May 22, 2024

DOL Releases Final Investment Advice Fiduciary Rule

The Department of Labor (DOL) recently released a regulatory package that includes a final amendment (the Retirement Security Rule) to the regulations that define what constitutes an investment advice fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA) Title I and Title II (codified in the Internal Revenue Code). The DOL also released final amendments to several prohibited transaction exemptions (PTEs) available to investment advice fiduciaries, including PTE 2020-02, *Improving Investment Advice for Workers & Retirees*; PTE 84-24, *Class Exemption for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, Investment Companies, and Investment Company Principal Underwriters*; and PTE 75-1; PTE 77-4; PTE 80-83; PTE 83-1; and PTE 86-128 (collectively, the Mass Amendment).

Background

Over the past fifty years, the retirement industry has witnessed a shift in control over retirement investing to individuals who lack professional expertise. This trend not only shifts the responsibility to individuals to make investment decisions for their retirement assets, but also transfers the investment risk associated with those decisions. While other regulatory agencies, such as the Securities and Exchange Commission (SEC) and the National Association of Insurance Commissioners, have imposed enhanced standards on the conduct of financial professionals who make investment recommendations (i.e., broker-dealers and insurance agents), the DOL's previous efforts to update these regulations have been challenged.

The final rule is intended to create a fiduciary standard that applies uniformly to all investments that individual retirement investors may make with respect to their retirement accounts. On October 31, 2023, the DOL released a proposed regulatory package in an attempt to align the standard of conduct for investment advice fiduciaries with the conduct prescribed by other regulatory agencies. The DOL invited public comment on the proposed regulations and also received testimony from interested parties during public hearings. In response to this feedback, the DOL has narrowed the contexts in which an investment recommendation will be considered fiduciary investment advice under ERISA Section (ERISA Sec.) 3(21)(A)(ii) with respect to an employee benefit plan. The final rule also amends the parallel definition of a fiduciary under Internal Revenue Code Section (IRC Sec.) 4975(e)(3)(B), that applies to 401(a) and 403(b) plans, individual retirement arrangements (IRAs), including SEP and SIMPLE IRAs, health savings accounts (HSAs), Archer medical savings accounts (MSAs), and Coverdell education savings accounts (ESAs).

Definition of Investment Advice Fiduciary

The current regulations provide a five-part test, which defines whether an individual is considered a fiduciary for investment advice purposes. The DOL identified several aspects of the five-part test that it believes are inconsistent with "the reasonable expectations of retirement investors" who may genuinely believe they are receiving fiduciary advice when in fact they are not. To address these and other issues, the final rule replaces the five-part test with a new definition of an investment advice fiduciary. Under the final rule, individuals are investment advice fiduciaries if they

- meet one of the following two criteria:
    - directly or indirectly make professional investment recommendations to investors on a regular basis as part of their business; and the recommendation is made under circumstances that would indicate to a reasonable investor in like circumstances that the recommendation
        - is based on review of the retirement investor's particular needs or individual circumstances,
        - reflects the application of professional or expert judgment to the retirement investor's particular needs or individual circumstances, and
        - may be relied upon by the retirement investor as intended to advance the retirement investor's best interest; or
    - represent or acknowledge that they are acting as a fiduciary under Title I or Title II of ERISA, or both, with respect to the recommendation; and
- make a recommendation regarding any securities or other investment transaction, or any investment strategy involving securities or other investment property to a "retirement investor"; and
- receive a fee or other compensation, direct or indirect in connection with the recommendation.

The final rule adopts a functional test; in other words, an individual is a fiduciary to the extent that she meets the requirements detailed in the final rule related to a specific investment advice transaction. Written disclaimers cannot be used to avoid fiduciary status if a recommendation meets the definition of an investment advice fiduciary as provided by the final rule. Unlike the 1975 regulation, the final rule does not require that advice be provided on a "regular basis," but will cover one-time advice, including advice related to a rollover.

- **Guidance Regarding Covered Recommendations.** The DOL declined to define the term "recommendation" in the final rule. Instead, the DOL explains that what constitutes a recommendation is an objective facts and circumstances inquiry that hinges on whether any communication to a retirement investor could be reasonably viewed as a "call to action," consistent with the SEC's Regulation Best Interest. A communication that is "individually tailored" is more likely to be considered a recommendation; such as when a platform provider furnishes a list of securities to an individual retirement investor as appropriate for that specific investor.

  A recommendation to take a distribution is considered a "recommendation of any securities transaction or other investment transaction or any investment strategy involving securities or other investment property" even if the retirement investor is not changing investments. And the DOL continues to believe that recommendations of how plan or IRA assets should be invested *after* they are rolled over, transferred, or distributed often involve an "implicit rollover recommendation."
- **Excluded From Consideration as a Covered Recommendation.** The final rule confirms that mere sales recommendations, as well as investment information and education, that do not meet the specific requirements for fiduciary advice will not result in ERISA fiduciary status (e.g., notifying an investor about the need to withdraw a required minimum distribution or reviewing the advantages and disadvantages of a loan or hardship withdrawal). But, if a sales communication crosses the line into making a recommendation about the investment or management of plan or IRA assets (including whether to roll over assets to another retirement plan or IRA), that recommendation will need to be evaluated separately under the provisions of the final rule. Whether information crosses the line between mere investment education and a recommendation held to a fiduciary standard will depend on whether a retirement investor is guided toward a particular course of action.

  The DOL declined to provide a blanket exclusion for call center activity or a specific carveout for responses to a request for proposal (RFP). Platform providers, including HSA providers, will not be considered to make a recommendation under the final rule if they assist with the selection and monitoring of investment alternatives using solely objective third-party criteria provided by the investor.
- **Representing or Acknowledging Fiduciary Status.** Individuals may represent or acknowledge that they are acting as a fiduciary under Title I or Title II of ERISA, or both, either orally or in writing. Once acknowledged, they will not be able to subsequently deny their fiduciary status in the event of a dispute. The final rule clarifies that fiduciary status does not attach to every future interaction: it applies only with respect to a specific recommendation.
- **Definition of "For a Fee or Other Compensation, Direct or Indirect".** This definition encompasses a variety of compensation types that are incident to an investment transaction, including commissions, revenue sharing payments, and gifts. There must be a link between the compensation and the professional recommendation; meaning that the compensation would not have been paid but for the recommended transaction or the

provision of investment advice—or eligibility for or the amount of the compensation is based in whole or part on the recommended transaction or the provision of investment advice.

- **Definition of Retirement Investor.** "Retirement investor" is defined as a plan, plan participant or beneficiary, IRA, IRA owner or beneficiary, or certain plan or IRA fiduciaries. The final rule excludes plan and IRA investment advice fiduciaries under ERISA Sec. 3(21)(A)(ii) and IRC Sec. 4975(e)(3)(B) from this definition to clarify that the rule is focused on communications with individuals who have authority over plan investment decisions. Accordingly, an individual does not render fiduciary advice when communicating to plan or IRA fiduciaries acting as investment advice fiduciaries. The final rule does not include any special provision for recommendations to sophisticated advice recipients. This same definition of retirement investor is also used in the final amendments to PTE 2020-02 and PTE 84-24.

Amendment to PTE 2020-02

The DOL has also finalized an amendment to PTE 2020-02 that includes some changes from the proposed rule that address how fiduciaries manage conflicts of interest with respect to providing fiduciary investment advice. First, the final amendment expands the scope of PTE 2020-02 so that it is available for all types of investment product recommendations (including insurance and annuity products) by all fiduciary investment providers. The final amendment also provides exemptive relief for *all* transactions, regardless of whether they are executed on a principal or agent basis.

- **Parties Eligible for Relief.** The final exemption is broadly available for financial institutions and investment professionals as well as their affiliates and related entities, including (but not limited to)
    - independent marketing organizations (IMOs), field marketing organizations (FMOs), brokerage general agencies (BGAs) and others providing administrative support;
    - pooled plan providers (PPPs), when selected by an independent fiduciary;
    - financial institutions providing fiduciary investment advice through computer models (i.e., robo-advice);
    - independent producers of insurance products; and
    - non-bank trustees/custodians with respect to HSAs.

  In response to comments, the DOL included a special provision for financial institutions and investment professionals that respond to an RFP to provide ongoing services as a fiduciary under ERISA Sec. 3(38) and are subsequently hired. Financial institutions and investment professionals may receive compensation under PTE 2020-02 for the provision of investment advice in the hiring process as long as they comply solely with the Impartial Conduct Standards (including the Care Obligation and Loyalty Obligation requirements, referenced below).
- **Impartial Conduct Standards.** The DOL retained the requirement for financial institutions and investment professionals to act in a retirement investor's best interest; however, chose to replace the term 'best interest' with two separate components—the Care Obligation and the Loyalty Obligation. While the terms have changed, the requirements remain the same. The DOL also added an example to the final amendment specifying that an investment professional may not recommend a product that is inconsistent with a retirement investor's particular needs or individual circumstance simply because it is better for the investment professional or financial institution's bottom line.

  The final amendment incorporates existing conditions, and adds new conditions as well as clarifying changes. Specifically, the final amendment requires that financial institutions and their investment professionals meet the following conditions.
    - Comply with the Impartial Conduct standards.
    - Acknowledge their fiduciary status in writing with respect to the recommendation.
    - Provide a written statement of the Care Obligation and Loyalty Obligation owed.
    - Disclose all material facts related to the scope and terms of the relationship with the investor (including services and fees) and all material facts related to conflicts of interest associated with the recommendation.
    - Consider, document, and disclose the bases for any rollover recommendations from plans governed by Title I of ERISA, or recommendations as to the post-rollover investment of assets held in plans governed by Title I of ERISA (the final amendment to PTE 2020-02 does not require disclosures on rollovers from IRA-to-IRA or rollovers from one account type to another).

- Adopt, maintain, and enforce written policies and procedures to ensure compliance with the exemption's conditions.
- Provide complete policies and procedures to the DOL upon request within 30 business days of the request.
- Conduct an annual retrospective compliance review.
- Report any nonexempt prohibited transactions associated with fiduciary investment advice by filing Form 5330, *Return of Excise Taxes Related to Employee Benefit Plans* and pay any applicable excise taxes owed.

The DOL modified the language regarding the timing of disclosures required to be provided by the financial institution to the retirement investor. Under the final amendment, the disclosures must be provided "at or before the time a covered transaction occurs" which is defined as the later of

- the date the recommendation is made, or
- the date the financial institution or investment professional becomes entitled to compensation (whether now or in the future) by reason of making the recommendation.

This requirement applies to the fiduciary acknowledgement, written statement of the Care Obligation and Loyalty Obligation owed, the disclosure of all material facts relating to the scope and terms of the relationship with the retirement investor, and the disclosure of all material facts relating to conflicts of interest. The rollover disclosure must be provided before engaging in or recommending that a retirement investor engage in a rollover from a plan covered by Title I of ERISA, or making a recommendation to a plan participant or beneficiary as to the post-rollover investment of assets currently held in a plan that is covered by Title I of ERISA.

The final amendment is applicable for transactions pursuant to investment advice provided on or after September 23, 2024. The prior version of PTE 2020-02 will remain available for all parties engaged in transactions resulting from investment advice recommendations that were provided before the final amendment's applicability date. In addition, the final amendment will not apply to compensation received if the recommendation was made or a systematic purchase program was established before the final amendment's applicability date, unless and until new investment advice is provided.

- **Phase-in Period.** The DOL added a new section to the final amendment that provides a one-year phase-in period beginning on September 23, 2024. This will permit financial institutions and investment professionals, during this phase-in period, to receive reasonable compensation under the final amended exemption if they comply with the Impartial Conduct Standards and the fiduciary acknowledgement required under the exemption.

Amendment to PTE 84-24

Currently, PTE 84-24 permits certain insurance agents or brokers, pension consultants, and principal underwriters to receive compensation from the sale of insurance or annuity contracts or investment company securities to plans and IRAs. The final amendment will exclude investment advice fiduciaries from relief for the transactions described under the existing sections of PTE 84-24 and add a new section providing relief to a select group of investment advice fiduciaries that are independent insurance agents (i.e., independent producers). The new section of PTE 84-24 will be available only for investment advice provided to a retirement investor by an independent insurance agent who

- sells products of multiple insurance companies to retirement investors;
- sells non-security annuities or other insurance products not regulated by the SEC, including as part of a rollover;
- is not an employee of an insurance company or is a statutory employee of an insurance company with no financial interest in the transaction in question, and
- complies with conditions similar to PTE 2020-02, with certain changes tailored to the unique conflicts of interest that arise when independent insurance agents provide advice regarding the purchase of an annuity.

PTE 84-24 imposes certain requirements on the insurer, although if an insurer is a fiduciary it would need to rely on another PTE for relief. PTE 2020-02 is generally available for financial institutions and investment professionals that engage in all other investment advice transactions, including insurance companies that are investment advice fiduciaries.

The final amendment expands availability of PTE 84-24 to cover the receipt of reasonable compensation, rather than limiting it to insurance sales commissions as was proposed.

The final amendment will apply to transactions pursuant to investment advice provided on or after September 23, 2024. The prior version of PTE 84-24 will remain available for investment advice transactions engaged in before the final amendment's applicability date. The final amendment will not apply to financial institutions or investment advisors that receive ongoing compensation that was based on a recommendation made before September 23, 2024.

- **Phase-in Period.** The DOL added a new section to the final amendment that provides a one-year phase-in period beginning on September 23, 2024. This will permit independent producers to receive compensation under the final amended exemption during the phase-in period if they comply with the Impartial Conduct Standards and the fiduciary acknowledgement required under the exemption.

The Mass Amendment

The DOL also finalized amendments to several other prohibited transaction exemptions that provide relief for investment advice fiduciaries that enter into specific transactions. Primarily, the finalized amendments remove fiduciary investment advice from the list of covered transactions. As a result, investment advice fiduciaries would be required to rely on PTE 2020-02 (or PTE 84-24, if applicable) to receive otherwise prohibited compensation.

Next Steps

The regulatory package is effective September 23, 2024. One lawsuit has already been filed challenging the validity of the final rule and amended PTEs at the time of this article's publication. Given the substantial similarities in this regulatory package as compared to what was released in 2016, it appears that additional legal challenges are likely. In addition, a joint resolution of congressional disapproval of the final rule was introduced on May 15, 2024. If the resolution passes both chambers of Congress, it will also need to be signed by the president to invalidate the rule. Visit ascensus.com for the latest developments on this contested regulation.

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