akerman

Practice Update

Redefining the Investment Advice Fiduciary (Again) – What a Long, Strange Trip It's Been…

May 23, 2024

By Gabriel S. Marinaro and Angelica C. Fortney

The Department of Labor has once again updated the definition of an "investment advice" fiduciary under ERISA and amended related prohibited transaction exceptions (PTEs). The new fiduciary rule (2024 Rule) will require plan sponsors to review their relationship with third-party administrators and investment advisers that were not previously treated as fiduciaries under the existing definition. This could include potential revisions to services agreements, additional considerations for rollover advice provided to participants, and fiduciary due diligence regarding investment products offered.

Published in April, the 2024 Rule and the PTE amendments generally take effect on **September 23, 2024,** although there is an additional one-year transitional period for certain conditions under the amended PTEs.

The Evolving Definition of Investment Advice Fiduciary

ERISA and the Code impose certain responsibilities, including the duties of prudence and loyalty, on persons who are fiduciaries with respect to a plan. One of the types of fiduciaries specified in the statutes is a person or entity that *renders investment advice for a fee or other compensation*. The DOL

Related People

Angelica C. Fortney
Gabriel S. Marinaro

Related Work

Employee Benefits and Executive Compensation

Related Offices

Chicago
Miami

issued regulations in 1975, shortly after ERISA became law, that construed when an investment advice provider was a fiduciary for these purposes. [1]

Since then, the DOL has observed that those standards no longer fit the investment landscape, which is now more populated by participant-directed 401(k)s and IRAs than defined benefit pension plans. In 2016, the DOL attempted to respond to these contemporary changes by adopting an updated investment advice fiduciary definition that broadly covered most paid recommendations to retirement investors and publishing new PTEs. These 2016 updates were struck down in 2018 by the Fifth Circuit Court of Appeals as overly broad and exceeding the DOL's authority, and the DOL ultimately returned to the 1975 version of the rule and published new PTE 2020-02.

In the DOL's latest attempt to update the investment advice rule, it expressed its intent to focus on whether an investment recommendation can be appropriately treated as trust and confidence advice, as guided by the Fifth Circuit. The DOL also emphasized that the 2024 Rule better complements guidance issued in the wake of its prior rulemaking by other regulators like the SEC and the NAIC, requiring actors to adhere to certain "best interest" standards.

The 2024 Rule expands the ERISA definition of an investment advice fiduciary to include a person who (for a fee or other compensation) makes a "recommendation" of any securities transaction or other investment transaction advice to a "retirement investor" in one of the following contexts:

- The person directly or indirectly (e.g., through or together with any affiliate) makes professional investment recommendations to "retirement investors" (under the 2024 Rule, a plan, plan fiduciary, plan participant or beneficiary, IRA (including HSAs), IRA owner or beneficiary, or

IRA fiduciary[2]) on a regular basis, as part of their business, and under circumstances that would indicate to a reasonable investor in like circumstances that the "recommendation":

  - is based on review of the retirement investor's particular needs or individual circumstances, [3]
  - reflects the application of professional or expert judgment to the retirement investor's particular needs or individual circumstances, and
  - may be relied upon by the retirement investor as intended to advance the retirement investor's best interest.
- The person represents or acknowledges that they are acting as a fiduciary under ERISA, with respect to the "recommendation."[4]

This would mean recommendations as to:

- investment strategy; the advisability of acquiring, holding, disposing of, or exchanging securities or other investment property; or how same should be invested after being rolled over, transferred, or distributed from a plan or IRA;
- the management of securities or other investment property; and
- the rolling over, transferring, or distributing of assets from a plan or IRA (including whether to engage in the transaction, the amount, the form, and the destination of same).

The 2024 Rule also defined "fee or other compensation" from the statute as any explicit fee from any source received in connection with or as a result of the recommended purchase, sale, or holding of a security or other investment property, or provision of investment advice. This would include commissions, revenue-sharing payments, finder's fees, marketing or distribution fees, underwriting compensation, payment to brokerage

firms for shelf space, gifts and gratuities, other non-cash compensation, and more.

Key Amendments to Prohibited Transaction Exemptions

In connection with the 2024 Rule, the DOL also adopted amendments to PTEs 2020-02, 75-1, 77-4, 80-83, 83-1, 86-28, and 84-24. For purposes of this alert, we only address the amendments to PTEs 2020-02 and 84-24. Investment professionals whose compensation for each recommendation to a retirement investor varies typically rely on two widely used exemptions, with certain conditions, to permit such arrangements: PTE 2020-02 (available to investment firms and professionals regardless of product recommended) and PTE 84-24 (for insurance agents).

Under PTE 2020-02, investment advice fiduciaries are permitted to receive variable compensation, depending on the investment product they recommend, if the investment firm or professional:

- Acknowledges their fiduciary status in writing to the retirement investor (disclosing their services and any material conflicts of interest);
- Adheres to "impartial conduct standards," by: (i) evaluating investments, providing advice and exercising sound judgment in the same way that knowledgeable and impartial professionals would in similar circumstances ("Care Obligation"), and (ii) never placing their own (investment professional or firm's) interests ahead of the retirement investor's interest ("Loyalty Obligation");
- Charges no more than reasonable compensation (if applicable, comply with the "best execution" standards under federal securities laws); and
- Avoids misleading statements about investment transactions and related matters, including: (i) adopting policies and procedures to ensure compliance with the impartial conduct standards

(noted above) and mitigate conflicts of interest that would otherwise violate such standards; (ii) documenting and disclosing specific reasons for any rollover recommendations; and (iii) conducting annual retrospective compliance reviews.

The amendments to PTE 2020-02, include expanding the scope of the exemption to include recommendations of any investment product, regardless of whether the product is sold on a principal or agency basis, and adding non-bank health savings account trustees and custodians to the definition of a "financial institution."

Relatedly, the DOL amended PTE 84-24 to exclude sales and compensation for "independent producers" (generally a person licensed under state laws to sell or negotiate insurance contracts, including annuities, and sells to retirement investors products of unaffiliated insurance companies and is independent of such insurance companies) that receive compensation in connection with the sale of a non-security annuity contract or other insurance products. The exemption and the amendments largely follow the requirements under PTE 2020-02, with some specific conditions to protect retirement investors from specific conflicts that can arise when independent producers are compensated through commissions and other compensation in connection with the provision of investment advice to retirement investors regarding the purchase of an annuity.

Takeaways for Plan Sponsors

Before the Rule takes effect in September 2024, plan sponsors should consider their relationships with investment advisers and their interaction with participants, including advice regarding rollovers.

Plan sponsors should be especially wary of attempted disclaimers of fiduciary status, as the 2024 Rule clarifies that such language will not

control in the analysis of fiduciary status. Before the 2024 Rule takes effect, plan sponsors may want to catalog their existing service agreements and consider amendments to strengthen or clarify the obligations of investment advisers and other third-party administrators in connection with investment advice interactions.

---

[1] The existing 1975 regulations create a five-part test to determine whether a person is an investment advice fiduciary: (i) such person renders advice to the plan as to value of securities or other property or makes recommendation as to the advisability of investing in, purchasing, or selling securities or other property; and (ii) such person either directly or indirectly (x) has discretionary authority or control, whether or not pursuant to an agreement or other understanding with respect to the purchasing or selling of securities or other property for the plan or (y) renders any advice on a regular basis to the plan, (iii) pursuant to a mutual agreement, arrangement or understanding, (iv) such services will serve as a primary basis for investment decision, and (v) such person will render individualized investment advice to the plan based on the particular needs of the plan.

[2] The DOL clarifies, however, this is not intended to cover instances where a person provides advice to a financial professional or firm that, in turn, will render advice to retirement investors in a fiduciary capacity.

[3] The DOL clarified in the final Rule that generalized sales pitches and investment education, thus, would not necessarily constitute fiduciary investment advice.

[4] The DOL clarified in the final Rule that a person acknowledging their fiduciary status would only apply with respect to that recommendation and not with respect to every future interaction with the same retirement investor.
