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The ECFC FLEX Reporter provides in-depth coverage of developments affecting the administration of cafeteria plans, flexible spending arrangements (FSAs), health reimbursement arrangements (HRAs), and health savings accounts (HSAs). Articles in The ECFC FLEX Reporter are authored by nationally recognized attorneys and consultants, and edited by John R. Hickman, a partner in the Employee Benefits Practice Group of Alston & Bird, LLP.

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Non-Delay of DOL Fiduciary Conflict of Interest Rule Has
Impact on HSA Custodians and Trustees

The recent non-delay of the Department of Labor ("DOL") Conflict of Interest Rule, which is commonly called the fiduciary rule, provides important new considerations for health savings account ("HSA") service providers.[1] The fiduciary rule was previously slated to become applicable April 10, 2017, but the DOL delayed its applicability date until June 9, 2017.[2] Additionally, the DOL delayed many of the more onerous requirements for the prohibited transaction exemptions (including the so-called best interest contract exemption or "BICE" PTE) for the fiduciary rule until at least January 1, 2018. There are significant implications, however, for HSA trustees, custodians, and service providers that apply sooner.

Late last month, the DOL issued Field Assistance Bulletin 2017-02, where it said that until January 1, 2018, it will not pursue claims against fiduciaries ***who are working diligently and in good faith to comply with the fiduciary rule and its prohibited transaction exemptions***, or treat them as being violation of the rule and its exemptions.[3] Moreover, the DOL will initially focus on compliance assistance rather than citing violations and imposing penalties. The IRS has extended similar relief to excises taxes under Internal Revenue Code ("Code") § 4975 during the DOL's temporary enforcement policy.[4]

The DOL has also issued a FAQ about its temporary enforcement relief and delay of certain requirements for the rule's prohibited transaction exemptions.[5]

What becomes applicable June 9, 2017?

Certain parts of the rule become applicable on June 9, 2017, including to non-ERISA plans like HSAs:

- The rule's definition of "fiduciary" of a plan under ERISA 3(21)(A)(ii) and Code 4975(e)(3)(B);
- The Impartial Conduct Standards required by some of the new and revised prohibited transaction exemptions related to the rule, including the Best Interest Contract Exemption ("BICE") on which many HSA providers will rely; and
- The applicability date of amendments to some existing DOL prohibited transaction exemptions for the fiduciary rule.

The DOL clarified that these requirements take effect at 11:59 P.M. local time on June 9, 2017, and the DOL will not treat parties as fiduciaries before that time.

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[1] The fiduciary rule applies to non-ERISA arrangements covered by Internal Revenue Code § 4975, including HSAs and Archer Medical Savings Accounts. 81 Fed. Reg. 20946, 20989 (Apr. 8, 2016).
[2] 82 Fed. Reg. 16902 (Apr. 10, 2017).
[3] https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2017-02 (as visited June 5, 2017).
[4] IRS Announcement 2017-04, stating "Code § 4975 and related reporting obligations with respect to any transaction or agreement to which the DOL's temporary enforcement policy, or other subsequent related enforcement guidance, would apply." https://www.irs.gov/pub/irs-drop/a-17-04.pdf (as visited June 5, 2017).
[5] https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-transition-period.pdf ("Transition Period FAQ") (as visited June 5, 2017).

***What becomes applicable January 1, 2018*?**

Entities using BICE or BICE for level fee fiduciaries ("BICE-Lite") must comply with the Impartial Conduct Standards beginning June 9, 2017. However, absent further delays or changes, the remaining BICE and BICE-Lite requirements will not take effect until January 1, 2018, such as the:

- Contract representation requirements, including representations about fiduciary status, compliance Best Interest standard of care, reasonable compensation, materially misleading statements, and material conflicts of interest.
- Warranty requirements for contracts, including warranties regarding its written policies and procedures for adherence to Impartial Conduct Standards, protections against material conflicts of interest, and receipt of differential compensation and other incentives.
- Contract disclosure requirements, including description of services, method of payment for services, material conflicts of interest, fees or charges imposed on account, type of compensation expected, ongoing monitoring (if any), right to obtain copies of policies and procedures to procedures to ensure compliance with impartial conduct standards, contact information for representative to address concerns regarding advice, whether the proprietary products are offered, or third party payments will be received, as well as costs, fees, and compensation, including third party payments;
- Transaction disclosures before or at time of transaction, including disclosure of Best Interest standard of care, material conflicts of interest, right to receive policies and procedures regarding Impartial Conduct Standards, right to receive specific disclosure of costs, fees, and other compensation, as well as link to website with model contract disclosures and quarterly updates;
- Website disclosures;
- Limitations on disclaiming or limiting liability, as well as mandatory arbitration of class actions, or arbitration of claims in distant venues;
- Requirement to designate person responsible for addressing material conflicts of interest and monitoring compliance; and
- Recordkeeping obligations.

In its recent FAQ, the DOL said it intends to issue a Request for Information ("RFI") soon, seeking public input on specific ideas for possible new exemptions or regulatory changes based on public comments and market developments. It also indicated that it might delay BICE's remaining requirements beyond January 1, 2018. According to the DOL's FAQ, "The RFI will specifically ask for public comment on whether an additional delay in the January 1, 2018, applicability date would allow more effective retirement investor assistance and help avoid needless or excessive expense as firms build systems and compliance structures that may ultimately be unnecessary or mismatched with the Department's final decisions on the issues[.]"

What does this mean for those using BICE or BICE-Lite?

The final rule requires written disclosures and warranties to provide "enforceable rights and remedies [that give] Financial Institutions and Advisers a powerful incentive to comply with the exemption's standards, implement policies and procedures that are more than window-dressing, and carefully police conflicts of interest to ensure that the conflicts of interest do not taint the advice." As such, BICE initially required a written statement of fiduciary status before or at the same time as the execution of a recommended transaction during the transition period from June 9, 2017, until January 1, 2018.

However, under the transition rule, this statement will not be required during the transition period. Additionally, the more onerous contract amendments regarding fiduciary status and other BICE requirements will not be required until at least January 1, 2018.[6] Since the DOL allows fiduciaries to forgo these written statements and contract amendments during the transition period, recourse by non-ERISA accountholders may be limited.[7]

Despite the transition relief, DOL appears to expect some diligence to ensure compliance with the Impartial Conduct Standards. It noted, "many financial institutions already had completed or largely completed work to establish policies and procedures necessary to make the business structure and practice shifts required by the Impartial Conduct Standards".[8] This included, "drafting and implementing training for staff, drafting client correspondence and explanations of revised product and service offerings, negotiating changes to agreements with product manufacturers as part of their approach to compliance with the PTEs, changing employee and agent compensation structures, and designing conflict-free product offerings."

As a result, the DOL expects "compliance with the Impartial Conduct Standards between June 9, 2017 and January 1, 2018, will be substantial, even if there is some reduction in compliance relative to the baseline." However, the DOL "is uncertain about the magnitude of this reduction and will consider this line of questions as part of its review". The most recent DOL FAQ seems to provide some leeway, as they gave financial institutions the "flexibility to choose precisely how to safeguard compliance with the impartial conduct standards" during the transition period from June 9, 2017, to January 1, 2018. It expects financial institutions to adopt policies and procedures "as they reasonably conclude are necessary to ensure that advisers comply with the impartial conduct standards." Compliance efforts might include "tamping down on conflicts of interest associated with adviser compensation, increased monitoring and surveillance of investment recommendations, or other approaches or combinations of approaches."

The DOL's most recent FAQ also noted that warranties are not required regarding the adoption of specific best interest policies and procedures during the transition period. Without such warranties, it is less likely that HSA accountholders can bring contractual lawsuits against fiduciaries for violations of the fiduciary rule (although claims for violation of state fiduciary requirements remain possible).

What do the Impartial Conduct Standards require?

The Impartial Conduct Standards require that:

- Advice is in the Best Interest of the investor;
- No more than reasonable compensation will be received, directly or indirectly; and
- Statements about the transaction, fees, compensation, material conflicts of interest, and other relevant matters are not materially misleading when made.

Entities that are operating under other prohibited transaction exemptions (e.g., the 408(b)(2) exception for reasonable compensation for necessary services) must already comply with requirements similar to those regarding reasonable compensation and misleading statements. Thus, the DOL non-enforcement and IRS' excise tax relief do not apply to these existing requirements. So the real "teeth" of the new requirement likely come from the elevation of the status of many entities to that of a fiduciary and the

[6] Additionally, the DOL delayed all conditions other than the Impartial Conduct Standards for robo-advice providers who are level fee fiduciaries until January 1, 2018.
[7] Claims for breach of fiduciary duty under state law remain possible.
[8] 82 Fed. Reg. at 16909.

associated "best interest" standard that comes with it. These "best interest" requirements would apply after June 9th even though the numerous disclosure, procedure, and contractual requirements would not apply.

Do the Impartial Conduct Standards Apply to Proprietary Products during the Transition Period?

Yes. The DOL clarified that even if a fiduciary adviser recommends proprietary products or investments that generate commissions or other payments that vary with the investment recommended during the transition period from June 9, 2017, until January 1, 2018, the impartial conduct standard can be met by ensuring: (i) the recommendations are prudent; (ii) the investment advice is based on the customer's financial interest rather than the adviser's competing financial interest in the transaction; (iii) the communications do not have material misrepresentations; and (iv) the fees and charges are reasonable.[9] The DOL states that advisers should be candid about compensation and the limits on investments.

Are Developers of Model Portfolios Fiduciaries?

The DOL's FAQ clarifies that a registered investment adviser ("RIA") that develops a model for another party without individualizing it generally will not be a fiduciary because it is not making a recommendation to the plan, plan fiduciary, participant or beneficiary, IRA or IRA owner for a fee or other compensation.[10] Assuming the model developer does not control how the other party charges fees to end clients, the developer will not be a fiduciary even if the adviser pays the developer a fee out of its own general assets that is separately reimbursed by a plan, plan participant, or IRA. Thus, some developers of model portfolios for HSAs may not be considered fiduciaries beginning June 9, 2017. While this is good guidance for some advisers, it likely provides little protection for HSA custodians and trustees that offer investment options directly to accountholders.

Is the DOL considering additional exemptions?

Yes. The DOL is considering additional exemptions in response to market trends regarding the fiduciary rule. One of the new products on the market that the DOL wants to consider is "clean shares".[11] Clean shares sold by a broker would not include any form of distribution-related payments to the broker. Instead, the financial institution sets its own commission levels uniformly across different mutual funds that advisers may recommend, which would substantially insulate advisers from conflicts among different mutual funds. If the compensation is reasonable, the DOL says clean shares are "a potentially powerful means of reducing conflicts of interest with respect to mutual fund recommendations and correspondingly reducing the need for heightened surveillance around adviser conflicts of interest." The DOL expects it will take longer than January 1, 2018, to implement clean shares. Thus, it may grant additional time and create a new streamlined exemption for clean shares after reviewing the RFI comments.

How does the DOL intend to enforce the rule initially?

The DOL says it will focus on "compliance assistance, both in the period before January 1, 2018, and for some time after." Of course, participants can still sue for violations, and excise taxes might need to be paid unless the IRS' relief under DOL enforcement guidance applies.

Is the DOL Providing Any Other Assistance?

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[9] DOL Transition Period FAQ, Q/A-6.
[10] DOL Transition Period FAQ, Q/A-14.
[11] DOL Transition Period FAQ, Q/A-6.

Consistent with its emphasis on compliance assistance, the DOL stated that it "is broadly available to discuss compliance approaches and related issues with interested parties, and would invite interested parties to contact the Department if they have questions about planned compliance systems, policies and procedures, or other compliance-related issues."[12] Thus, the RFI will not be the only opportunity to bring issues and questions to the attention of the DOL. Entities might wish to bring their questions and concerns to the DOL sooner as part of their compliance strategy.

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[12] *Id.*

[13] https://www.irs.gov/pub/irs-wd/201703013.pdf

[14] John Hickman, Ashley Gillihan, Carolyn Smith, and Dan Taylor, "Whack-a-Mole – IRS Takes Aim at Latest Wellness Program Scheme, But Overly Broad Language Can Be Taken Too Far As Applied to Traditional Coverage," *The Self-Insurer* (March 2017)

[15] https://www.irs.gov/pub/irs-wd/201719025.pdf