Proskauer

New DOL Fiduciary Rule Package: What You Really Need to Know

Employee Benefits & Executive Compensation Blog on **July 13, 2020**

The U.S. Department of Labor's (the "DOL") new "fiduciary rule" package, issued on June 29, 2020, and published in the Federal Register on July 7, 2020, has three important components:

1. The DOL has formally reinstated its "five-part test" initially set forth in its 1975 regulation for determining whether a person is a "fiduciary" by reason of providing "investment advice" for a fee. This reinstatement is effective immediately, and generally reflects the status quo after the Obama administration's 2016 fiduciary rule was vacated by the Fifth Circuit in 2018.
2. The DOL has provided commentary on its interpretation of the "five-part test". Most notably, the DOL states that advice on whether to take a distribution from a retirement plan and roll it over to an IRA could be considered fiduciary "investment advice" after considering the facts and circumstances surrounding the advice. In describing this interpretation, the DOL stated that it will no longer follow its "incorrect" contrary analysis set forth in Advisory Opinion 2005-23A (the "Deseret Letter").
3. The DOL has proposed a new prohibited transaction exemption (the "Proposed Exemption") that would give "investment advice" fiduciaries more flexibility to provide advice (including with respect to IRA rollovers) that affects their compensation. The Proposed Exemption would also permit "investment advice" fiduciaries to enter into and receive compensation from "riskless" and certain other "principal transactions" where the fiduciary is purchasing a security for its own account or selling a security from its own inventory. **Comments on this proposal are due by August 6, 2020.** If granted, the Proposed Exemption would become effective 60 days after the final exemption is published in the *Federal Register*.

Below we describe in more detail the rules for determining whether a person is a "fiduciary" (including by way of providing "investment advice" under the "five-part test"), the DOL's views on the "five-part test" and rollover advice, the consequences of being a "fiduciary", and the Proposed Exemption.

Who is a Fiduciary? The "Five-Part Test"

Under each of Section 3(21) of the U.S. Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and Section 4975(e)(3) of the U.S. Internal Revenue Code of 1986, as amended (the "Code"), there are three ways for a person to be considered a "fiduciary" with respect to a retirement plan or IRA:

1. The person exercises any discretionary authority or control respecting management of the plan or IRA or with respect to the management or disposition of its assets;
2. The person renders "***investment advice***" for a fee or other compensation, direct or indirect, or has any authority or responsibility to do so; or
3. The person has any discretionary authority or responsibility in the administration of the plan or IRA.

The "fiduciary rule" package (like the Obama administration's vacated rule) relates only to the second prong – rendering "investment advice" for a fee. The guidance has no bearing on becoming a fiduciary by reason of having discretionary authority or responsibility over the management, administration, or investment of the assets of a plan or IRA.

Under the “five-part test”, a person is considered to be providing “investment advice” only if the person: (i) renders advice as to the value of securities or other property, or makes recommendations as to investing in, purchasing or selling securities or other property, (ii) on a regular basis, (iii) pursuant to a mutual agreement, arrangement, or understanding with the plan, the plan fiduciary or IRA owner that, (iv) the advice will serve as a primary basis for investment decisions with respect to plan or IRA assets, and (v) the advice will be individualized based on the particular needs of the plan or IRA. A person who meets all five prongs of the test ***and*** receives direct or indirect compensation will be considered an “investment advice” fiduciary with respect to the applicable plan or IRA.

On April 8, 2016, the DOL replaced the “five-part test” with a new fiduciary regulation that significantly expanded the scope of “investment advice.” However, that rule was vacated by the U.S. Court of Appeals for the Fifth Circuit on March 15, 2018. Following that decision, on May 7, 2018, the DOL issued Field Assistance Bulletin 2018-02 (“FAB 2018-02”), which provided (among other things) that the DOL would not enforce the 2016 fiduciary rule and instead would go back to the “five-part test.” The latest regulation implements that decision.

DOL’s Commentary on the Five-Part Test

Historically, service providers have often taken the position that advice on whether to leave money in a plan or to roll over to an IRA was not provided on a “regular basis” and/or was not provided pursuant to a “mutual” agreement, arrangement or understanding that the advice would serve as a “primary basis” for the decision. Further, in the Deseret Letter, the DOL suggested that advice to roll assets out of a plan to an IRA did not constitute “investment advice,” because it was not advice with respect to moneys or property of a plan.

In the commentary to the Proposed Exemption, the DOL disclaimed its guidance in the Deseret Letter as an “incorrect analysis.” The DOL now says that the “better view” is that IRA rollover advice is a recommendation to liquidate or transfer the plan’s property to effectuate the rollover. This means that advice on whether to take a distribution from a retirement plan and roll it over to an IRA (or to roll over from one plan to another plan, or one IRA to another IRA) may be covered by the “five-part test,” if the advice is either part of an ongoing relationship or the start of an ongoing relationship.

In this regard, the DOL notably stated the following:

- The full “five-part test” applies for determining whether a service provider is an “investment advice” fiduciary. Whether or not the prongs of the test are satisfied “will be informed by all the surrounding facts and circumstances”;
- IRA rollover advice may be an isolated and independent transaction that would fail to meet the “regular basis” prong, but the analysis will depend on the surrounding facts and circumstances:
  - In circumstances where an advice provider has been giving financial advice to an individual about investing in, purchasing, or selling securities or other financial instruments, any rollover advice provided to the individual would be considered part of an ongoing advice relationship that would satisfy the “regular basis” requirement;
  - Similarly, where a rollover advice provider will be regularly giving financial advice with respect to the IRA ***following*** the rollover (even if it has not otherwise provided ***any*** advice before the rollover), the rollover advice would be the start of an advice relationship that could satisfy the “regular basis” requirement;
- 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 will be based on the ***reasonable*** understanding of each of the parties:
  - Written statements disclaiming a mutual understanding are not determinative, but may be considered as part of the analysis;
  - The advice does not need to serve as “***the***” primary basis of investment decisions, but rather it only need to serve as “***a***” primary basis; and
  - When a financial service professional makes recommendations that are based on the individualized needs of the recipient or made in accordance with a best interest standard such as the Securities and Exchange Commission’s (“SEC”) best interest standard, the parties “typically should reasonably understand that the advice will serve as at least a primary basis for the investment decision.”

Consequences of Being a “Fiduciary”

If a person is considered to be a "fiduciary" of a plan or IRA under ERISA and/or the Code, it will be subject to the prohibited transaction rules under Section 406 of ERISA and/or Section 4975 of the Code. These rules generally prohibit a fiduciary from causing the plan or IRA to engage in many different types of transactions with a potentially broad universe of counterparties unless the transaction qualifies for an exemption. The prohibited transaction rules also prohibit a fiduciary from engaging in certain "self-dealing" transactions whereby it deals with the assets of the plan or IRA for its own account or receives a "kick-back" in connection with a transaction involving the assets of the plan or IRA. In particular, a fiduciary would be prohibited from providing investment advice to the applicable plan or IRA that results in the fiduciary or its affiliate receiving additional compensation; and the fiduciary also would not be able to engage in principal transactions with the plan or IRA, unless an exemption is available.

Further, even if the requirements for an exemption are satisfied, fiduciaries of ERISA-covered plans are also subject to ERISA's fiduciary duties, including prudence and loyalty, which are among the highest known to the law. ERISA gives plan participants and beneficiaries a private right of action to challenge the prudence and loyalty of advice, even if the requirements of an exemption have been satisfied.

The Proposed Exemption

The Proposed Exemption would provide relief for certain "investment advice" fiduciaries (but not for parties with discretion) that is broader and more flexible than existing exemptions, provided that the fiduciary is willing and able to comply with the "impartial conduct" standards. The "impartial conduct" standards are intended to be aligned with the standards of conduct for investment advice professionals established and considered by other U.S. Federal and State regulators – in particular, the SEC and its Regulation Best Interest.

More specifically, the Proposed Exemption would permit “investment advice” fiduciaries to receive compensation as a result of providing what would otherwise be considered “conflicted” fiduciary investment advice (including IRA rollover advice) to a Retirement Investor (i.e., an ERISA plan participant or beneficiary, IRA owner, and a fiduciary of an ERISA plan or IRA) if the “investment advice” fiduciary is a registered investment adviser, broker-dealer, bank, or insurance company (or an employee, agent, or representative of an eligible entity). The compensation could include, for example, including 12b-1 fees, trailing commissions, sales loads, mark-ups and mark-downs, and revenue sharing payments from investment providers or third parties.

The Proposed Exemption would also permit qualifying “investment advice” fiduciaries to enter into and receive compensation with respect to “riskless” and certain other “principal transactions” with a Retirement Investor where the fiduciary either purchases certain investments from a Retirement Investor for its own account or sells certain investments out of its own inventory to the Retirement Investor.

The critical protective condition set forth in the Proposed Exemption is that the investment advice must be provided in accordance with “impartial conduct” standards – namely, a best interest standard (which includes duties of prudence and loyalty specifically requiring the “investment advice” fiduciary not to place its financial or other interests ahead of the interests of the Retirement Investor or to subordinate the Retirement Investor’s interests to interests of the financial institution or the investment professional; duties that would not otherwise apply to advice provided to an IRA not subject to ERISA); a reasonable compensation standard; and a requirement to make no materially misleading statements. The Proposed Exemption also requires that the “investment advice” fiduciary:

- Disclose both the financial institution’s and the investment professional’s status as an “investment advice” fiduciary and material conflicts of interest;
- Establish, maintain and enforce policies and procedures designed to ensure compliance with the “impartial conduct standards”; and
- Conduct an annual review to ensure compliance with the conditions of the Proposed Exemption.

In contrast to the DOL's vacated class exemptions, the Proposed Exemption would not provide a separate right of action to Retirement Investors, nor would it require a separate written contract or otherwise create any new legal claims beyond what is already provided under ERISA.

An "investment advice" fiduciary could lose the ability to rely on the Proposed Exemption for a period of 10 years for certain criminal convictions, providing misleading statements to the DOL in connection with relying on the exemption, or engaging in an intentional violation or systematic pattern of violating the conditions of the exemption.

The Proposed Exemption would not cover advice arrangements that rely solely on "robo-advice" without interaction with an investment professional. Those advice arrangements are covered by the statutory exemption in Sections 408(b)(14) and 408(g) of ERISA and Sections 4975(d)(17) and 4975(f)(8) of the Code and the regulations thereunder.

As part of the 2016 fiduciary rule package, the DOL granted two new prohibited transaction class exemptions (i.e., the Best Interest Contract Exemption and a Class Exemption for Principal Transactions) and amended several pre-existing exemptions. FAB 2018-02 (described above) allowed "investment advice" fiduciaries to continue to rely on the new Best Interest Contract Exemption and Class Exemption for Principal Transactions if they worked diligently and in good faith to comply with the impartial conduct standards required by those exemptions.

The Proposed Exemption is consistent with the DOL's temporary enforcement policy under FAB 2018-02, in that investment advice professionals that established processes and procedures to comply with the "impartial conduct" standards under the vacated exemptions would be able to use the same processes and procedures under the Proposed Exemption. For the time being, the DOL's temporary enforcement policy in FAB 2018-02 remains in place.

In connection with the issuance of the Proposed Exemption, the DOL removed from its website the vacated exemptions (i.e., the Best Interest Contract Exemption and the Class Exemption for Principal Transactions), and the DOL has confirmed that the pre-existing class exemptions that were amended in 2016 (i.e., PTEs 75-1, 77-4, 80-83, 83-1, 84-24 and 86-128) have reverted to their pre-amendment form.

Proskauer Perspective

Although the ERISA world has been operating under the "five-part test," we now have confirmation from the DOL that it applies. The DOL's commentary that IRA rollover advice could be fiduciary "investment advice" is a formal departure from the Deseret Letter, but it is consistent with prior comments from DOL officials. The Proposed Exemption would formally implement the temporary guidance from FAB 2018-02, but will not go into effect unless and until it is finalized. The latest guidance undoubtedly will not be the last word on this topic.

View Original

Related Professionals

- **Ira G. Bogner**
  Managing Partner
- **Seth J. Safra**
  Partner
- **Adam W. Scoll**
  Partner
- **Pamela A. Onufer**
  Special Pension investment Counsel