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DOL Releases Guidance on Fiduciary Advice Exemption and Tips for Retirement Investors

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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: Pension RE: DOL Releases Guidance on Fiduciary Advice Exemption and Tips for Retirement Investors

On April 13, 2021, the Department of Labor (DOL) issued two items of sub-regulatory guidance related to the recent prohibited transaction exemption for fiduciary advice providers (PTE 2020-02):[1]

- A set of compliance-focused frequently asked questions (FAQs) providing guidance for investment advice providers who are relying, or planning to rely, on PTE 2020-02.[2] The FAQs also include information on DOL's next steps in its regulation of investment advice.
- A document with information aimed at retirement investors entitled "Choosing the Right Person to Give You Investment Advice: Information for Investors in Retirement Plans and Individual Retirement Accounts."[3] This document includes questions a retirement investor can ask when interviewing potential advice providers, background information to help them understand the purpose of each question, and investor-focused FAQs about PTE 2020-02.

A description of the guidance follows. We note that it may take time to determine the full impact of the FAQs. While much of the analysis merely confirms previous statements made in the preamble to PTE 2020-02, some early commentary suggests that the FAQs serve to significantly tighten certain of the PTE's conditions?particularly those related to conflicts mitigation and avoidance?and represent a clear return to some of the problematic aspects of the 2016 fiduciary rulemaking. Importantly, the FAQs appear to represent the new administration's initial reconsideration of the prior administration's work in this area, as the FAQs signal that further regulatory and sub-regulatory actions (including amending the investment advice fiduciary regulation, amending PTE 2020-02, and amending or revoking some of the other existing class exemptions available to investment advice fiduciaries) are likely.

Compliance FAQs

The Compliance FAQs cover the following topics (selected FAQs are highlighted below):

- Background information on the issuance of PTE 2020-02. FAQ 1 provides an overview of the exemption framework and a discussion of the impartial conduct standards.[4] It also reiterates DOL's statements in the preamble to PTE 2020-02 that Advisory Opinion 2005-23A (the "Deseret Letter") was incorrect in its conclusion that the 1975 fiduciary rule did not extend to rollover advice.
- Compliance dates and expected additional action relating to the regulation of fiduciary advice.
  - FAQ 3 confirms that the temporary enforcement policy announced in FAB 2018-02[5] will remain in place until December 20, 2021, which is unchanged from the period set forth in PTE 2020-02.
  - FAQ 4 explains that, as of February 16, 2021, DOL will begin enforcing the prohibited transaction rules for activity that would have been treated as non-fiduciary under the Deseret Letter.
  - FAQ 5 indicates that DOL anticipates taking further regulatory and sub-regulatory actions, as appropriate (including amending the investment advice fiduciary regulation, amending PTE 2020-02, and amending or revoking some of the other existing class exemptions available to investment advice fiduciaries), noting that such regulatory actions will be preceded by notice and an opportunity for public comment. Accordingly, like the 2016 fiduciary rulemaking package, which amended several class exemptions in connection with the expanded definition of investment advice fiduciary, it is reasonable to expect that those same exemptions (e.g., PTEs 77-4, 84-24, 86-128) will be amended to make conforming changes incorporating many of the new conditions from PTE 2020-02. It is also expected that DOL will take another shot at the investment advice fiduciary definition. In the preamble to PTE 2020-02, DOL rejected the argument that its preamble statements interpreting the five-part test are contrary to the investment advice definition or the holding in U.S. Chamber of Commerce v. U.S. Department of Labor,[6] which requires a relationship of "trust and confidence" for fiduciary status to be present. We understand that DOL staff believe that ample authority exists for establishing that many regulated financial services providers are clearly in relationships of "trust and confidence" with their clients and will support their proposed changes to the definition.
- The 5-part test definition of fiduciary advice.
  - FAQ 7 discusses the regular basis prong of the 5-part test and confirms DOL's prior statements in the preamble to PTE 2020-02 that, in the context of a rollover recommendation, when an investment advice provider has not previously provided advice but expects to regularly make investment recommendations regarding the IRA as part of an ongoing relationship, the advice to roll assets out of an employee benefit plan into an IRA would be the start of an advice

    relationship that satisfies the regular basis requirement.
  - FAQ 8 discusses the mutual understanding prong of the 5-part test, reaffirming that written disclaimers would not defeat the mutual understanding prong when the parties have a mutual understanding that the adviser is making an individualized recommendation upon which the investor can be expected to rely in making the investment decision.[7]
- Compliance with the various conditions of the exemption.
  - FAQ 13, relating to the requirement to provide a written acknowledgement of fiduciary status, reiterates DOL's view that parties wishing to take advantage of the exemption's broad relief should make a conscious up-front determination that they are acting as fiduciaries (e.g., rather than attempting to comply with the exemption as a protective measure in case fiduciary status is contended later).
  - FAQ 15 specifies that, in the context of documenting the reasons why a rollover would be in the investor's best interest, "[w]hen considering the alternatives to a rollover, the financial institution and investment professional generally should not focus solely on the retirement investor's existing investment allocation, without any consideration of other investment options in the plan."
  - FAQ 16 discusses conflict mitigation strategies, providing an example of how to mitigate conflicts for investment professionals (reminiscent of guidance under the 2016 rulemaking), in which "a firm could ensure level compensation for recommendations to invest in assets that fall within reasonably defined investment categories (e.g., mutual funds), and exercise heightened supervision as between investment categories (e.g., between mutual funds and fixed annuities) to the extent that it is not possible for the institution to eliminate conflicts of interest between these categories." The FAQ further specifies that "[f]inancial institutions' policies and procedures must also include supervisory oversight of investment recommendations, particularly in areas in which differential compensation remains. In addition, financial institutions' policies and procedures could provide for increased monitoring of investment professional recommendations at or near compensation thresholds, recommendations at key liquidity events for investors (e.g., rollovers), and recommendations of investments that are particularly prone to conflicts of interest, such as proprietary products and principal-traded assets. However, in many circumstances, supervisory oversight is not an effective substitute for meaningful mitigation or elimination of dangerous compensation incentives." It is unclear if FAQ 16 is intended to indicate a rethinking by DOL of its prior statements in the preamble to PTE 2020-02 that conflict mitigation strategies identified by other regulators, including the SEC, would be relevant in determining the adequacy of conflict mitigation strategies, or whether DOL intends only to signal that it intends to carefully scrutinize compliance with this condition.
  - FAQ 17 outlines special considerations for financial institutions using payout grids, noting several practices that, in DOL's view, would misalign the interests of the investment professional with the investor's interests. This includes paying the investment professional a fixed percentage of the commission generated for the financial institution; payout grids with large or disproportionate increases; and increased compensation upon reaching a threshold that applies retroactively to past investments.
  - FAQ 18 addresses compliance issues specific to insurance product recommendations.

- Enforcement of exemption compliance. FAQ 21 explains that for ERISA-covered plans, DOL will investigate for compliance with the exemption and enforce the protections of Title I of ERISA, and that participants, beneficiaries, and fiduciaries of ERISA-covered plans have a statutory cause of action under Section 502 of ERISA for fiduciary breaches and prohibited transactions. For IRAs and other non-ERISA plans, FAQ 21 notes that DOL has interpretive authority to determine compliance with the exemption conditions and will transmit information to the IRS for enforcement of the applicable excise tax on prohibited transactions. Significantly, it also confirms that PTE 2020-02 does not impose contract or warranty requirements on financial institutions or investment professionals and does not expand retirement investors' ability to enforce their rights in court or create any new legal claims beyond those in Title I of ERISA and the Internal Revenue Code.

Information for Investors

This document, entitled "Choosing the Right Person to Give You Investment Advice: Information for Investors in Retirement Plans and Individual Retirement Accounts," suggests several sets of questions for an investor to ask an advice provider, including:

- Whether the advice provider is a fiduciary under federal law;
- Whether the provider can supply a written statement of fiduciary status;
- Whether the advice provider is complying with PTE 2020-02, and if not, whether the provider is relying on another exemption or does not believe it has conflicts of interest;
- What fees and expenses will be charged, whether a list can be provided, and how the fees and expenses are paid (i.e., directly or indirectly);
- What conflicts of interest the provider has in making investment recommendations, whether the provider gets paid from other sources, and whether the provider pays anyone else in connection with the investor's investments (including asking for a written statement of such payments);
- Whether there are any limitations on the investments the provider will recommend (e.g., proprietary products only);
- Under what circumstances the provider will monitor the investor's account investments and recommend changes as warranted; and
- Why the provider is recommending a rollover from one plan or account to another, and whether such a rollover will better serve the investor's interests and goals.

Each set of questions is accompanied by background information intended to explain to the investor the relevance of the questions and any related terminology or legal concepts. For example, the questions relating to fees and expenses are accompanied by a discussion of the impact of fees on a retirement account balance over time.

In addition, the document contains several FAQs regarding PTE 2020-02, aimed at explaining the exemption in plain language. One of the FAQs notes that investors may receive from the advice provider a Form CRS, the customer relationship summary required of SEC-registered broker-dealers and investment advisers.

Finally, the document includes an Appendix of Additional Concepts and Terms referenced throughout the document, with definitions of terms like Conflicts of Interest, Fiduciary, Prudent, Loyal, and Proprietary Products.

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Endnotes

[1] For an overview of PTE 2020-02, *see* ICI Memorandum No. 32999, dated December 18, 2020, *available at* https://www.ici.org/my_ici/memorandum/memo32999.

[2] The compliance FAQs are *available at* https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/faqs/new-fiduciary-advice-exemption.

[3] The document with information for retirement investors is *available at* https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/faqs/choosing-the-right-person-to-give-you-investment-advice.

[4] FAQ 11 also describes the impartial conduct standards, but the description contained in FAQ 1 is more substantial. According the FAQ 1, the impartial conduct standards require an investment professional to:

- investigate and evaluate investments, provide advice, and exercise sound judgment in the same way that knowledgeable and impartial professionals would (i.e., their recommendations must be "prudent"),
- act with undivided loyalty to retirement investors when making recommendations (in other words, they must never place their own interests ahead of the interests of the retirement investor, or subordinate the retirement investor's interests to their own),
- charge no more than reasonable compensation and comply with federal securities laws regarding "best execution," and
- avoid making misleading statements about investment transactions and other relevant matters.

[5] 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.

[6] 885 F.3d 360 (5th Cir. 2018).

[7] FAQ 8 states: "When firms and investment professionals hold themselves out in their oral communications, marketing materials, or interactions with retirement investors as making individualized recommendations that the investor can rely upon to make an investment decision that is in the best interest of the investor, and the investor, accordingly, relies upon the recommendation to make an investment decision, the 1975 test's requirement for a 'mutual agreement, arrangement, or understanding' is satisfied." This suggests that typical brokerage recommendations provided in compliance with Reg BI would likely satisfy the mutual agreement test.