuity Contract Exemption”, both as supplemental exemptions under the Best Interest Contract Exemption, as well as an Exemption for Principal Transactions in Debt Securities.

Unfortunately, the primary exemptions on which many providers currently rely may be withdrawn or significantly modified so that those exemptions, even when used in combination, may no longer support current service delivery and compensation models.

**Some Final Observations**

There are several significant issues raised by the 2015 Proposed Regulation and accompanying materials for those who provide services to US ERISA-covered pension plans and IRAs. Currently only proposed, we anticipate that the financial and plan service provider industry will be making extensive comments to the DOL on the proposed regulations and changes to class exemptions, and they may well change before being finalized. Those in the pension industry should be monitoring these developments closely because, if finalized, the new regulations and guidance promise to usher in major changes to how services are provided to and compensation received from pension plans.
INTERNATIONAL PENSION LAWYER

Journal of the International Pension and Employee Benefits Lawyers Association