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# The Proposed DOL Fiduciary Rule: Significant Changes for Advisers

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The proposed fiduciary rule (the "Proposal") recently issued by the Department of Labor (DOL), if finalized, will have a significant impact on services provided by advisers to retirement plans and IRAs. The Proposal has an expansive fiduciary definition that will cover many activities previously considered non-fiduciary under the Employee Retirement Income Security Act of 1974, as amended (ERISA), and the Internal Revenue Code of 1986, as amended (the "Code"). As a result, advisers may need the relief provided by Prohibited Transaction Exemption (PTE) 2020-02, which was also proposed to be amended as part of the Proposal, to avoid a prohibited transaction.

PTE 2020-02 is an exemption from the prohibited transaction rules of the Code and ERISA that allows advisers to receive conflicted compensation resulting from non-discretionary fiduciary investment advice to private sector tax-qualified and ERISA-governed retirement plans, participants in those plans, and IRA owners (collectively, "retirement investors"). When an adviser provides fiduciary investment advice that an investor can accept or reject, the DOL considers it to be nondiscretionary advice. For instance, fiduciary advice recommending a plan rollover is nondiscretionary – even if the rolled over funds will be managed on a discretionary basis in the rollover IRA – because an investor can decide not to implement the recommended rollover. And, if that advice results in a fee that the adviser would not have otherwise received – for example, the investment management fee from the IRA – it is a prohibited self-dealing transaction and the adviser will need the relief provided by PTE 2020-02.

This article highlights key provisions of the Proposal and the amendments to PTE 2020-02 that will impact investment advisers.

## The Proposed Fiduciary Advice Definition

In a marked departure from the current fiduciary advice definition, the Proposal eliminates the current five-part test for nondiscretionary advice, including the "regular basis" component of the test.

***Current Regulatory Definition***

Under the current regulatory definition of fiduciary advice, an adviser is a fiduciary under ERISA and/or the Code when (1) providing advice about investments for a fee, (2) on a regular basis, (3) under a mutual understanding with the plan fiduciary, plan participant or IRA owner, (4) that the advice will serve as a primary basis for investment decisions with respect to plan or IRA assets, and (5) that the advice is based on the particular needs of the plan or IRA (the "5-Part Test").

The DOL expanded its interpretation of the "regular basis" component in the Preamble to PTE 2020-02. Under the re-interpretation, an adviser would have been providing advice on a regular basis (1) if the adviser has a pre-existing advice relationship with the investor on tax-qualified retirement assets (*e.g.*, advising on another IRA), or (2) if the adviser anticipates that the rollover recommendation is the first step in an ongoing financial relationship concerning tax-qualified retirement assets (*e.g.*, the rollover IRA).

However, a judge in a Federal District Court in Florida found that the DOL's re-interpretation conflicted with the current regulation and vacated the guidance. In response, the DOL has proposed a new regulation (the Proposal).


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Instead of applying a five-part test, the Proposal expands the meaning of covered advice and defines fiduciary based on the context in which the person provides the covered advice.

**Expansive Meaning of Covered Advice**

Under the Proposal, covered advice includes recommending investment in securities for a retirement investor, but it also includes:

- *Recommendations with respect to investment property* – A covered recommendation includes advice about non-securities investments for plans and IRAs, such as non-security annuities, banking products, and digital assets (regardless of status as a security).
- *Recommendations on investment policies or strategies* – The DOL offers, as an example, "recommendations generally to use a bond ladder, day trading … or margin strategy involving securities" regardless of whether the recommendation identifies particular securities. This suggests that, if an adviser recommends an asset allocation strategy, it would be a covered recommendation even if the adviser does not recommend any specific investments.
- *Recommendation of how rollover proceeds should be invested* – Recommendations about the investment of assets after they are rolled over from a plan or IRA is covered advice under the Proposal. This means that if an adviser provides a retirement investor with an investment proposal for IRA assets after they are rolled over from a plan or transferred from another IRA—even without a rollover recommendation, the investment proposal would be fiduciary advice.
- *Recommending an investment adviser or investment manager* – This is a surprising expansion of covered advice. Under current DOL guidance, recommending an investment manager is akin to recommending an investment, but until issuance of the Proposal, the DOL had not taken this same view in connection with recommending a nondiscretionary investment adviser.
- *Recommending a rollover or distribution* – A recommendation as to rolling over, transferring, or distributing assets from a plan or IRA including whether to engage in the transaction, the amount, the form and the destination of the rollover, transfer, or distribution is also a covered recommendation. In other words, recommending a plan to IRA rollover, plan to plan rollover, IRA to IRA transfer, or an IRA to plan rollover is a covered recommendation. Also, a recommendation of a distribution from a plan or an IRA is itself a covered recommendation; but the recommendation would need to satisfy the Proposal's definition of nondiscretionary advice which means, *g.*, that the adviser would need to earn a fee or other compensation as a result of the advice.
- *Recommending an investment account arrangement* – The DOL explains that recommending a selection of an investment account, such as moving from a commission-based account to an advisory fee-based account (or vice versa) is also a covered recommendation. Other than this example, the DOL provides no additional guidance on what constitutes an account. However, this does not mean that these are the only two account types the DOL has in mind. The DOL points out that this provision is intended to be consistent with the SEC's Regulation Best Interest and the Advisers Act's fiduciary obligations. And, the SEC is far more specific in its description of account types (*g.*, 529 education accounts, IRAs, Roth IRAs, SEP-IRAs, HSAs, etc.).

**The Context in Which the Advice Is Provided**

Under the Proposal, an adviser that makes a covered recommendation (as described above) is considered to be providing fiduciary advice under the following circumstances:

- **An adviser already has discretionary investment management authority over investor's assets.** An adviser that has discretionary authority over any investment property of the investor – regardless of whether or not the investment property is held in a retirement account – and makes a covered recommendation about the investor's plan or IRA assets would be considered a fiduciary. For example, if an adviser is providing wealth management services with respect to personal assets of an investor, any covered recommendations that the adviser makes to the investor about retirement assets would be considered a fiduciary act under the Proposal. This has not been in past definitions of fiduciary status.
- **Investment recommendations are a regular part of business.** The Proposal says that where (i) a person provides recommendations to investors on a regular basis as part of their business; (ii) a person provides a covered recommendation to a retirement investor based on the investor's particular needs or individual circumstances; and (iii) the circumstances indicate that the retirement investor may reasonably rely on the recommendations as being in the retirement investor's best interest, the person is providing fiduciary advice. Under this new definition, it appears that one-time recommendations by investment advisers would ordinarily be fiduciary advice because an adviser is in the business of providing investment recommendations to investors on a regular basis, is required by SEC guidance to obtain information for an investor profile and base recommendations on that information, and the SEC deems an adviser's duties of care and loyalty as an obligation to act in the best interest of the adviser's clients. That could apply, for example, to recommendations to rollover from a retirement plan to an IRA. Where an adviser provides a fiduciary recommendation to rollover from an ERISA plan to an IRA managed by the adviser, the Proposal and PTE 2020-02 require that an adviser engage in a prudent process to evaluate the retirement investor's options (*g.*, stay in the plan, rollover, transfer to another plan if the investor is switching jobs, or take a distribution) and the relevant factors for each (*e.g.*, investments, services, fees, etc.) and then determine whether the rollover recommendation is in the investor's best interest based on the investor's financial circumstances, investment objectives, and needs.

The Proposal, if finalized, will cause more adviser interactions with retirement investors to be considered fiduciary advice under ERISA and/or the Code. And, if the fiduciary advice results in compensation that the adviser would not have otherwise received, the adviser will be engaged in a self-dealing transaction and will need to rely on PTE 2020-02. For example, the advisory fees earned from a recommended rollover IRA or a transferred IRA would be prohibited transactions; similarly, any revenue sharing from custodians would be prohibited transactions. Another example would be if an investment adviser recommends products managed by the adviser or an affiliate. Also, if the fiduciary advice is with respect to ERISA plan assets, then the ERISA fiduciary duties of prudence and loyalty will apply.

## Amendments to PTE 2020-02

The DOL also proposes to amend the disclosure requirements of PTE 2020-02 and the self-correction process. We will focus on the amendments to the disclosure requirements. The other PTE conditions remain much the same.

> The PTE 2020-02 conditions are: (1) adherence to a best interest standard (a standard that mirrors the ERISA duties of prudence and loyalty), (2) reasonable compensation and best execution standards, (3) no materially misleading statements, (4) pre-transaction disclosures, (5) adoption and implementation of policies and procedures to ensure compliance, and (6) an annual retrospective review reduced to a written report certified by a senior executive officer.

PTE 2020-02 requires that disclosures be provided to retirement investors before engaging in a recommended transaction. The amendment proposes the following changes:

- *Fiduciary Acknowledgement* – The DOL's proposed changes to PTE 2020-02 retain the requirement that the adviser acknowledge that, in making the covered recommendation, the adviser is a fiduciary under ERISA, the Code or both. In the Preamble, the DOL emphasizes that the fiduciary acknowledgement must be clearly stated so that the retirement investor knows whether the recommendation is coming from an ERISA or Code fiduciary. The DOL cautions that the acknowledgement should not be worded to say that the adviser "may" be a fiduciary or that the adviser is a fiduciary to the extent the adviser meets the fiduciary advice definition.
- *Best Interest Statement* – The disclosure would need to include a written statement of the best interest standard owed to the retirement investor.
- *Additional Fee Description* – The PTE continues to require that the disclosure describe the services to be provided and the material conflicts of interest. It also adds a requirement that there be a statement as to whether the retirement investor will pay for such services directly or indirectly (*g.*, third party payments). In addition, the disclosure would need to include a statement that the retirement investor has the right to obtain – free of charge – specific information regarding costs, fees, and compensation in order to permit the investor to make an informed decision about costs and the significance and severity of the conflicts of interest.
- *Rollover Disclosure* – If the covered recommendation is a rollover, the adviser must document the basis for its conclusion as to whether the rollover was in the investor's best interest and provide that documentation to the investor. The DOL's proposed changes require that relevant factors for the adviser to consider in developing a rollover recommendation include (but are not limited to) the alternatives to the rollover, the fees and expenses associated with each alternative, whether the employer pays for some or all of the plan's administrative expenses, and the different levels of services and investments under each alternative. The PTE currently requires that the disclosure identify the specific reasons why the rollover is in the best interest of the retirement investor (*g.*, the plan participant or IRA owner). This change appears to go beyond that by requiring that the documentation supporting the best interest determination be provided to the investor. Unfortunately, the DOL did not discuss this change in the Preamble to the proposed changes to PTE 2020-02 and, as a result, the extent of the disclosure is not clear.

The Preamble to the proposed changes to PTE 2020-02 includes model language that satisfies the fiduciary acknowledgement condition, the statement of the best interest standard and a statement addressing the investor's right to receive specific information about fees, costs, and compensation. The other parts of the disclosure would need to be customized to align with the specific recommendation and service offering.

## Closing Thoughts

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Under the Proposal, more interactions with retirement investors – including one-time advice – could be considered fiduciary acts subject to the prohibited transaction rules of ERISA and/or the Code. To avoid a prohibited transaction for covered recommendations, investment advisers would need to satisfy the conditions in PTE 2020-02, which requires, among other things, a best interest process and pre-transaction disclosures. This article discusses the proposed changes; the next step is for the DOL to receive comments on the proposed changes and develop a final regulation. It would be reasonable to expect final rules in mid-year 2024. In the meantime, advisers should review policies, procedures and disclosures and consider how these changes could be addressed.

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