DOL Reaffirms 1975 Rule

The fiduciary investment advice rule is back.

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KEY POINTS

- The U.S. Department of Labor ("DOL") formalized reinstatement of the 1975 fiduciary investment advice rule.
- The proposal includes new interpretations of the 1975 rule and rejects the DOL's prior stance that rollover recommendations were generally not fiduciary investment advice.
- The DOL also proposed a flexible prohibited transaction exception.

On June 29, 2020, the DOL issued a final rule that formally withdraws the ill-fated 2016 Fiduciary Investment Advice Rule and reaffirms 1975 standards. In addition, the DOL proposed a new, flexible prohibited transaction exemption that allows those who become ERISA fiduciaries by virtue of providing investment advice to retirement investors to influence their own compensation.

Although the DOL returned to 1975 standards for fiduciary investment advice, the proposed prohibited transaction and its preamble contain new interpretations of fiduciary investment advice. Specifically, the DOL has rejected the position held before 2016 that rollover recommendations were generally not investment advice.

The proposed Prohibited Transaction Exemption (PTE) covers circumstances in which a fiduciary receives compensation that can vary based upon investment advice it provides, as well as circumstances in which a fiduciary engages in riskless principal and certain other principal transactions with the plan. A brief overview of the proposed prohibited transaction (excluding sections addressing principal transactions with a plan) follows.

What does the PTE do?

The proposed PTE allows certain financial firms and individuals to provide investment advice to retirement investors that might influence their own compensation, provided they adhere to the requirements of the PTE. The exemption covers advice to fiduciaries of ERISA-governed retirement plans, as well as individual retirement investors. (See the definition of retirement investors later in this article.)

Who can take advantage of the exemption?

Financial Institutions and Investment Professionals, both as defined in the proposed PTE, can take advantage of the exemption (as long as they are not convicted of financial crimes or found ineligible by DOL after a finding of systemic violations).

Financial Institutions are those who provide fiduciary investment advice to retirement investors through Investment Professionals, and who are:

- Registered investments advisers under state or federal law;
- Banks or similar institutions (including credit unions);
- Insurance companies licensed to do business in a state meeting specific requirements of audit and regulatory review;
- Registered broker-dealers; or
- Any other entity that the DOL identifies as a financial institution in future individual exemptions.

Investment Professionals are individual employees, independent contractors, agents or representatives of Financial Institutions who provide investment advice to retirement investors.

Are there certain exclusions?

The proposed PTE does not apply if the Financial Institution, Investment Professional, or affiliates are an employer of employees covered by the plan or named fiduciaries of the plan. The proposed PTE also does not cover pure "robo-advice" (although hybrid robo-advice services are covered). Finally, the proposed exemption does not apply if the Financial Firm or Investment Professional is a fiduciary because of duties or activities other than the provision of fiduciary investment advice.

What investment advice is covered?

Outside of excluded contexts, any non-discretionary fiduciary investment advice (within the meaning of the 1975 DOL rule) to Retirement Investors (as defined) is covered.

Retirement Investors include fiduciaries of ERISA-governed retirement plans, as well as participants and beneficiaries in such plans with the ability to direct investments, and retail retirement investors.[1]

[1] This includes holders of IRAs or annuities, as well as holders of Archer Medical Savings Accounts, Health Savings Accounts, or Coverdell Education Savings Accounts.

What types of compensation can investment advice fiduciaries receive?

The proposed PTE covers the receipt of a wide variety of payments in connection with fiduciary investment advice, so long as the compensation is "reasonable" in light of the value of the services provided. Compensation permitted for those meeting the proposed PTE requirements include commissions, 12b-1 fees, trailing commissions, sales loads, mark-ups and mark-downs and revenue sharing payments.

Unlike the 2016 Best Interest Contract Exemption, there is no requirement of level compensation, although a Financial Institution must maintain policies designed to prevent misalignment of interests between the firm and its representatives and advice recipients.

What is required to comply with the proposed PTE?

Fiduciaries seeking to take advantage of the proposed PTE would be required to:

1. Comply with impartial conduct standards;
2. Provide certain disclosures and acknowledgement;
3. Adopt compliance policies and procedures;
4. Conduct an annual retrospective review of compliance, certified by the CEO; and
5. Meet recordkeeping requirements.

The following sections provided more detailed information about these requirements.

#1: Impartial conduct standards

Investment Advice must be in the "best interest" of the retirement investors. Specifically, the investment advice must meet traditional ERISA standards of prudence and loyalty and must not place interests of the advice provider (firm or individual) or affiliates or related parties, ahead of the interests of the retirement investor.

In addition, the compensation received by investment advice fiduciaries for their services must be reasonable (and to the extent applicable, trade execution must meet best execution standards).

Finally, statements made in connection with the recommended transaction "and other relevant matters" must not be materially misleading.

#2: Disclosures and acknowledgement

Financial Institutions must provide a written acknowledgment that the Financial Institution and its Investment Professionals are fiduciaries with respect to the investment advice provided, and a written description of material conflicts of interest (accurate and not misleading in material respects). Unlike the 2016 exemption, there is **no** requirement of a contract between the fiduciary and the advice recipient.

The requirement to declare fiduciary status is potentially problematic. Certainly, the requirement to concede, in advance, fiduciary status that is traditionally based on facts and circumstances limits the usefulness of the proposed exemption. It would not be possible for a firm to use the proposed exemption as a precaution against the impact of inadvertent fiduciary advice.

#3: Policies and procedures

Financial Institutions must establish and maintain written policies and procedures designed to comply with impartial conduct standards, mitigate conflicts of interest so that incentive practices "viewed as a whole" are designed to avoid misalignment of interests of Financial Institutions and Investment Professionals and the interests of the advice recipients with respect to fiduciary advice. The procedures must require documentation of the specific reasons for a recommendation to rollover from a plan to an IRA (or vice versa), to roll from one IRA to another, or to change from one type of account to another (such as a switch from a commission-based account to a fee-based account).

#4: Annual retrospective review

Financial institutions must conduct an annual retrospective review, summarized in a timely written report, that is designed to detect and prevent violations of the impartial conduct standards. The Financial Institution's CEO must certify that he/she has reviewed the report, that the Financial Institution has policies and procedures designed to achieve compliance with the proposed PTE conditions, and that the Financial Institution has a process designed to modify policies and procedures as needed and to test effectiveness of policies on a periodic basis. The Financial Institution must retain the report for 6 years and make it available to the DOL upon request.

#5: Recordkeeping

Financial Institutions must maintain records showing compliance for six years and make them available upon request to specific audiences. Those who can access the materials include the DOL, a fiduciary of any plan engaged in an investment transaction, any contributing employer or employee organization whose members are covered by a plan engaged in an investment transaction, and any individual that engaged in an investment transaction. Financial Institutions need not reveal "privileged" trade secrets or financial information, or information pertaining to another Retirement Investor's transaction.

New interpretations of fiduciary investment advice

In the preamble to the proposed PTE, the Department has articulated several new interpretations of ERISA's 1975 fiduciary investment advice rule.

The DOL's 1975 fiduciary investment advice rule is often described as a five-part test. An individual or firm becomes an ERISA fiduciary if it provides a recommendation to a plan:

- As to the advisability of buying/selling securities or other property (or advice as to value);
- For a fee, direct or indirect;
- On a regular basis;
- By an individual with discretionary authority or control, or pursuant to a mutual understanding that the advice will serve as a primary basis for an investment decision; and
- The advice is individualized to the plan's needs.(The Act confers discretion on the Secretary of the Treasury to include other factors for these distributions.)

In its reissuance of the 1975 rule, the DOL has confirmed its long-standing view that the rule covers advice to ERISA-governed plan participants and beneficiaries that have the ability to direct investments. The DOL has also formally reinstated Interpretive Bulletin 96-1, providing an important safe harbor governing the distinction between investment education for plan participants and other individual retirement investors, and fiduciary investment advice.

The preamble rejects prior DOL informal guidance and clarifies that a recommendation to rollover from a plan to an IRA, or from one IRA to another, or to convert from one type of investment account to another, can be ERISA fiduciary investment advice if it fits the five-part test. The DOL has noted that rollover recommendations are often isolated, but if they are part of an ongoing advisory relationship involving other assets, or designed to create an advisory relationship going forward, the "regular basis" criteria could be met. (Note that this could make a firm or individual an ERISA fiduciary based on conduct that was to occur in the future, creating a lack of clarity as to fiduciary status at the moment the recommendation is provided.)

The DOL has also clarified that a unilateral statement by one party disclaiming any mutual understanding that the recommendation is not intended to serve as a primary basis for an investment decision would not necessarily serve to disprove the existence of a mutual understanding. Instead, the DOL noted that the mutual understanding would be based on a reasonable understanding of each of the parties. While the disclaimer would be informative, it would not be dispositive.

Finally, the DOL takes the position that any Financial Firm or Investment Professional providing fiduciary investment advice with respect to rollover from an ERISA-governed plan to an IRA would be deemed to be a plan fiduciary under ERISA subject to oversight by the DOL and suit by private litigants.

While there are opportunities for improvement, the proposed PTE is likely to be an important tool in facilitating the delivery of investment advice to retirement plans, participants and IRA investors. If the proposed exemption is finalized, we expect that it will provide opportunities for potential expansion of the investment help T. Rowe Price provides to ERISA plan fiduciaries and participants.

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