

TYPES NOT MAPPED YET September 02, 2020 | TTR not mapped yet | Lori W. Jones

# What employers should know about DOL's final fiduciary rule and proposed prohibited transaction exemption for fiduciaries

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In late June and early July, the Department of Labor (DOL) published guidance regarding the standards that apply to fiduciaries providing investment advice to employee benefit plans subject to the Employee Retirement Income Security Act of 1974, as amended (ERISA), and individual retirement accounts (IRAs). The guidance includes (i) a final rule in the form of a technical amendment (Final Rule), and (ii) a proposed class exemption (Proposed Exemption) from certain prohibited transaction restrictions impacting the provision of investment advice by fiduciaries.

The recent guidance reflects the June 21, 2018 action of the U.S. Court of Appeals for the Fifth Circuit which vacated (i) the Conflict of Interest Rule issued in 2016 (the "2016 Rule"), (ii) prohibited transaction exemptions (PTEs) 2016-01 and 2016-02, and (iii) 2016 amendments to PTEs 75-1, 77-4, 80-83, 84-24 and 86-128.<sup>1</sup> The guidance also proposes new standards by which fiduciaries can render investment advice without violating the prohibited transaction rules under ERISA and the Internal Revenue Code of 1986, as amended (Code).

The following are key elements of the recently issued guidance.

### Final rule

Section 3(21)(A)(ii) of ERISA defines the term "fiduciary" to include a person who renders investment advice for a fee (or other direct or indirect compensation) with respect to any money or other property of a plan subject to ERISA. Code Section 4975(e)(3)(B) of the Code includes the same definition for purposes of the Section 4975 excise tax on "prohibited transactions" involving specified plans. Both ERISA and the Code prohibit a fiduciary from engaging in prohibited transactions, including conflict of interest transactions and self-dealing transactions.<sup>2</sup>

### Reinstates the five-part test for determining fiduciary status

The Final Rule conforms the regulations under ERISA to the Fifth Circuit decision. As a result, the regulations in effect prior to the 2016 Rule, referred to herein as the "1975 Rule," as well as Interpretive Bulletin 96-1, are reinstated.

The Final Rule reinstates a five-part test under the 1975 Rule for determining whether a person providing investment advice is a fiduciary under ERISA. The five-part test provides that a person is deemed to be rendering investment advice within the meaning of ERISA Section 3(21)(A)(ii) if he or she:

1. Renders advice to the plan as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property,
2. On a regular basis,
3. Pursuant to a mutual agreement, arrangement, or understanding with the plan, plan fiduciary or IRA owner, that
4. The advice will serve as a primary basis for investment decisions with respect to plan or IRA assets, and that

5. The advice will be individualized based on the particular needs of the plan or IRA. <sup>3</sup>

Persons meeting the five-part test must satisfy certain fiduciary duties under ERISA and must not engage in prohibited transactions unless an administrative exemption has been issued by the DOL.

#### **Immediate effective date**

The Final Rule is effective July 7, 2020. Because issuance of the Final Rule is considered an administrative step necessary to reflect the Fifth Circuit decision, the DOL determined that the notice and public comment procedures under the Administrative Procedure Act and the reporting and timing requirements of the Congressional Review Act are not applicable.

#### **Proposed exemption**

The Proposed Exemption, titled “Improving Investment Advice for Workers & Retirees,” permits certain fiduciaries to receive compensation for providing investment advice to ERISA plans and IRAs if the requirements of the Proposed Exemption are satisfied.

#### **Financial institutions**

The Proposed Exemption applies to investment advice provided by “Financial Institutions” to Retirement Investors. A Financial Institution is defined in the Proposed Exemption to include an entity that is;

- Registered as an investment adviser under the Investment Advisers Act of 1974 or under the laws of the state in which the adviser maintains its principal officer or place of business;
- A bank or similar financial institution supervised by the United States or a state or savings association;
- An insurance company qualified to do business under the laws of a state that (i) has obtained a certificate of authority in its domiciliary state, (ii) has undergone, and continues to undergo, an examination by an independent certified public account for its last completed tax year, or has undergone a financial examination by the state’s insurance commissioner within the preceding 5 years, and (iii) is domiciled in a state whose law requires an annual actuarial review of reserves that is reported to the appropriate regulatory authority;
- A broker/dealer registered under the Securities Exchange Act of 1934; or
- An entity described in an individual exemption granted by the DOL after the date of the Proposed Exemption that provides relief for the receipt of compensation in connection with the rendering of investment advice. <sup>4</sup>

In addition, such entity must engage “Investment Professionals” and not be disqualified or barred from making investment recommendations by any insurance, banking or securities law, or regulatory authority. An “Investment Professional” is defined as a fiduciary of an ERISA plan or IRA who is an employee, independent contractor, agent or representative of a Financial Institution, who satisfies the federal and state regulatory and licensing requirements of insurance, banking and securities laws, and who is not disqualified or barred from making investment recommendations by any insurance, banking or securities law, or regulatory authority. <sup>5</sup>

#### **Retirement investor**

The Proposed Exemption defines the term “Retirement Investor” to include (i) a participant or beneficiary of an employee benefit plan subject to ERISA with authority to direct the investment of his or her plan account, (ii) the beneficial owner of an IRA acting on behalf of the IRA, or (iii) a fiduciary of such a plan or IRA. <sup>6</sup>

#### **Covered transactions**

The Proposed Exemption permits a Financial Institution or Investment Professional to receive reasonable compensation for the following:

- providing investment advice, such investment advice to acquire, hold, dispose of, or exchange securities and other investments, including investment advice to take a distribution from an ERISA plan, or rendered as part of a rollover from an ERISA plan to an IRA, or a similar type of rollover; <sup>7</sup>
- engaging in a “Riskless Principal Transaction;” or
- engaging in a “Covered Principal Transaction.”

The preamble to the Proposed Exemption describes a “principal transaction” as a transaction involving the sale or purchase of investments between an employee benefit plan or IRA and its fiduciary in which the fiduciary is acting, directly or indirectly, on its own behalf. <sup>8</sup> A Riskless Principal Transaction is defined in the preamble as a transaction in which a Financial Institution, after receiving an order from a Retirement Investor to buy or sell an investment, purchases or sells the same investment for the Financial Institution’s own account to offset the transaction with the Retirement Investor. <sup>9</sup>

With respect to purchases from an employee benefit plan or IRA, the term “Covered Principal Transaction” is defined to include any securities or other investment property. <sup>10</sup> The preamble to the Proposed Exemption states that, for these transactions, the definition is intentionally broad to address potential liquidity needs of a Retirement Investor. <sup>11</sup> In contrast, with respect to sales to an employee benefit plan or IRA, the term Covered Principal Transaction is defined more narrowly to include the following:

- corporate debt securities offered pursuant to a registration statement under the Securities Act of 1933;
- U.S. Treasury securities;
- debt securities issued or guaranteed by a U.S. federal government agency other than the U.S. Department of Treasury;
- debt securities issued or guaranteed by a government-sponsored enterprise (GSE);
- municipal bonds;
- certificates of deposit; and
- interests in unit investment trusts.

#### **Impartial conduct standards**

In order to qualify for the Proposed Exemption, Financial Institutions and Investment Professionals must comply with the following Impartial Conduct Standards:

- The investment advice must be, at the time it is provided, in the Best Interest of the Retirement Investor;
- The compensation received, directly or indirectly, by the Financial Institution or Investment Professional must not exceed reasonable compensation as defined in ERISA Section 408(b)(2) and Code Section 4975(d)(2);
- The Financial Institution and Investment Profession must seek to obtain the best execution of the investment transaction reasonably available under the circumstance in as required under federal securities laws.
- The Financial Institution and its Investment Professionals must not make statements about the recommended transaction and other relevant matters that are materially misleading. <sup>12</sup>

The definition of “Best Interest” in the Proposed Exemption incorporates a duty of prudence, based on concepts under ERISA and the common law of trusts, and a duty of loyalty to the Retirement Investor. <sup>13</sup> According to the preamble, the Best Interest standard is to be interpreted consistent with the SEC’s Regulation Best Interest and the SEC’s interpretation of the standard of conduct for registered investment advisers. <sup>14</sup>

#### **Disclosure, policies and procedures and retrospective review**

Reliance on the Proposed Exemption requires that a Financial Institution and its Investment Professionals provide a written acknowledgement that they are fiduciaries under ERISA and the Code with respect to their investment advice. In addition, the Financial Institution and Investment Professionals must provide a written discretion of the services to be provided and a disclosure of material conflicts of interest (as defined in the Proposed Exemption). <sup>15</sup>

In addition, a Financial Institution must establish and maintain policies and procedures designed to ensure compliance with the Impartial Conduct Standards and to mitigate conflicts of interest. The Financial Institution must also document the reasons that a recommended rollover is in the Best Interest of the Retirement Investor. <sup>16</sup>

Finally, the Financial Institution must conduct a retrospective review, at least annually, that is designed to assist it in detection and preventing violations of the Impartial Conduction Standards. The Proposed Exemption includes requirements relating to such review. <sup>17</sup>

#### **Effective date**

The Proposed Exemption will be available 60 days after the date of publication of the final exemption in the Federal Register.

#### **Conclusion**

The Final Rule is intended to implement the Fifth Circuit decision in *Chamber of Commerce v. DOL* by reinstating the regulations in effect prior to the 2016 Rule. According to the preamble to the Proposed Exemption, the Proposed Exemption is intended to (i) provide broader and more flexible relief than existing PTEs, (ii) provide additional certainty regarding compensation arrangements, and (iii) avoid the complexity associated with required reliance on multiple PTEs when providing investment advice. The comment period on the Proposed Exemption ended in early August.

Employers should review the Proposed Exemption for additional details regarding the requirements for compliance and the circumstances that would result in Financial Institutions and Investment Professionals being excluded from relief under the Proposed Exemption.

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1. Chamber of Commerce v. DOL, 885 F.3d 360 (5th Cir. 2018). [↵](#)
2. ERISA §§ 406(a)(1)(A) and (D) and 406(b); Code §§4975(c)(1)(A), (D), (E) and (F). [↵](#)
3. Fact Sheet, "Improving Investment Advice for Worker & Retirees," U.S. Department of Labor Employee Benefits Security Administration, <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/improving-investment-advice-for-workers-and-retirees> [↵](#)
4. Improving Investment Advice for Worker & Retirees," Section V(d), 85 Fed. Reg. 40864 (July 7, 2020). [↵](#)
5. Id. at Section V(f) at 40865. [↵](#)
6. Id., Section V(h). [↵](#)
7. Id., Preamble at 40838. [↵](#)
8. d., Preamble at 40840. [↵](#)
9. Id., Preamble at 40838. [↵](#)
10. Id., Section V(c) at 40864 [↵](#)
11. Id., Preamble at 40834. [↵](#)
12. Id., Section II(a) at 40862. [↵](#)
13. Id., Section V(a) at 40864; preamble at 40842. [↵](#)
14. Id. [↵](#)
15. Id., Section II(b) at 40863. [↵](#)
16. Id., Section II(c). [↵](#)
17. Id., Section II(d). [↵](#)

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