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DOL Releases Final Class Exemption for Fiduciary Advice

[32999]

December 18, 2020 TO: ICI Members
Bank, Trust and Retirement Advisory Committee
Broker/Dealer Advisory Committee
Investment Adviser and Broker-Dealer Standards of Conduct Working Group
Investment Advisers Committee
Operations Committee
Pension Committee
Pension Operations Advisory Committee
SEC Rules Committee
Transfer Agent Advisory Committee SUBJECTS: Compliance
Disclosure
Distribution
Fees and Expenses
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Operations
Pension RE: DOL Releases Final Class Exemption for Fiduciary Advice

On December 15, 2020, the US Department of Labor (DOL or the "Department") released a final prohibited transaction class exemption for providers of fiduciary investment advice ("Final PTE")[1] that will permit investment advice fiduciaries to receive compensation for their advice.[2]

This prohibited transaction exemption was proposed in June ("Proposed PTE") as part of a rulemaking package that also included a technical amendment, issued as a final rule, to reinstate the five-part test for determining fiduciary advice and other pre-existing guidance.[3] ICI submitted a comment letter that generally expressed support for the Proposed PTE, but also urged certain changes to the Proposed PTE and requested that DOL clarify its discussion in the preamble regarding the five-part test, which we explained are needed to ensure that the rulemaking package meets its intended goal.[4]

As discussed below, the Final PTE confirms the reinstatement of the traditional "five-part test" for determining fiduciary status, and generally confirms previous statements regarding the status of rollover transactions—ostensibly in an effort to better align its guidance with the Securities and Exchange Commission (SEC)'s Regulation Best Interest

(Reg BI).

In issuing the Final PTE, Secretary of Labor Scalia and SEC Chairman Clayton emphasized the coordination of their agencies, stating:

> The Labor Department's action dovetails with a package of investor-oriented measures adopted last year by the Securities and Exchange Commission. For the first time, our agencies are aligned on a coherent framework centered on ensuring that American workers and retirees receive advice in their best interest, across the spectrum of investment professionals and account types.[5]

The Final PTE will go into effect on February 16, 2021, after the Biden administration takes office on January 20. As prior new administrations have done, the Biden administration can halt and review any previous administration's rulemaking that is not then effective—meaning that the exemption has an uncertain fate. The new administration may choose to review or modify the exemption, further delaying its effective date. While this review is underway, however, the Department is likely to apply the interpretation of the five-part test in the preamble to the Final PTE.

DOL also announced that its temporary enforcement policy announced in Field Assistance Bulletin 2018-02 will remain in place until December 20, 2021 (one year following the date of publication of the Final PTE in the Federal Register).[6]

A detailed description of (1) the Final PTE, and (2) DOL's discussion in the preamble regarding its interpretation of the five-part test, is provided below.

Final Prohibited Transaction Class Exemption

No significant changes were made to the scope of the class exemption. In this regard, it continues to offer broad relief for registered investment advisers, broker-dealers, insurance companies, banks, and individual investment professionals who are their employees or agents, permitting them to receive compensation as a result of providing fiduciary investment advice. However, as described below, several important changes were made to the exemption's conditions.

The Final PTE allows investment advice fiduciaries under both ERISA and the Internal Revenue Code ("Code") to receive compensation (including as a result of advice to roll over assets from a plan to an IRA) and to engage in certain principal transactions, that would otherwise violate the prohibited transaction provisions of ERISA and the Code.[7] The best interest standard in the PTE is intended to be aligned with the conduct standards in the SEC's Reg BI and the fiduciary duty of registered investment advisers under securities laws.[8]

Scope of Relief

The Final PTE is available to "Financial Institutions" (i.e., registered investment advisers, broker-dealers, insurance companies, and banks) and "Investment Professionals" (*i.e.*, individual investment professionals who are employees, agents, independent contractors, or representatives of a Financial Institution). The exemption permits Financial Institutions and Investment Professionals (and their affiliates and related entities) who provide fiduciary investment advice to "Retirement Investors"[9] to receive otherwise prohibited compensation and engage in riskless principal transactions and certain other principal

transactions ("Covered Principal Transactions"),[10] subject to conditions described below.

Like the Proposed PTE, the Final PTE may not be used for:

1. transactions involving ERISA-covered plans if the Investment Professional, Financial Institution, or an affiliate is either (i) the employer of employees covered by the plan, or (ii) is a named fiduciary or plan administrator, or an affiliate thereof, who was selected to provide advice to the plan by a fiduciary who is not independent[11] of the Financial Institution, Investment Professional, and their affiliates;

2. transactions that result from robo-advice arrangements that do not involve interaction with an Investment Professional;[12] or

3. transactions in which the Investment Professional is acting in a fiduciary capacity other than as an investment advice fiduciary.

In the preamble, the Department specifically declined to address the Final PTE's application to advice in connection with "Pooled Employer Plans" (PEPs) established under the SECURE Act.[13] In our comment letter, ICI explained that the exclusion of situations involving a Financial Institution that is a named fiduciary or plan administrator (or an affiliate thereof) selected to provide advice to the plan by a fiduciary who is not independent of the Financial Institution, raises questions in the context of PEPs.[14] In response, the Department indicated that it believes it is premature to address issues related to PEPs, given their novel and unique nature, and noted that it is separately considering exemptions related to these types of plans, pursuant to its recent request for information on prohibited transactions applicable to PEPs.[15]

Conditions for Advice

The Final PTE requires fiduciary investment advice to be provided in accordance with the same "Impartial Conduct Standards" as the proposal (which includes 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). Also like the proposal, the Final PTE includes conditions requiring an acknowledgement of fiduciary status and other disclosures to Retirement Investors, maintenance of policies and procedures to mitigate conflicts of interest, and a retrospective compliance review. The Final PTE includes a welcome new self-correction provision, as described below.

Impartial Conduct Standards

Investment advice fiduciaries relying on the class exemption must provide advice in the best interest of Retirement Investors,[16] must receive no more than reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2), must seek to obtain the best execution of the investment transaction reasonably available under the circumstances (as required by the federal securities laws), and must not make any materially misleading statements to Retirement Investors about the recommended transaction and other relevant matters.

The best interest standard is satisfied if the advice is (at the time provided):

- 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.

Disclosures

The Final PTE retains the proposal's requirement that a Financial Institution provide Retirement Investors a written acknowledgement of the Financial Institution's (and its Investment Professionals') status as investment advice fiduciaries under ERISA and the Code, as applicable, and a written description of their services and material conflicts of interest.[17]

In a change from the proposal, the Final PTE requires that, "[p]rior to engaging in a rollover recommended pursuant to the exemption, the Financial Institution provides the documentation of specific reasons for the rollover recommendation, required by [the exemption], to the Retirement Investor."[18]

The preamble to the Final PTE makes clear that the fiduciary status acknowledgement is intended to prevent Financial Institutions and Investment Professionals from attempting to rely on the exemption "merely as a back-up protection for engaging in possible prohibited transactions when their ultimate intention is to deny the fiduciary nature of their investment advice."[19] DOL states, however, that it "does not intend that the fiduciary acknowledgment or any of the disclosure obligations create a private right of action as between a Financial Institution or Investment Professional and a Retirement Investor, and it does not intend that any of the exemption's terms, including the acknowledgement, give rise to any causes of action beyond those expressly authorized by statute."[20] The preamble to the Final PTE provides model fiduciary acknowledgement language.[21]

Policies and Procedures

The Final PTE requires Financial Institutions to establish, maintain, and enforce written 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 must mitigate conflicts of interest to the extent that a reasonable person reviewing the policies and procedures and incentive practices as a whole would conclude that they do not create an incentive for a Financial Institution or Investment Professional to place their interests ahead of the interest of the Retirement Investor.[22] As with the proposal, a Financial Institution must document the specific reasons that a rollover recommendation is in the investor's best interest.

Retrospective Review

Financial institutions would be required to conduct an annual review (reduced to a written report) 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. In a change from the proposal, the Final PTE permits the required annual certification of the retrospective review and

report to be made by any Senior Executive Officer,[23] rather than requiring certification by the chief executive officer (or equivalent officer) as proposed. Like the Proposed PTE, the Final PTE requires completion of the review, report and certification no later than six months following the end of the period covered by the review; retaining the report, certification and supporting data for six years; and making these available to DOL within 10 business days of request (to the extent permitted by law).

Self-Correction

A new provision of the Final PTE permits Financial Institutions to self-correct a violation of the exemption's conditions, if it satisfies the following requirements:

1. Either the violation did not result in investment losses or the Financial Institution made the Retirement Investor whole;
2. The Financial Institution corrects the violation and notifies DOL within 30 days;
3. The correction occurs no later than 90 days after the Financial Institution learned of the violation or reasonably should have learned of the violation; and
4. The Financial Institution notifies the person(s) responsible for conducting the retrospective review and specifically sets forth the violation and correction in the written report of the retrospective review.

Principal Transactions

As with the proposal, the Final PTE includes relief for principal transactions that is limited in scope and subject to additional conditions. Certain transactions, including those that are "riskless principal transactions" would not be considered Covered Principal Transactions for purposes of the exemption, and so could occur under the more general conditions.[24] Principal transactions that are not riskless and that do not fall within the definition of Covered Principal Transaction are not covered by the exemption.

With respect to *purchases* from a plan or an IRA, a Covered Principal Transaction is broadly defined to include any security or other investment property. With respect to *sales* to a plan or an IRA, a Covered Principal Transaction is limited to transactions involving: US dollar denominated corporate debt securities offered pursuant to a registration statement under the Securities Act of 1933, US Treasury securities, debt securities issued or guaranteed by a US federal government agency other than the US Department of Treasury, debt securities issued or guaranteed by a government-sponsored enterprise, municipal securities, certificates of deposit, and interests in Unit Investment Trusts.[25]

For transactions that meet the exemption's definition of Covered Principal Transaction, the Final PTE would require the Financial Institution to adopt written policies and procedures related to credit quality and liquidity. The policies and procedures must be reasonably designed to ensure that the debt security, at the time of the recommendation, has no greater than moderate credit risk and has sufficient liquidity that it could be sold at or near its carrying value within a reasonably short period of time. In the case of tax-exempt municipal bonds, DOL repeats an observation made in connection with the proposal, that investment advice fiduciaries may wish to document the reasons for any recommendation of such investment and why the recommendation was in the Retirement Investor's best interest.[26]

Proprietary Products and Limited Menus

DOL confirms in the preamble that the best interest standard can be satisfied by Financial Institutions and Investment Professionals that provide investment advice on proprietary products or on a limited menu of investment options, including limitations to proprietary products and products that generate third party payments.[27] To meet the Impartial Conduct Standards when recommending proprietary products and using limited menus, DOL envisions the following actions:

1. providing complete and accurate disclosure of their material conflicts of interest in connection with such products or limitations; and
2. adopting policies and procedures that mitigate conflicts to the extent that a reasonable person reviewing the policies and procedures and incentive practices as a whole would conclude that they do not create an incentive for a Financial Institution or Investment Professional to place their interests ahead of the interest of the Retirement Investor.[28]

DOL further envisions that Financial Institutions "would carefully consider their product offerings and form a reasonable conclusion about whether the menu of investment options would permit Investment Professionals to provide fiduciary investment advice to Retirement Investors in accordance with the Impartial Conduct Standards."[29] To use the exemption, a financial institution should "prudently" conclude "that its offering of proprietary products, or its limitations on investment product offerings, in conjunction with the policies and procedures, would not create an incentive for Financial Institutions or Investment Professionals to place their interests ahead of the interest of the Retirement Investor."[30]

In the preamble, the Department noted that it "has not added a specific requirement that Financial Institutions document their conclusions" regarding offering of proprietary products or limited menus.[31] Notably, however, the preamble indicates "that this is a best practice and may serve the interests of Financial Institutions since they are required . . . to keep records demonstrating compliance with the exemption."[32]

Loss of Eligibility Due to Convictions or Egregious Conduct

As under the Proposed PTE, Financial Institutions and Investment Professionals may lose eligibility to rely on the Final PTE for a 10-year period upon the occurrence of (1) certain criminal convictions (crimes described in section 411 of ERISA) arising out of the provision of investment advice to retirement investors, or (2) for egregious conduct with respect to compliance with the class exemption, as determined by the Department.[33] More specifically, such egregious conduct is defined as a finding by DOL that the Financial Institution or Investment Professional has:

- engaged in a systematic pattern or practice of violating the conditions of the exemption in connection with otherwise non-exempt prohibited transactions;
- intentionally violated the conditions of the exemption in connection with otherwise nonexempt prohibited transactions; or
- provided materially misleading information to DOL.

In the Proposed PTE, such a determination would have been made by DOL's Office of Exemption Determinations. ICI's comment letter urged DOL to remove this provision from the final exemption in its entirety, or at a minimum, remove the ability of the Office of

Exemption Determinations to find Financial Institutions and Investment Professionals ineligible.[34] Regarding its decision to replace all references to the "Office of Exemption Determinations" with references to the "Department," DOL said "[t]his will ensure that the Department, acting under the direction of the Secretary of Labor, maintains full responsibility for eligibility determinations under the exemption."[35]

Recordkeeping

Representing an improvement from the Proposed PTE, Financial Institutions must maintain records for six years demonstrating compliance with the exemption and must make these records available to authorized employees of DOL or the Department of Treasury.[36] The Proposed PTE would have required that Financial Institutions make such records available not only to DOL, but also to plan participants, beneficiaries, and IRA owners that engaged in an investment transaction pursuant to the exemption, fiduciaries to a plan that engaged in an investment transaction pursuant to the exemption, and any contributing employer or employee organization whose members are covered by a plan that engaged in an investment transaction pursuant to the exemption. The change to narrow access to the Financial Institution's records responds to ICI's comment letter, which urged DOL to narrow the availability of compliance records under the Proposed PTE to cover only authorized employees of DOL or IRS.[37]

Discussion in Preamble on the Five-Part Test

In response to the Department's solicitation for comments on statements made in the preamble to the Proposed PTE regarding its interpretation of the five-part test,[38] the ICI and many others expressed concern that such statements could be read to be inconsistent with the unambiguous provisions of the Department's investment advice regulation as well as the Fifth Circuit's holding in *U.S. Chamber of Commerce v. U.S. Department of Labor* ("Fifth Circuit Decision"),[39] which requires a relationship of "*trust andconfidence*" to be present for fiduciary status. We also raised concern about the preamble statement that compliance with Reg BI by non-fiduciary broker-dealers could trigger fiduciary status for ERISA purposes under the five-part test, which can be interpreted as disregarding the critical distinction the SEC made between broker-dealers and registered investment advisers.

We cautioned that the failure to clarify the Department's preamble statements would leave the fiduciary definition plagued by many of the same concerns that the 2016 rulemaking raised. For this reason, we asked that the Department clarify certain aspects of the statements—providing illustrated recommendations for this purpose.

In the preamble to the Final PTE, the Department rejects the argument that its preamble statements interpreting the five-part test are contrary to the investment advice definition or the Fifth Circuit holding.[40] While the Department did include some helpful clarifications in the preamble, many will argue that it did not go far enough and that its interpretation of the five-part test expands fiduciary status to individuals who were previously not considered fiduciaries under the fiduciary definition. The preamble to the Final PTE also confirms the withdrawal of the 2005 Deseret letter guidance exempting rollover solicitations by non-fiduciaries from fiduciary status, although the Department does acknowledge that some advice may be isolated and therefore would not meet the "regular basis" standard of the five-part test unless the advice was administered as part of an ongoing prior relationship or continued after the rollover advice.

Withdrawal of Deseret Letter Confirmed

In the preamble to the Proposed PTE, the Department stated that it was electing to withdraw its 2005 advisory opinion[41] construing the five-part test in connection with rollover recommendations (the "Deseret Letter") and provided *new* interpretations of the application of the five-part test to rollover recommendations.[42] In the preamble to the Final PTE, the Department reasserts its previous position that the analysis in the Deseret Letter was incorrect to the extent it stated that advice to take a distribution of assets from an ERISA plan is not advice to sell, withdraw, or transfer investment assets currently held in the plan. As reasserted by the Department, "[a] recommendation to roll assets out of [an ERISA] Plan is necessarily a recommendation to liquidate or transfer the plan's property interest in the affected assets and the participant's associated property interest in plan investments."[43] The Department notes that such an interpretation is consistent with the prior recognition by both the SEC and FINRA that recommendations to roll over plan assets to an IRA will almost always involve a securities transaction.[44]

In confirming the withdrawal of the Deseret Letter, the Department also rejected the argument that it should have engaged in notice and comment prior to announcing that it would no longer apply the Deseret Letter, noting that—as an advisory opinion—the Deseret Letter represents interpretive statements not subject to the notice and comment process and therefore not subject to notice and comment to offer a new interpretation.[45] Notwithstanding this position and because the Department does not wish to disturb the reliance interests of those who looked to the Deseret Letter for guidance, the Department states that it does not expect or intend a private right of action to be viable for a transaction conducted in reliance on the Deseret Letter prior to February 16, 2021.[46]

Regular Basis Prong Clarified

The preamble to the Proposed PTE stated that "advice to roll assets out of the Plan into an IRA where the advice provider will be regularly giving financial advice regarding the IRA in the course of a more lengthy financial relationship would be the start of an advice relationship that satisfies the 'regular basis' requirement."[47] The ICI and other commentators expressed concern that such an interpretation is inconsistent with the plain language of the investment advice regulation,[48] and would also mean that recommendations given at a time when no relationship of trust and confidence is present would be considered fiduciary investment advice if in the future more recommendations are given, or it is "anticipated" they will be given.[49] We explained that such an interpretation was difficult to square with the Fifth Circuit Decision finding that sales activity cannot be considered fiduciary investment advice and urged that the Department clarify its statement.[50]

In the preamble to the Final PTE, the Department strongly rejected the argument that the "regular basis" requirement must first be met with respect to the plan, and then again with respect to the IRA.[51] Nonetheless, it clarified that parties can enter into one-time sales transactions in which there is no ongoing investment advice relationship, or expectation of such a relationship, and therefore not trigger the regular basis prong of the five-part test.[52] The Department provides as an example a participant who purchases an annuity based upon a recommendation from an insurance agent without receiving subsequent, ongoing advice. In such circumstances, the advice does not meet the "regular basis" prong, according to the Department. The Department also rejects the idea that a rollover transaction should always satisfy the regular basis prong on the grounds that it can be viewed as involving two separate steps—the rollover and a subsequent investment

decision. “These two steps do not, in and of themselves, establish a regular basis,” according to the Department.[53]

Perhaps more helpful, the Department also adds a new exclusionary notion for “sporadic” transactions, clarifying that “sporadic interactions between a financial service professional and a Retirement Investor do not meet the regular basis prong.” To illustrate what it considers “sporadic” interactions, the Department provides the example of an investor who, when assisted with a rollover, expresses the intent to direct his or her own investments in a brokerage account, without any expectation of entering into an ongoing advisory relationship and without receiving repeated investment recommendations from the investment professional. The Department states that it “would not view the regular basis prong as being satisfied merely because the investor subsequently sought the professional’s advice in connection with another transaction long after receiving the rollover assistance.”[54] In cases where a fiduciary relationship is ultimately established, the Department would not extend fiduciary status back “to a prior isolated interaction, if the facts and circumstances surrounding the interaction do not reflect that the interaction marked the beginning of an ongoing fiduciary advice relationship.”[55] The Department acknowledges its recognition “that relationships, and the parties’ understandings of their relationships, can change over time.”[56]

The Department cautions, however, that the regular basis prong may be met where advice to roll over plan assets occurs as part of an ongoing relationship or an intended ongoing relationship that an individual enjoys with his or her investment advice provider. The Department explains that—

> “[i]n circumstances in which the investment advice provider has been giving advice to the individual about investing in, purchasing, or selling securities or other financial instruments through tax-advantaged retirement vehicles subject to Title I or the Code, the advice to roll assets out of a Title I Plan is part of an ongoing advice relationship that satisfies the regular basis prong. Similarly, advice to roll assets out of a Title I Plan into an IRA where the investment advice provider has not previously provided advice but will be regularly giving advice regarding the IRA in the course of a more lengthy financial relationship would be the start of an advice relationship that satisfies the regular basis prong. It is clear under Title I and the Code that advice to a Title I Plan includes advice to participants and beneficiaries in participant-directed individual account pension plans, so in these scenarios, there is advice to the Title I Plan—meaning the Plan participant or beneficiary—on a regular basis.”[57]

The Department suggests that financial services professionals can substantiate their intent to engage in one-time sales transactions by making clear in their communications that they do not intend to enter into an ongoing relationship to provide investment advice and act in conformity with that communication. It cautions, however, that where the facts and circumstances show “that assistance with a rollover does in fact mark the beginning of an ongoing relationship,” the functional fiduciary test covers the entire fiduciary relationship, “including the first instance of advice.”[58] The Department rejects the argument that such an interpretation of the regular basis prong results in retroactive imposition of fiduciary status. According to the Department, “fiduciary status is determined by the facts as they exist at the time of the recommendation, including whether the parties, at that time, mutually intend an ongoing advisory relationship.”[59]

Also, helpful, the Department clarifies that payment of a trailing commission will not, in and of itself, result in the regular basis prong being satisfied with respect to a transaction. On the other hand, according to the Department, "if the trailing commission is intended to compensate a financial professional for providing advice to the Retirement Investor on an ongoing basis, the conclusion could be different, depending on the full facts and circumstances of the advice arrangement."[60]

Use of Disclaimers Clarified

The Department also reconfirmed its prior statements in the preamble that for purposes of determining whether there is "a mutual agreement, arrangement, or understanding" that investment advice will serve as "a primary basis for investment decisions," it intends to consider the reasonable understanding of each of the parties, if no mutual agreement or arrangement is demonstrated. The Department adds that, while "written statements disclaiming a mutual understanding or forbidding reliance on the advice as a primary basis for investment decisions will not be determinative… such statements can be appropriately considered in determining whether a mutual understanding exists."[61]

The Department cautions that it intends to consider marketing materials in which financial professionals hold themselves out as trusted advisers, in evaluating the parties' reasonable understandings with respect to the relationship. The Department explains that—

> "if a Financial Institution or Investment Professional does not want to assume a fiduciary relationship or create misimpressions about the nature of its undertaking, it can clearly disclose that fact to its customers up-front, clearly disclaim any fiduciary relationship, and avoid holding itself out to its Retirement Investor customer as acting in a position of trust and confidence."[62]

Primary Basis Prong Clarified

The ICI and many other commenters also expressed concern that the Department's preamble statements could be interpreted to effectively remove the "primary basis" prong from the five-part test by putting new emphasis on reading "a" primary basis in the meaning of the prong and supporting a view that there can be more than one and perhaps several "primary bases."[63] We explained that such a reading not only ignores the most natural reading of the word "primary" in the primary basis prong,[64] it also disregards the Department's own prior statements acknowledging the difficulty in avoiding the plain meaning of the word.[65]

While reasserting that fiduciary status applies only if all five prongs are satisfied, the Department states that it "does not interpret the 'primary basis' requirement as requiring proof that the advice was the single most important determinative factor in the Retirement Investor's investment decision."[66] According to the Department, this interpretation is consistent with the regulation's reference to the advice as "a" primary basis rather than "the" primary basis. The Department further explains that "the fact that a Retirement Investor may consult multiple financial professionals about a particular investment does not indicate that the Department's analysis is incorrect. If, in each instance, the parties reasonably understand that the advice is important to the Retirement Investor and could determine the outcome of the investor's decision, that is enough to satisfy the 'primary basis' requirement."[67]

The Department was also not persuaded by commenters to change its position on the role of written disclaimers of fiduciary status or of elements of the five-part test. The Department states that its statement on the use of disclaimers in the context of the rendering of investment advice by a financial services professional will not deprive parties of the ability to define the nature of their relationship so long as there is consistency in how the interactions are made.[68] The Department cautions that—

> "[a] financial services provider should not, for example, expect to avoid fiduciary status through a boilerplate disclaimer buried in the fine print, while in all other communications holding itself out as rendering best interest advice that can be relied upon by the customer in making investment decisions. While financial services professionals may contractually disclaim engaging in activities that trigger elements of the five-part test, such as rendering advice that can be relied upon as a primary basis for the Retirement Investor's investment decisions, they must do so clearly and act accordingly to demonstrate that there is in fact no mutual agreement, arrangement, or understanding to the contrary."[69]

"Hire Me" Communications

The Department also downplayed commenters' concerns about introductory "hire me" conversations. Some commenters asked the Department to confirm that so-called "hire me" communications, in which financial services professionals engage in introductory conversations to promote their advisory services, will not be treated as fiduciary communications. Referencing an FAQ issued by the SEC staff in the context of Reg BI,[70] the Department confirmed that the interpretive statements in this preamble are not intended to suggest that marketing activity of the type described would be treated as investment advice covered under the five-part test.[71] "To the extent, however, that the marketing of advisory services is accompanied by an investment recommendation, such as a recommendation to invest in a particular fund or security, the investment recommendation would be covered if all five parts of the test were satisfied."[72]

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endnotes

[1] The Final PTE (PTE 2020-02) was published at 85 Fed. Reg. 82798 (December 18, 2020), and is *available at* https://www.govinfo.gov/content/pkg/FR-2020-12-18/pdf/2020-27825.pdf. DOL's fact sheet is *available at* https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/fact-sheets/fact-sheet-improving-investment-advice-for-workers-and-retirees.pdf, and DOL's

press release is *available at* https://www.dol.gov/newsroom/releases/ebsa/ebsa20201215.

[2] The Employee Retirement Income Security Act of 1974 (ERISA) prohibits fiduciaries from self-dealing, meaning they cannot cause themselves, their affiliates or related entities to receive additional compensation from transactions involving plans and IRAs unless an exemption applies.

[3] For an overview of the rulemaking package, including the Proposed PTE, *see* ICI Memorandum No. 32581, dated July 6, 2020, *available at* https://www.ici.org/my_ici/memorandum/memo32581.

[4] The comment letter, dated August 6, 2020, is *available at* https://www.ici.org/pdf/32665a.pdf ("ICI Comment Letter"). *See* ICI Memorandum No. 32665, dated August 7, 2020, *available at* https://www.ici.org/my_ici/memorandum/memo32665.

[5] Eugene Scalia and Jay Clayton, "A Simple Framework for Financial Advice," *Wall Street Journal* (December 15, 2020), *available at* https://www.wsj.com/articles/a-simple-framework-for-financial-advice-11608064648?mod=opinion_lead_pos8.

[6] 85 Fed. Reg. 82798, 82799. For a summary of FAB 2018-02, *see* ICI Memorandum No. 31200, dated May 7, 2018, *available at* https://www.ici.org/my_ici/memorandum/memo31200.

[7] Under these prohibited transaction provisions, a fiduciary may not deal with the income or assets of a plan or IRA in his or her own interest or for his or her own account, and a fiduciary may not receive payments from any party dealing with the plan or IRA in connection with a transaction involving assets of the plan or IRA. 85 Fed. Reg. 82798. The Final PTE "extends broadly to [a fiduciary's] receipt of reasonable compensation as a result of the provision of fiduciary investment advice," (85 Fed. Reg. 82798, 82800) and DOL specifies this would cover "a wide variety of payments that would otherwise violate the prohibited transaction rules, including, but not limited to, commissions, 12b-1 fees, trailing commissions, sales loads, mark-ups and mark-downs, and revenue sharing payments from investment providers or third parties." 85 Fed. Reg. 82798, 82799.

[8] In addition to the SEC's recent rulemaking, DOL also mentions standards of conduct developed by other standard setting bodies, including (1) the New York State Department of Financial Services amendment of its insurance regulations to establish a best interest standard in connection with life insurance and annuity transactions; (2) the Massachusetts Securities Division's amendment to its regulations for broker-dealers to apply a fiduciary conduct standard; and (3) The National Association of Insurance Commissioners' revision of its Suitability In Annuity Transactions Model Regulation. DOL explains that "general alignment with the other regulators' conduct standards is beneficial in allowing for the development of compliance structures that lack complexity and unnecessary burden." 85 Fed. Reg. 82798, 82802.

[9] "Retirement Investors" are plan participants and beneficiaries, IRA owners, and plan and IRA fiduciaries.

[10] "Covered Principal Transactions" are defined in Section V(d) of the Final PTE as principal transactions involving certain specified types of investments, and are discussed

later in this memorandum. Principal transactions that are not riskless and that do not fall within the definition of Covered Principal Transaction are not covered by the exemption.

[11] The Final PTE includes a definition of "independent" for this purpose (previously only discussed in the preamble to the Proposed PTE): For purposes of subsection I(c)(1), a fiduciary is "independent" of the Financial Institution and Investment Professional if: (i) the fiduciary is not the Financial Institution, Investment Professional, or an Affiliate; (ii) the fiduciary does not have a relationship to or an interest in the Financial Institution, Investment Professional, or any Affiliate that might affect the exercise of the fiduciary's best judgment in connection with transactions covered by the exemption; and (iii) the fiduciary does not receive and is not projected to receive within the current federal income tax year, compensation or other consideration for his or her own account from the Financial Institution, Investment Professional, or an Affiliate, in excess of 2% of the fiduciary's annual revenues based upon its prior income tax year. The Department declined to raise the 2 percent threshold under the independence requirement, despite comments from ICI and others that 2 percent is too low. 85 Fed. Reg. 82798, 82819.

[12] The Department declined to extend the exemption to pure robo-advice arrangements, despite comments from ICI and others. 85 Fed. Reg. 82798, 82820.

[13] *See* ICI Memorandum No. 32118, dated December 20, 2019, *available at* https://www.ici.org/my_ici/memorandum/memo32118.

[14] *See* ICI Memorandum No. 32665, dated August 7, 2020, *available at* https://www.ici.org/my_ici/memorandum/memo32665. In a PEP, a Financial Institution or its affiliate would serve as the Pooled Plan Provider, which is required to be a named fiduciary and administrator with respect to the plan.

[15] 85 Fed. Reg. 82798, 82819. For a description of the request for information, *see* ICI Memorandum No. 32539, dated June 18, 2020, *available at* https://www.ici.org/my_ici/memorandum/memo32539.

[16] The Department reiterated statements from the preamble to the proposal that the PTE does not establish a monitoring requirement, but that financial institutions must disclose the existence, scope, and duration of any monitoring services. 85 Fed. Reg. 82798, 82824. DOL cautions, however that "as part of making a best interest recommendation, the Department expects that Financial Institutions and Investment Professionals will consider whether the investment can be prudently recommended without some mechanism or plan for ongoing monitoring. To the extent that prudence requires ongoing monitoring, the final exemption does not require that such monitoring be done by the Financial Institution or Investment Professional; such monitoring could be performed by a third party, but the advice fiduciary should clearly explain the need for monitoring to the investor when making the recommendation." *Id.*

[17] DOL makes clear that a separate disclosure document is not required; rather, the disclosure "can be satisfied through any disclosure, or combination of disclosures, required to be provided by other regulators so long as the disclosure required by Section II(b) is included." 85 Fed. Reg. 82798, 82826.

[18] Section II(c)(3) of the Final PTE requires a Financial Institution to document the specific reasons that any recommendation to roll over assets from a plan to another plan or an IRA, from an IRA to a plan, from an IRA to another IRA, or from one type of account to another

(*e.g.*, from a commission-based account to a fee-based account) is in the best interest of the Retirement Investor.

[19] 85 Fed. Reg. 82798, 82827. The preamble also states that a "Financial Institution and Investment Professional that seek to provide investment advice to a Retirement Investor and otherwise engage in a relationship that satisfies the five-part test should, at a minimum (if they wish to avail themselves of this particular exemption), make a conscious up-front determination of whether they are acting as fiduciaries; tell their Retirement Investor customers that they are rendering advice as fiduciaries; and, based on their conscious decision to act as fiduciaries, implement and follow the exemption's conditions." *Id.*

[20] 85 Fed. Reg. 82798, 82828. DOL goes on to state that "the fiduciary acknowledgement does not create a contractual fiduciary duty." *Id.*

[21] For the model language, see 85 Fed. Reg. 82798, 82827: "When we provide investment advice to you regarding your retirement plan account or individual retirement account, we are fiduciaries within the meaning of Title I of the Employee Retirement Income Security Act and/or the Internal Revenue Code, as applicable, which are laws governing retirement accounts. The way we make money creates some conflicts with your interests, so we operate under a special rule that requires us to act in your best interest and not put our interest ahead of yours." The preamble also provides model language to "more fully explain" the exemption's terms, noting however that the exemption does not require such explanation. *Id.*

[22] To meet the conflict mitigation requirement with respect to commission-based compensation arrangements, DOL reiterated statements from the preamble to the Proposed PTE, that Financial Institutions should focus on financial incentives to Investment Professionals and supervisory oversight of investment advice. 85 Fed. Reg. 82798, 82835. DOL further notes that it envisions that Financial Institutions would implement conflict mitigation strategies identified by the institutions' other regulators, and DOL specifically identifies a number of examples of practices identified as options by the SEC that might be implemented for compliance with the Final PTE. *Id.*

[23] A "Senior Executive Officer" is any of the following: the chief compliance officer, the chief executive officer, president, chief financial officer, or one of the three most senior officers of the Financial Institution.

[24] DOL also specifies that the sale of an insurance or annuity contract, or a mutual fund transaction, would not be considered principal transactions for purposes of the exemption, and so could occur under the more general conditions. 85 Fed. Reg. 82798, 82816.

[25] The Department received comments requesting the addition of other types of assets to the enumerated list of investments eligible under the definition of Covered Principal Transaction (including ICI's request to include closed end funds), but expressly declined to expand the exemption's definition of a Covered Principal Transaction. 85 Fed. Reg. 82798, 82817. To accommodate additional types of investments, the exemption allows DOL to grant an individual exemption covering a particular type of principal transaction. DOL explains that "[a]n individual exemption request would provide the Department with the opportunity to gain the additional information it would need to determine whether an investment should be included in this exemption." *Id.*

[26] DOL asserts that "[t]ax-exempt municipal bonds are typically a poor choice for

investors in [ERISA] Plans and IRAs because the Plans and IRAs are already tax advantaged and, therefore, do not benefit from paying for the bond's tax-favored status." 85 Fed. Reg. 82798, 82818.

[27] *Id.* at 82836.

[28] *Id.* at 82836-7.

[29] *Id.* at 82837.

[30] *Id.*

[31] *Id.*

[32] *Id.*

[33] In the case of a Financial Institution, a loss of eligibility will extend to other Financial Institutions in the same Controlled Group, defined in accordance with the definitions in Code sections 414(b) and (c). This definition was changed from the Proposed PTE, to "provide a well-known frame of reference for Financial Institutions and avoid uncertainty as to how the definition will be applied." 85 Fed. Reg. 82798, 82844. An Investment Professional subject to these provisions will become ineligible immediately; however Financial Institutions are provided a one-year winding down period after becoming ineligible, during which they may continue to rely on the exemption. In a change from the Proposed PTE, the winding down period begins 21 days after the date of the written ineligibility notice from DOL.

[34] The letter argued that DOL already has the ability to limit use of prohibited transaction exemptions through its well-established enforcement mechanisms, and that Financial Institutions would expend significant sums building new compliance systems and complying with this section on an on-going basis. Further, the same officials who drafted the exemption should not be permitted to judge compliance. ICI Comment Letter at page 13.

[35] ICI Comment Letter at page 13.

[36] In the preamble, DOL explains what documentation it expects Financial Institutions to retain:

> To demonstrate compliance with the exemption, Financial Institutions are required to maintain, among other things, documentation of rollover recommendations; their written policies and procedures adopted pursuant to Section II(c); and the report of the retrospective review, certification, and supporting data. Except with respect to rollovers, the Department does not expect Financial Institutions to document the reason for every investment recommendation made pursuant to the exemption. However, documentation may be especially important for recommendations of particularly complex products or recommendations that might, on their face, appear inconsistent with the best interest standard. 85 Fed. Reg. 82798, 8284.

[37] ICI Comment Letter at page 15.

[38] *See* 85 Fed. Reg. 40834, 40840.

[39] 885 F.3d 360 (5th Cir. 2018).

[40] 85 Fed. Reg. 82798, 82809-10.

[41] DOL Advisory Opinion 2005-23A (December 7, 2005), *available at* https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/advisory-opinions/2005-23a.

[42] 85 Fed. Reg. 40834, 40838–40.

[43] 85 Fed. Reg. 82798, 82803.

[44] *See* Regulation Best Interest Release, 84 FR at 33339; FINRA Regulatory Notice 13-45 Rollovers to Individual Retirement Accounts (December 2013), *available at* www.finra.org/sites/default/files/NoticeDocument/p418695.pdf.

[45] 85 Fed. Reg. 82798, 82804.

[46] *Id.*

[47] 85 Fed. Reg. 40834, 40839.

[48] The regulation defines the circumstance under which "[a] person shall be deemed to be rendering 'investment advice' *to an employee benefit plan*," and requires that advice be rendered "on a regular basis *to the plan*," i.e., the particular plan or IRA at issue. A subsequent advice relationship with respect to assets held outside the relevant plan (*i.e.*, assets held in the rollover IRA) is simply not germane for purposes of the five-part test, which by its own terms applies on a plan-by-plan basis.

[49] 85 Fed. Reg. 40834, 40839-40.

[50] 885 F.3d at 380.

[51] 85 Fed. Reg. 82798, 82807.

[52] *Id.* at 82805.

[53] *Id.* at 82804.

[54] *Id.* at 82805.

[55] *Id.* at 82807.

[56] *Id.*

[57] *Id.* at 82805.

[58] *Id.*

[59] *Id.* at 82807.

[60] *Id.* at 82807-08.

[61] *Id.* at 82808.

[62] *Id.* at 82806.

[63] 85 Fed. Reg. 40834, 40840.

[64] The definition of "primary": "of *first* rank, importance, or value," limits the concept of primary to a singular item. Merriam-Webster Dictionary, *available at* https://www.merriam-webster.com/dictionary/primary (*emphasis added*).

[65] The Department itself recognized such a reading when, in the 2016 preamble discussion justifying the elimination of the "primary basis" prong, the Department acknowledged the difficulty of establishing fiduciary status by having to prioritize advice when multiple advisors are consulted. 81 Fed. Reg. 20955, 20956 (Apr. 8, 2016).

[66] 85 Fed. Reg. 82798, 82808.

[67] *Id.*

[68] *Id.*

[69] *Id.*

[70] *Id. c*iting Frequently Asked Questions on Regulation Best Interest, available at www.sec.gov/tm/faqregulation-best-interest. The example provides: "I have been working with our mutual friend, Bob, for fifteen years, helping him to invest for his kids' college tuition and for retirement. I would love to talk with you about the types of services my firm offers, and how I could help you meet your goals. Here is my business card. Please give me a call on Monday so that we can discuss."

[71] *Id.* at 82809.

[72] *Id.*
