Fact Sheet: Improving Investment Advice for Workers & Retirees

Overview

On June 29, 2020, the U.S. Department of Labor announced the following actions regarding the regulation of investment advice under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (the Code):

- The Department proposed a new prohibited transaction class exemption that would be available for investment advice fiduciaries and has submitted it to the Federal Register for publication.

- The Department has submitted a technical amendment to conform the text of the Code of Federal Regulations to a 2018 decision by the U.S. Court of Appeals for the 5th Circuit. That decision vacated the Department's 2016 fiduciary rule and the exemptions that accompanied the rule, which had the effect of reinstating the previous regulatory text, including the 1975 regulation and its five-part test for defining an investment-advice fiduciary as well as Interpretive Bulletin 96-1 regarding participant investment education.

- The Department has updated its website to reflect changes to its pre-existing prohibited transaction class exemptions to reflect the court's vacatur of the 2016 rulemaking.

    - Two class exemptions that were newly granted in 2016 —the Best Interest Contract Exemption and the Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs—are removed.

    - Pre-existing class exemptions that were amended in 2016 have reverted to their pre-amendment form. This includes Prohibited Transaction Exemptions (PTEs) 75-1, 77-4, 80-83, 83-1, 84-24 and 86-128.

Five-Part Test for Status as an Investment Advice Fiduciary

- ERISA and the Code provide that a person is an investment advice fiduciary to the extent he or she renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so.

- Under the Department's five-part test, for advice to constitute "investment advice," a financial institution or investment professional who is not a fiduciary under another provision of the statute must—

    1) Render advice to the plan as to the value of securities or other property, or make 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 agreement, arrangement, or understanding with the plan, plan fiduciary or IRA owner, that

4) The advice will serve as a primary basis for investment decisions with respect to plan or IRA assets, and that

5) The advice will be individualized based on the particular needs of the plan or IRA.

- A financial institution or investment professional that meets this five-part test, and receives a fee or other compensation, direct or indirect, is an investment advice fiduciary under ERISA and under the Code.
    - Title I of ERISA imposes fiduciary duties on fiduciaries with respect to employee benefit plans.
    - Title I of ERISA and the Code each contain provisions forbidding fiduciaries from engaging in certain specified "prohibited transactions" involving plans and IRAs, including conflict of interest transactions, unless an exemption applies.

Improving Investment Advice for Workers & Retirees - Fiduciary Investment Advice Concerning Rollovers from Employee Benefit Plans to IRAs

- In the proposed exemption's preamble, the Department provides important information on its views regarding rollovers from employee benefit plans to IRAs. As amounts accrued in an employee benefit plan can represent a lifetime of savings, and often comprise the largest sum of money a worker has at retirement, the decision to roll over plan assets to an IRA is potentially a very consequential financial decision.
- The Department believes that advice to take a distribution of assets from an employee benefit plan is advice to sell, withdraw, or transfer investment assets currently held in the plan, and therefore may be covered by the five-part test.
    - The Department does not intend to apply analysis to the contrary that was set forth in Advisory Opinion 2005-23A (the Deseret Letter).
- All prongs of the five-part test must be satisfied for a financial institution or investment professional to be an investment advice fiduciary when making a rollover recommendation. Status as an investment advice fiduciary will be informed by all the surrounding facts and circumstances.
    - Advice to take a distribution from an employee benefit plan and roll over the assets to an IRA may be an isolated and independent transaction that would fail to meet the regular-basis prong of the five-part test.
    - On the other hand, advice to roll over employee benefit plan assets can occur as part of an ongoing relationship or an anticipated ongoing relationship that an individual enjoys with his or her advice provider.

- The determination of whether there is a mutual agreement, arrangement, or understanding that the investment advice will serve as a primary basis for investment decisions is appropriately based on the *reasonable* understanding of each of the parties, if no mutual agreement or arrangement is demonstrated.

  - Written statements disclaiming a mutual understanding or forbidding reliance on the advice as a primary basis for investment decisions are not determinative, although such statements may be considered to determine whether a mutual understanding exists.

- Investment advice fiduciaries who recommend a rollover from an employee benefit plan are subject to the fiduciary duties imposed by Title I of ERISA as well as the prohibited transactions provisions in Title I of ERISA and the Code.

Proposed Class Exemption

- The prohibited transaction provisions in Title I of ERISA and the Code prohibit investment advice fiduciaries from self-dealing—i.e., causing themselves or their affiliates or related entities to receive additional compensation from transactions involving plans and IRAs—unless an exemption applies.

- The new proposed class exemption would be available to registered investment advisers, broker-dealers, insurance companies, banks, and individual investment professionals who are their employees or agents.

- The new proposed class exemption would permit investment advice fiduciaries to receive compensation as a result of providing fiduciary investment advice, including fiduciary investment advice to roll over a participant's account in an employee benefit plan to an IRA and other similar types of rollover recommendations (e.g., IRA to IRA).

- The new proposed class exemption would also permit investment advice fiduciaries to enter into "principal transactions" in which they could sell or purchase certain securities and other investments from their own inventories to or from plans and IRAs.

Protective Conditions of the Proposed Class Exemption

- The new proposed class exemption would require fiduciary investment advice to be provided in accordance with the following "Impartial Conduct Standards:" a best interest standard; a reasonable compensation standard; and a requirement to make no materially misleading statements about recommended investment transactions and other relevant matters.

- The new proposed class exemption also would include other protective conditions requiring disclosure to retirement investors, conflict mitigation, and a retrospective compliance review.

- Investment advice fiduciaries could lose access to the class exemption for a period of 10 years for certain criminal convictions in connection with the provision of investment advice to retirement investors or for egregious conduct with respect to compliance with the class exemption.

Best Interest Standard

- Investment advice fiduciaries relying on the class exemption would have to provide advice in the best interest of retirement investors.

- The best interest standard is satisfied if the advice is:

    - *Prudent*: the advice reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor, and

    - *Loyal*: the advice does not place the financial or other interests of the investment professional, financial institution or any affiliate, related entity, or other party ahead of the interests of the retirement investor, or subordinate the retirement investor's interests to their own.

- The best interest standard in the new proposed class exemption is aligned with the conduct standards in the Securities and Exchange Commission's Regulation Best Interest and the fiduciary duty of registered investment advisers under securities laws.

- Under the class exemption, financial institutions would be required to document the specific reasons that recommendations to roll over employee benefit plan assets from a plan to an IRA, or from one type of account to another, are in the best interest of the retirement investor.

Disclosure

- The new proposed class exemption would require financial institutions to disclose to retirement investors their status as investment advice fiduciaries under ERISA and the Code, as applicable, and provide an accurate written description of their services and material conflicts of interest.

- This disclosure is intended to ensure that the fiduciary nature of the relationship is clear to all parties. The Department does not intend the fiduciary acknowledgment or any of the disclosure obligations to create a private right of action as between a financial institution or investment professional and a retirement investor and it does not believe the exemption would do so.

Policies and Procedures Requiring Mitigation of Conflicts of Interest

- The new proposed class exemption would require financial institutions to establish, maintain, and enforce policies and procedures prudently designed to ensure that they and their investment professionals comply with the Impartial Conduct Standards in connection with covered fiduciary investment advice.

- The financial institution's policies and procedures would be required to mitigate conflicts of interest to the extent that the policies and procedures, and the financial institution's incentive practices, when viewed as a whole, are prudently designed to avoid misalignment of the interests of the financial institution and investment professional with the interests of retirement investors.

Retrospective Compliance Review

- Financial institutions would be required to conduct an annual review that is reasonably designed to assist them in detecting and preventing violations of, and achieving compliance with, the Impartial Conduct Standards and the policies and procedures governing compliance with the class exemption.

Eligibility

- Financial institutions and individual investment professionals could lose access to the class exemption for a period of 10 years for certain criminal convictions in connection with the provision of investment advice to retirement investors or for egregious conduct with respect to compliance with the class exemption. Ineligible financial institutions and investment professionals could rely on existing statutory exemptions or seek an individual prohibited transaction exemption from the Department.

- The Department would provide financial institutions with the opportunity to be heard before they became ineligible.

- Financial institutions would have a one-year winding-down period to avoid disruptive transitions.

Robo-advice Arrangements

- Robo-advice is a term sometimes used to describe automated investment advice that involves computer models that utilize portfolio management algorithms.

- The new proposed class exemption would not cover advice arrangements that rely *only* upon robo-advice. Thus, an advice arrangement that uses robo-advice without interaction with an investment professional would not be covered. These advice arrangements are covered by the statutory exemption in ERISA sections 408(b)(14) and 408(g) and Code sections 4975(d)(17) and 4975(f)(8) and the accompanying regulations.

- The new proposed class exemption would cover "hybrid" robo-advice arrangements which involve advice that is generated by computer models in connection with additional interaction from an investment professional.

Benefits for Retirement Investors from the Proposed Class Exemption

- The new proposed class exemption is designed to promote fiduciary investment advice that meets the best interest standard and other Impartial Conduct Standards.

- The Department believes the approach taken in the new proposed class exemption will preserve wide availability of investment advice arrangements and products for retirement investors.

Flexibility for Investment Advice Fiduciaries

- The new proposed class exemption would provide relief that is broader and more flexible than the Department's pre-existing prohibited transaction class exemptions for investment advice fiduciaries, which generally provide relief for more discrete transactions.

- The best interest standard in the new proposed class exemption is aligned with the conduct standards in the Securities and Exchange Commission's Regulation Best Interest and the fiduciary duty of registered investment advisers under securities laws.

- The new proposed class exemption would be available to insurance companies that sell insurance products and fixed (including indexed) annuities through their employees as well as independent agents.

- The Department's pre-existing prohibited transaction class exemptions remain available in their pre-amendment form.

    - This includes PTE 84-24, a pre-existing class exemption that includes relief for insurance companies and insurance agents.

History of the Department of Labor's Regulation of Fiduciary Investment Advice

- In 1975, the Department issued a regulation establishing a five-part test for fiduciary status under ERISA. The five-part test also applies to the definition of fiduciary in the Code, which is identical in its wording.

- On April 8, 2016, the Department replaced the five-part test with a revised fiduciary regulation. It also granted two new prohibited transaction class exemptions—the Best Interest Contract Exemption and the Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs—and amended several pre-existing prohibited transaction class exemptions.

- On March 15, 2018, the U.S. Court of Appeals for the Fifth Circuit issued an opinion (followed by its mandate on June 21, 2018) vacating the 2016 rulemaking *in toto*.

- In connection with the court's opinion, on May 7, 2018, the Department issued a temporary enforcement policy for investment advice fiduciaries, announced in Field Assistance Bulletin (FAB) 2018-02.

- The Department stated that until after regulations or exemptions or other administrative guidance has been issued, it would not pursue prohibited transactions claims against investment advice fiduciaries who worked diligently and in good faith to comply with Impartial Conduct Standards for transactions that would have been exempted under the new exemptions, or treat the fiduciaries as violating the applicable prohibited transaction rules.

- The new proposed class exemption is based on the temporary enforcement policy announced in FAB 2018-02. Financial institutions that created and implemented compliance structures designed to ensure satisfaction of the Impartial Conduct Standards would be able to continue those approaches under the new exemption, if it is granted.

Next Steps

- The Department requests comments on the new proposed class exemption within 30 days of the date of publication in the Federal Register. Comments may be submitted at www.regulations.gov at Docket ID number: EBSA-2020-0003. Comments received will be included in the public record and will be made available online at www.regulations.gov and https://www.dol.gov/agencies/ebsa.

- The temporary enforcement policy announced in FAB 2018-02 remains in place.