How the New Fiduciary Rules Apply to HSA Service Providers and Employers

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Overview

On June 9, 2017, new Department of Labor ("DOL") regulations ("Fiduciary Rules") took effect which expand the categories of persons who may now be considered plan "fiduciaries" under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code ("Code").[1] The new Fiduciary Rules broaden the definition of plan "fiduciary" to include persons who provide investment advice to account holders of Individual Retirement Accounts and Health Savings Accounts ("HSAs"). As such, the new Fiduciary Rules have important implications for HSA service providers, including employers who act as HSA service providers.

The New Fiduciary Rules

Insofar as HSA service providers are considered "fiduciaries" under the new rules, they are required to act impartially and solely in the "best interest" of HSA account holders and beneficiaries. They are also subject to the prohibited transaction provisions of ERISA and the Code, which limits their ability to receive commissions, fees and other compensation from plans, account holders and beneficiaries. The new Fiduciary Rules provide for a private cause of action for a breach of the "best interest" standard of care and also provide that, in the absence of an applicable prohibited transaction exemption ("PTE"), illegal fee arrangements may subject fiduciaries to penalty excise taxes of as much as 15%-100% of the total monetary amount involved.

The ERISA and Code definitions of "fiduciary" include any person that provides "investment advice for a fee or other compensation, direct or indirect ...."[2] The new Fiduciary Rules provide that with respect to HSAs, a person is deemed to provide "investment advice" if he/she (i) receives compensation for the advice ("investment-related compensation"), (ii) makes investment "recommendations" to account holders **and** (iii) (a) represents or acknowledges that he/she is acting as a fiduciary, (b) renders the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the particular investment needs of the recipient or (c) directs the advice to a specific recipient regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the HSA.

Under the new Fiduciary Rules, investment-related compensation received by HSA service providers could include, among other things, income on HSA deposits, transaction-based fees, revenue sharing from HSA investments and interchange fees on HSA disbursements. On the other hand, level or flat fee arrangements

[1] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 29 CFR Parts 2509, 2510, and 2550, 81 Fed. Reg. 20945 (Apr. 8, 2016), *available at* https://webapps.dol.gov/federalregister/PdfDisplay.aspx?DocId=28806. *See also* 82 Fed. Reg. 16902 (April 7, 2017) (extending effective date of new Fiduciary Rules until June 9, 2017), *available at* https://www.federalregister.gov/documents/2017/04/07/2017-06914/definition-of-the-term-fiduciary-conflict-of-interest-rule-retirement-investment-advice-best.

[2] *See* ERISA §3(21)(A), *available at* https://legcounsel.house.gov/Comps/Employee%20Retirement%20Income%20Security%20Act%20Of%201974.pdf and Code §4975(e)(3), *available at* https://www.law.cornell.edu/uscode/text/26/4975.

with customers (*e.g.,* recordkeeping fees) that are not based on the sale of certain financial products would not constitute investment-related compensation under the new Fiduciary Rules.

The new Fiduciary Rules explain that whether a "recommendation" has been made is an objective, rather than a subjective, determination. The rules provide that a communication constitutes a "recommendation" if, based on content, context and presentation, a reasonable person would believe there was a suggestion made about engaging, or refraining from engaging, in a specific investment or investment strategy. Certain factors, if present, are more likely to make certain communications seem like "recommendations." For example, the new Fiduciary Rules provide that:

- The more individually tailored the communication is to its recipient, the more likely it is to be considered a recommendation;
- Giving account holders a menu of investment options deemed appropriate for the investor, even if no recommendation is made about any particular security, would be considered a recommendation;
- A series of actions that may not individually constitute a recommendation may amount to a recommendation when considered in the aggregate; and
- When considering whether something is a recommendation, it makes no difference whether the communication is initiated by a person or a computer.

On the other hand, the new Fiduciary Rules provide specific examples of communications that would not be deemed to be "recommendations." These include general investment educational information, plan information and general marketing materials that are not tailored to a specific investor.

The New Prohibited Transaction Exemptions ("PTEs")

The new Fiduciary Rules provide that HSA service providers must avoid receipt of payments that create a conflict of interest unless they can comply with the terms of an approved PTE. In conjunction with the new Fiduciary Rules, the DOL issued two new PTEs and amended several existing PTEs to enable investment service providers to continue receiving common forms of compensation that would otherwise be prohibited under the new Fiduciary Rules and trigger the penalty excise tax. The new PTEs include:

- Best Interest Contract Exemption. This PTE allows HSA service providers who hold, manage or control assets of less than $50 million to receive investment-related compensation if they acknowledge their fiduciary status, provide advice that is in the "best interest" of the account holder and disclose any conflicts of interest and the cost of the advice. In addition, the compensation received must be considered "reasonable" under ERISA. Investment advisors are also precluded from making any statements that are materially misleading.
- Principal Transactions Exemption. This PTE allows certain securities transactions between an HSA account holder and HSA investment advisor, so long as the investment advisor acknowledges

fiduciary status, adheres to the "best interest" standard in rendering advice, discloses material conflicts of interest and receives consent from the account holder.

The PTEs that were amended by the DOL in conjunction with the issuance of the new Fiduciary Rules include:

- PTE 84-24 (pertaining to the use of plan assets to purchase investments and pay advisory fees);
- PTE 86-128 (pertaining to fiduciaries executing investment transactions on behalf of the plan);
- PTE 75-1 (pertaining to securities transactions by parties in interest other than the fiduciary);
- PTE 77-4 (pertaining to the purchase or sale of mutual fund shares by the plan fiduciary);
- PTE 80-83 (pertaining to a fiduciary causing a plan to purchase securities in a public offering when the proceeds will be used to reduce the indebtedness to another party in interest); and
- PTE 83-1 (pertaining to the sale of certificates by the sponsor of a mortgage pool to the plan).

While the new Fiduciary Rules took effect on June 9, 2017, the requirements necessary to comply with certain PTEs are being phased in through January 1, 2018.[3] Consequently, during the transition period, fewer conditions apply to HSA service providers seeking to rely on these PTEs.[4]

Absent further action from the DOL, however, on January 1, 2018, full compliance with all relevant PTE conditions will be required for HSA service providers to avoid engaging in transactions that would otherwise be prohibited under ERISA and the Code. Among other things, these conditions will include: executing a contract containing certain enforceable promises with HSA investors, making specified disclosures and implementing certain specified policies and procedures to protect HSA investors from advice that is not in their best interest.

How the New Fiduciary Rules Apply to Employers

Employers who merely make available to their employees the option to contribute pre-tax salary reductions to an HSA through a cafeteria plan will generally not face any increased risk or liability as a result of the new Fiduciary Rules. However, employers who act like HSA service providers and give investment recommendations or advice or who receive a monetary benefit if employees elect certain investment options would be impacted by the new Fiduciary Rules. For example, an employer who creates and manages a custom HSA investment option for its employees could be subject to the new Fiduciary Rules if a reasonable employee would construe this as a "recommendation."

In addition, employers who take a more active role with regard to influencing employees' HSA investment decisions run the risk that their actions may convert the employees' HSAs into ERISA plans. DOL guidance provides that so long as employer involvement is limited to activities such as including an HSA as part of a cafeteria plan, making contributions to employees' HSAs, paying HSA fees and choosing an HSA vendor,

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[3] *See* DOL Field Assistance Bulletin No. 2017-02, *available at* https://www.dol.gov/sites/default/files/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2017-02.pdf.

[4] *See* DOL Conflict of Interest FAQs (Transition period) (May 2017), *available at* https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-transition-period.pdf.

HSAs are not subject to ERISA. However, if an employer represents to its employees that their HSAs are an employer-sponsored plan, receives payment or compensation in connection with an HSA or related investments or attempts to make or influence employees' HSA investments, these actions could trigger the application of ERISA. For example, ERISA, along with its attendant obligations and requirements, may be triggered in circumstances where an employer attempts to influence the scope of investments offered to its employees by requiring an HSA trustee or custodian to offer investments to the employees that the HSA trustee or custodian typically would not offer to other account holders.[5]

If ERISA were to be deemed to apply to employees' HSAs, the employer would be required to comply with ERISA's plan document requirements, Form 5500 reporting and participant disclosure obligations, HIPAA portability, privacy and security requirements and COBRA continuation requirements, among others. In the case of COBRA continuation, an employer might, for example, be required to continue providing qualified beneficiaries with the same HSA contributions that the employer provides to active employees for the maximum COBRA period.

Further, it is important to note that both ERISA and the Code define a plan "fiduciary" not only as someone who provides "investment advice for a fee or other compensation," but also as someone "[who] exercises any discretionary authority or discretionary control respecting management of such plan or … its assets … [or who] has any discretionary authority or discretionary responsibility in the administration of such plan."[6] These provisions may make it more likely that an employer that creates and manages a custom HSA investment option for its employees could be deemed to be a "fiduciary" with respect to its employees' HSAs, particularly in light of the expansion of the types of plans and investors deemed worthy of protection under the new Fiduciary Rules.

Conclusion

Employers wanting to do more than merely sponsor a cafeteria plan through which pre-tax HSA contributions can be taken from payroll should consult their legal counsel to discern whether their intended actions could convert them into a plan fiduciary, and if so, how to comply with all applicable rules and regulations, including the new Fiduciary Rules.

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[5] *See* DOL Field Assistance Bulletin 2004-1, *available at* https://www.dol.gov/ebsa/regs/fab_2004-1.html and DOL Field Assistance Bulletin 2006-02, *available at* https://www.dol.gov/ebsa/regs/fab_2006-2.html.

[6] *See* ERISA §3(21)(A), *available at* https://legcounsel.house.gov/Comps/Employee%20Retirement%20Income%20Security%20Act%20Of%201974.pdf and Code §4975(e)(3), *available at* https://www.law.cornell.edu/uscode/text/26/4975.

