akerman

Practice Update

DOL to Begin Enforcement of New Fiduciary Advice Exemption

December 28, 2021

By Paul J. Foley, John M. Faust, and Kiki M. Scarff

On December 18, 2020, the United States Department of Labor (the DOL) adopted Prohibited Transaction Exemption 2020-02, *Improving Investment Advice for Workers & Retirees* (PTE 2020-02 or the Exemption), a new prohibited transaction exemption under Title I of the Employee Retirement Income Security Act of 1974 (ERISA), as amended, and the Internal Revenue Code of 1986, as amended (the Code), that impacts registered investment advisers (each, an Adviser) who provide fiduciary investment advice to Retirement Investors, a term which includes participants in workplace retirement plans (Plans) and Plan beneficiaries, individual retirement account (IRA) beneficial owners, and Plan and IRA fiduciaries. Specifically, PTE-2020-02 allows such Advisers to receive otherwise prohibited compensation, including commissions, 12b-1 fees, trailing fees, sales loads, revenue sharing payments, and mark ups and mark downs in certain principal transactions, in exchange for rendering fiduciary investment advice. Importantly, PTE 2020-02 also expanded the scope of the term "fiduciary investment advice" such that more Advisers may be considered fiduciaries under PTE 2020-02 and thus will need the protections afforded by the Exemption. PTE 2020-02 went into effect on February 16, 2021; however, enforcement of the Exemption was delayed until January 31, 2022. Accordingly, parts of the Exemption will be enforced beginning February 1, 2022, and the remaining parts

Related People

John M. Faust
Paul J. Foley
Kiki M. Scarff

Related Work

Investment Management

Related Offices

Washington, D.C.
Winston-Salem

of the Exemption will be enforced beginning July 1, 2022.

Fiduciary Investment Advice

Under ERISA, an Adviser to a Plan is a fiduciary when "render[ing] investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such [P]lan, or ha[ving] any authority or responsibility to do so." The Code includes a parallel provision defining a fiduciary of a tax-qualified plan, including IRAs. The DOL has adopted a five-prong test for determining when recommendations constitute investment advice made by a fiduciary under ERISA, which test also applies to the definition of fiduciary in the Code. Under this test, recommendations are considered investment advice when (i) advice is rendered as to the value of securities or other property, or that pertain to the advisability of investing in, purchasing, or selling securities or other property; (ii) on a regular basis; (iii) pursuant to a mutual agreement, arrangement, or understanding with the Plan, Plan fiduciary, or IRA owner; (iv) that the recommendation will serve as the primary basis for investment decisions with respect to Plan or IRA assets; and (v) that the recommendation will be individualized based on the particular needs of the Plan or IRA.

Under PTE 2020-02, rollover recommendations made to Plan participants and beneficiaries and IRA owners may also constitute fiduciary advice. The term "rollover" is construed broadly to include a rollover from: (i) a Plan to an IRA, (ii) a Plan to another Plan, (iii) an IRA to a Plan, (iv) an IRA to another IRA, and (v) one type of account to another (e.g., from a brokerage account to an advisory account). A rollover recommendation is deemed to be fiduciary investment advice when it satisfies the five-prong test described above. Accordingly, a single, discrete rollover recommendation would not constitute fiduciary investment advice, as it would not meet the "regular basis" prong of the test; however, a rollover recommendation made as part of

an ongoing relationship or as the start of an anticipated ongoing relationship would likely constitute fiduciary investment advice.

Compliance with PTE 2020-02

Advisers who are providing fiduciary investment advice to Retirement Investors under ERISA and/or the Code will need to take certain steps to receive or continue receiving otherwise prohibited compensation in accordance with PTE 2020-02, including each of the following:

- *Complying with Impartial Conduct Standards*. The impartial conduct standards (the Impartial Conduct Standards) require investment advisers and broker-dealers to (i) give advice that is in the best interest of the Plan or IRA owner; (ii) charge only reasonable fees (e.g., fees that are customary and reasonable based on what the investor is receiving) and comply with securities laws regarding best execution; and (iii) make no misleading statements about investment transactions or other relevant matters.
- *Acknowledging Fiduciary Status*. Advisers must provide a written acknowledgment of their status as fiduciaries under ERISA. The DOL has provided model language in the preamble of PTE 2020-02 that can be used by Advisers to satisfy this requirement. This requirement can be satisfied by including the model language in the investment management agreement and Part 2A of the Form ADV. The DOL has also recommended including certain additional language in this written acknowledgment, but such language is not required to be included in the acknowledgement.
- *Providing Written Disclosures About Scope of Relationship and Conflicts*. Advisers must provide written disclosures to their clients regarding the scope of their relationship and all material conflicts of interest arising from the services being provided or any recommended investment transaction. This requirement can be satisfied by including such disclosures on existing disclosure

forms, such as Form ADV and/or Form CRS. Additionally, amendments can be made to ERISA Section 408(b)(2) disclosures to meet this requirement.

- *Providing Written Disclosures About Rollovers.* Advisers who are providing rollover recommendations to Plans or IRA owners must document in writing the reasons why the rollover recommendation is in the retirement investor's best interest. The DOL has provided certain factors that should be considered and documented when making such decisions. When the recommendation of an Adviser is to rollover from a 401k plan to an IRA, the factors to be considered and documented include: (i) alternatives to a rollover, (ii) a comparison of fees and expenses associated with the plan and the IRA, (iii) whether the employer pays all or any part of the plan's administrative expenses, and (iv) a comparison of the levels of service and investments available for each plan. The DOL has provided similar factors to be considered and documented when the recommendation is to rollover from one IRA to another IRA, including: (i) the long-term impact of increased costs, (ii) the appropriateness of the rollover, and (iii) the impact of economically significant investment features.
- *Drafting Policies and Procedures*. Advisers must adopt and implement policies and procedures to: (i) ensure compliance with the Impartial Conduct Standards, (ii) mitigate conflicts of interest, and (iii) document specific reasons for recommendations made to retirement investors.
- *Conducting Annual Compliance Review*. Advisers are required to conduct an annual compliance review regarding their compliance with PTE 2020-02. This review is designed to detect and prevent violations of PTE 2020-02. Results of the compliance review must be documented and given to a senior executive officer, who will then provide certain written certifications regarding the report. The review, report, and certification

must be completed no later than six (6) months following the end of the reporting period, and the report, certification, and supporting data maintained by the Adviser for a period of six (6) years.

Enforcement

The DOL will begin enforcing compliance with the Impartial Conduct Standards on February 1, 2022 and will begin enforcing the remaining documentation and disclosure requirements on July 1, 2022. Advisers should expect that the DOL, the Securities and Exchange Commission, and the Internal Revenue Service will work closely together to enforce compliance with PTE 2020-02 and that punishments for violations of PTE 2020-02 will be harsh. If an Adviser violates PTE 2020-02, then the Adviser may be banned from relying on the Exemption for a period of ten years, during which time the Adviser would be prohibited from receiving certain compensation in exchange for providing fiduciary investment advice to a Retirement Investor.

Conclusion

Advisers should begin gearing up to ensure their compliance with the Impartial Conduct Standards well ahead of the January 31, 2022, deadline and should also begin undertaking preparations to comply with the remaining documentation and disclosure requirements well ahead of the June 30, 2022, deadline. While most firms are currently operating in compliance with a best interest or fiduciary standard (e.g., the fiduciary standard under the Investment Advisers Act of 1940, as amended (the Advisers Act)), adjustments to policies and procedures are still likely needed. In fact, the DOL has stated that firms complying with current standards under Regulation Best Interest (Reg-BI) or the Advisers Act may not necessarily be in compliance with PTE 2020-02.

For additional information please contact Paul Foley, Chair, John Faust, or Kiki Scarff, each of Akerman's

Investment Management Practice.
