LEGAL UPDATE

Do You Have Questions About How to Comply with the New DOL Fiduciary "Investment Advice" Prohibited Transaction Exemption?

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Part 2 of Several Parts

Editor's Note: The first part of this Article can be found in our May 2021 issue, Vol. 28, No. 4. As with Jeff Mandell's note thereto, subsequent developments may affect this topic. We will do our best to post future material changes, if any.

On December 15, 2020, the DOL issued class exemption 2020-02 (the PTE or Exemption) which provides conditional relief to fiduciaries who render investment advice to employee benefit plans, plan participants, and owners of individual retirement accounts (IRAs) from the prohibited transaction rules under Title I of ERISA and

the Internal Revenue Code. The PTE is designed to replace the prior law.

All experts seem to agree that more advisers are now deemed to be fiduciaries, and that most investment advice is at least potentially conflicted. But the law provides disclosure, self-monitoring, and mitigation rules for advice fiduciaries and their financial institutions. We pick up here where the May 2021 issue ended.

Editor's Note: To fully appreciate the following context, including this paragraph regarding rollover, reading our Part 2 is compelling.

Disclaimers

Also, according to the PTE preamble and the DOL Fact Sheet, an adviser making a rollover recommendation may disclaim fiduciary status unequivocally even though, in general, disclaimers about fiduciary status are not necessarily determinative. In the rollover context, the preamble states that ". . . Additionally, parties can make clear in their communications that they do not intend to enter into an ongoing relationship to provide investment advice, and avoid fiduciary status, if they act in conformity with that communication. . ."

General PTE Provisions to Avoid Fiduciary Status

The PTE requires the advice fiduciaries to comply with impartial conduct standards, including a best interest standard. The investment advice must be, at the time it is provided, in the best interest of the retirement investor. Such advice:

1. meets ERISA's prudent expert rule, based on the objectives, risk tolerance, financial circumstances, and needs of the retirement investor, and
2. does not place the financial or other interests of the advice fiduciary, or any affiliate, related entity, or other party ahead of the interests of the investor or subordinate the investor's interests to their own.

The PTE further requires that the compensation received, directly or indirectly, for both the advice and for all related transactions, does not exceed reasonable compensation within the meaning of ERISA and the Code, and, as required by the federal securities law, the advice fiduciary seeks to obtain the best execution of the investment transaction reasonably available under the circumstances.

The PTE includes conditions designed to support compliance with the impartial conduct standards:

- Advice fiduciaries must make certain disclosures to retirement investors in advance of interaction, including a written acknowledgment that the advice fiduciary is a fiduciary as well as a written description of the services to be provided and any material conflicts of interest.
- The advice fiduciary must provide prior documentation of the specific reasons why a rollover recommendation is in the best interest of the investor, whether the transfer is plan to plan, plan to IRA, or from one type of account to another (*e.g.*, commission-based to fee-based account).
- Advice fiduciaries must not make any statements about recommended investment transactions and other relevant matters that are materially misleading at the time they are made. An example given as misleading is to include any exculpatory clauses or indemnification provisions in an agreement with a retirement investor that are precluded by applicable law.
- The advice fiduciaries must maintain written policies and procedures for compliance with the impartial conduct standards, including having policies that ". . . 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 the [advice fiduciaries] to place their interests ahead of the Retirement Investor."
- The advice fiduciaries must conduct, and report on, an annual retrospective review designed to detect any violations of the impartial conduct standards or of the advice fiduciaries' own policies and procedures. A responsible fiduciary must certify the report within six months. The report and certification and supporting data must be held for six years and made available to the DOL within ten days' notice of a request. The advice fiduciary is also required to maintain for six years records generally demonstrating compliance to be available to authorized employees of the DOL and the Department of the Treasury.
- There is a conditional bar on using the PTE by persons and entities who have engaged in criminal conduct or other egregious conduct regarding compliance with the exemption.

The Exemption covers certain riskless "principal transactions," certain advice by insurance companies that sell insurance products and certain annuities through their employees as well as independent agents, and advice involving an Archer medical, a health savings, or Coverdell education savings account (except for rollover advice).

Exclusions from Use of the Exemption

The exemption is not available for plans for which the advice fiduciary, or an affiliate, is: (a) the employer of employees covered by the plan or (b) a named fiduciary or plan administrator selected by a fiduciary that is not independent of the investment advice fiduciary. Nor is it available for certain

detached computer, investment advice, or discretionary fiduciary investment arrangements.

The Final PTE Also:

- Adds a self-correction program for non-exempt prohibited transactions due to a violation of the PTE's conditions with respect to a transaction. The PTE provides that there is no prohibited transaction if, among other conditions, there is no investment loss, or the investor is made whole, and the advice fiduciary corrects the violation within 90 days and notifies the DOL within 30 days of the correction.
- Adds a requirement that, prior to engaging in any of the types of rollovers described in the PTE recommended pursuant to the exemption, the fiduciary provide in advance a specific written explanation to the investor for its recommendations relating to the rollover.
- Streamlines the required retrospective annual report delivery to just one plan functionary before certification and transmittal to the DOL, removes a requirement that the advice fiduciary make the fiduciary's annual reports available to plans and participants, and also limits access to the advice fiduciaries' compliance data to only authorized employees of the DOL and the Treasury Department.
- Adds definitions for important PTE terms and rewrites the mitigation policy regarding a "misalignment of interests."
- Has a broad and subjective definition of "conflict of interest" to make a recommendation that is not in the best interest of the retirement Investor. The purpose seems to be to encourage advice fiduciaries to assume there might be conflicts of interest, and therefore a need for mitigation, for any possible interest, especially for every IRA rollover, plan to plan transfer or transfer to a different type of compensation scheme, and likely as well, for any type of variable compensation, revenue sharing or other indirect compensation, use of proprietary products, use of limited investment product options, and transactional costs related to the advice.

As we have described, the mitigation appears to be largely a matter of self-policing—disclosure, written policies, monitoring by the advice fiduciary institution of both advice and related transactions, written justification for some specific conflicts of interest, retrospective certifications as to compliance by the financial institution, and recordkeeping.

Conclusion

The PTE appears to suggest that it is safest to assume that the five-part test sweeps in most investment advisers, and to assume that all investment advice is potentially imprudent, disloyal, a prohibited transaction, or otherwise problematic. But the PTE in effect passes the responsibility to the investor, whether a plan, plan participant, or IRA owner, to understand, and determine, under the reasonable person standard in the PTE, whether the disclosed potential conflict does or does not create an incentive for the advice fiduciary, either individual or institution, to place its interest ahead of the interest of the investor.

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