Definition of an Investment Advice Fiduciary – April 25, 2024

On April 25, 2024, the Department of Labor (Department) issued the final Retirement Security Rule and amendments to several existing Prohibitive Transaction Exemptions. This regulation is **effective on September 23, 2024**. The final rule better reflects the text and the purposes of ERISA and better protects the interests of **retirement investors**[1], consistent with the Department's mission to ensure the security of the retirement, health, and other workplace-related benefits of America's workers and their families. The final rule is designed to ensure that retirement investors' reasonable expectations are honored when they receive advice from financial professionals who hold themselves out as trusted advice providers. The final rule is intended to protect the interests of retirement investors by requiring persons who are defined in the final rule as investment advice **fiduciaries**[2] to adhere to stringent conduct standards and mitigate their conflicts of interest.

THE FINAL RULE

This final rule defining when a person renders "investment advice for a fee or other compensation, direct or indirect" with respect to any moneys or other property of an employee benefit plan, for purposes of **the definition of a "fiduciary"** in the Employee Retirement Income Security Act of 1974 (Title I of ERISA or the Act). The final rule also applies for purposes of Title II of ERISA to the definition of a fiduciary of a plan defined in Internal Revenue Code (Code), including an **individual retirement account (IRA)** or other plan identified in the Code. Additionally, the Department issued amendments to Prohibited Transaction Exemption 2020–02 (Improving Investment Advice for Workers & Retirees) and to several other existing administrative exemptions from the prohibited transaction rules applicable to fiduciaries under Title I and Title II of ERISA.

The fiduciary protections and prohibited transaction rules set forth in Title I and Title II of ERISA, as applicable, broadly apply to covered fiduciaries, irrespective of the particular investment product they recommend or their status as investment advisers under the Advisers Act, broker-dealers, insurance agents, bankers, or other status. This final rule is designed to ensure that the standards and rules applicable under Title I and Title II of

[1] **Retirement Investor** - a plan, plan fiduciary, plan participant or beneficiary, IRA, IRA owner or beneficiary or IRA fiduciary

[2] A ''**fiduciary**'' or "**fiduciaries**" are intended to mean an ERISA Title I and Title II fiduciary unless otherwise stated.

ERISA are broadly uniform as applied to retirement investors receiving advice from a trusted advisor across different categories of investment advice providers and advisory relationships.

FIDUCIARIES UNDER ERISA

Broadly under Title I and Title II of ERISA, the statutory definition of a fiduciary at **section 3(21)(A)**, which provides that "a person is a fiduciary with respect to a plan to the extent the person (the final rule focuses on section (ii)):

(i) exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,

(ii) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or

(iii) has any discretionary authority or discretionary responsibility in the administration of such plan.11 The same definition of a fiduciary is in Code section 4975I(3)[3].

In 1975, the Department issued a regulation at 29 CFR 2510.3–21I(1)[4] (the **1975 regulation**) that defined the circumstances under which a person renders "investment advice" to an employee benefit plan within the meaning of ERISA section 3(21)(A)(ii),
such that the person would be a fiduciary under ERISA.

THE 1975 FIVE PART TEST (this is being replaced)

The 1975 regulation significantly narrowed the plain and expansive language of ERISA
section 3(21)(A)(ii), creating a five-part test that must be satisfied in order for a person to be treated as a fiduciary by reason of rendering investment advice. Under the five-part test, a person is a fiduciary only if they:

1) render advice as to the value of securities or other property, or make 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 or a plan fiduciary that;
4) the advice will serve as a **primary basis** for investment decisions with respect to plan assets, and that
5) the advice will be **individualized** based on the particular needs of the plan.

[3] https://codes.findlaw.com/us/title-26-internal-revenue-code/26-usc-sect-4975/

[4] https://www.ecfr.gov/current/title-29/subtitle-B/chapter-XXV/subchapter-B/part-2510/section-2510.3-21

THE RATIONALE FOR THE NEW RULE

An important premise of Title I and Title II of ERISA is that fiduciaries' conflicts of interest should not be left unchecked, but rather should be carefully regulated through rules requiring adherence to basic fiduciary norms and avoidance of prohibited transactions.

The specific duties to avoid conflicts of interest or comply with a prohibited transaction exemption applicable to fiduciaries under Title I and Title II of ERISA stem from Congress' judgment regarding the best way to protect the public interest in tax-advantaged benefit arrangements. The statutory prohibited transaction provisions in Title I and Title II of ERISA contemplate a stringent approach for the protection of these tax-advantaged retirement savings. In this context, an appropriately constructed regulatory definition of an investment advice fiduciary under Title I and Title II of ERISA is essential.

Developments in retirement savings vehicles and in the investment advice marketplace since the 1975 regulation was adopted that have altered the way retirement investors interact with investment advice providers. In 1975, retirement plans were primarily defined benefit plans, which were typically managed by sophisticated financial professionals. IRAs were not major market participants and 401(k) plans were not yet in existence. Today, however, plan participants, IRA owners, and their beneficiaries exercise direct authority over their investments, and depend upon a wide range of financial professionals, including broker-dealers, investment advisers subject to the Advisers Act, insurance agents, and others on how to make complex decisions about the management of retirement assets.
The Department expressed the view in the proposal that when a financial professional satisfies all five parts of the 1975 regulation with respect to a given instance of advice, the professional is properly treated as an investment advice fiduciary in accordance with the parties' reasonable understanding of the nature of their relationship.

However, the 1975 regulation, as applied to the current marketplace, is underinclusive in assigning fiduciary status because it fails to capture many circumstances in which an investor would reasonably expect that they can place their trust and confidence in the advice provider as acting in their best interest. The Department's experience in the current marketplace is that the five-part test—in particular, the "regular basis" requirement and the requirement of "a mutual agreement, arrangement or understanding" that the investment advice will serve as "a primary basis for investment decisions"—too often works to defeat legitimate retirement investor expectations of impartial advice and allows investment advice providers to hold themselves out as offering individualized advice that is intended to promote the best interest of the customer, when they, in fact, have no such obligation under the 1975 regulation's implementation of Title I or Title II of ERISA.

THE NEW INVESTMENT ADVICE FIDUCIARY (Final Rule 2024)

The final rule defines when a person is a fiduciary in connection with providing advice to an **investor**[5] saving for retirement through a workplace retirement plan or other type of retirement plan such as an **IRA**[6]. A person is an investment advice fiduciary if they provide a recommendation in one of the following contexts:

(1) The person either directly or indirectly (e.g., through or together with any affiliate) makes professional investment **recommendations**[7] to investors on a regular basis as part of their business and the recommendation is made 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,
- 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.

or

(2) The person represents or acknowledges that they are acting as a fiduciary under Title I of ERISA, Title II of ERISA, or both with respect to the recommendation.

The recommendation also must be provided "for a fee or other compensation, direct or indirect" as defined in the final rule. Advice providers that satisfy the definition of an investment advice fiduciary will be required to adhere to the prudence standard of care, reduce retirement investor exposure to conflicted advice that may erode investment returns, and adopt protective conflict-mitigation requirements.

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[5] **Retirement investors** are (1) participants and beneficiaries in workplace retirement plans, (2) IRA owners and beneficiaries, and (3) plan and IRA fiduciaries with authority or control with respect to the plan or IRA. This excludes plan and IRA investment advice fiduciaries from the definition of a retirement investor. As a result, an asset manager does not render fiduciary advice simply by making recommendations to a financial professional or firm that, in turn, will render advice to retirement investors in a fiduciary capacity.

[6] **IRA** is defined as any account or annuity described in Code section 4975(e)(1)(B)–(F), and includes individual retirement accounts, individual retirement annuities, health savings accounts, and certain other tax-advantaged trusts and plans.

[7] whether a **recommendation** has been made will turn on the facts and circumstances of the particular situation, including whether the communication reasonably could be viewed as a ''call to action.'' The more individually tailored the communication to a specific customer or a targeted group of customers about a security or other investment or group of securities or other investments, the greater the likelihood that the communication may be viewed as a recommendation. The determination of whether a recommendation has been made is an objective rather than a subjective inquiry.

AMENDMENT TO Prohibitive Transaction Exemptions (PTE)[8]

The Department has finalized amendments to several existing exemptions to ensure all retirement investors receive the same quality investment advice, regardless of the product or service they receive.

Under the final amendments, there are two administrative exemptions available for the management of conflicts of interest with respect to advice.

- PTE 2020-02 is broadly available for advice with respect to the wide universe of investments recommended to retirement investors.
- PTE 84-24 is tailored for use by independent insurance agents and is intended to facilitate their ability to make best interest recommendations under their business model.

Both exemptions require that investment recommendations adhere to Impartial Conduct Standards. Those standards state:

- Advice must meet obligations of care and loyalty.
  - Under the care obligation, the advice must meet a professional standard of care as specified in the exemptions.
  - Under the loyalty obligation, advice providers may not place their own interests ahead of the interests of the retirement investor.
- The investment professional and firm must charge no more than reasonable compensation and comply with applicable federal securities laws regarding "best execution."
- The advice must be free from misleading statements about investment transactions and other relevant matters.

PTE 2020-02

PTE 2020-02 allows investment advice fiduciaries to receive compensation that would otherwise be prohibited by law, as long as the fiduciaries comply with the exemption's conditions. The exemption conditions, which include the care and loyalty obligations, emphasize mitigating conflicts of interest and ensuring that retirement investors receive prudent and loyal advice. (Exhibit B)

[8] https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/retirement-security-rule-and-amendments-to-class-pte-for-investment-advice-fiduciaries

The Department's amendment to PTE 2020-02 makes clarifying changes that build on the existing exemption conditions to provide more certainty for fiduciary investment advice providers and more protection for retirement investors.

PTE 84-24

PTE 84-24 is tailored to the special challenges of overseeing investment recommendations by independent insurance agents who recommend annuities issued by more than one insurance company.

Under the amendment, a new section is added to PTE 84-24 to provide relief for independent insurance agents receiving compensation that would otherwise be prohibited for investment advice transactions, subject to conditions like those in PTE 2020-02.

However, unlike PTE 2020-02, the insurance company selling its products through the independent agent is not required to provide a fiduciary acknowledgment and is not treated as a fiduciary merely because it exercised oversight responsibilities over independent agents.

Instead, the independent insurance agent is required to acknowledge its fiduciary status, and the insurance company is required to exercise supervisory authority over the independent agent with regard to an agent's recommendation of the insurance company's own products.

The remaining provisions of PTE 84-24 remain available for transactions that don't involve advice, with minor language changes.

Amendments to PTEs 75-1, 77-4, 80-83, 83-1, and 86-128

The Department also finalized amendments to several existing administrative exemptions that provide relief for certain transactions. The amendments remove fiduciary investment advice transactions from the covered transactions in each exemption and make other administrative changes.

As a result of these amendments, all investment advice fiduciaries will be held to the same conduct standards in administrative exemptions, because they will have to rely on PTE 2020-02 or PTE 84-24 to receive compensation that otherwise would be prohibited.

<u>EXHIBIT A:</u> PUBLIC OBJECTIONS TO THE FINAL RULE SUMMARY HIGHLIGHT

- The five parts of the 1975 regulation are needed to describe a relationship of trust and confidence, consistent with the Fifth Circuit's Chamber opinion.
- The Department had not provided sufficient evidence of existing problems that would be solved by the updated investment advice fiduciary definition.
- The proposed rule exceeded the Department's jurisdiction, for a variety of reasons, including in covering advice to roll over from a workplace retirement plan to an IRA as advice under Title I of ERISA.
- The proposal suffered the same legal flaws as the 2016 Final Rule and would be legally vulnerable under the Chamber opinion.
- The statutory language in ERISA section 3(21)(A) and Code section 4975(e)(3) provides that a person is a fiduciary only "to the extent" they "provide investment advice for a fee or other compensation, direct or indirect," which indicated there were limits on the breadth of what is considered ERISA fiduciary investment advice.
- Financial professionals paid by commission cannot satisfy the ERISA fiduciary duties under Title I which require, among other things, fiduciaries to discharge their duties with respect to the plan "solely in the interests of the participants and beneficiaries." This standard to require a complete disregard of any financial interest, which is incompatible with the business of broker-dealers and insurance agents.
- The SEC in Regulation Best Interest and the NAIC in its Model Regulation intentionally created standards that were not fiduciary standards, and the Department should not override those decisions.
- An updated definition of an investment advice fiduciary is unnecessary in light of the conduct standards in SEC Regulation Best Interest and the adoption by many States of the NAIC Model Regulation. Commenters described these regulatory actions as establishing robust, effective, and workable best interest standards while preserving the ability of retirement investors to work with the financial professional of their choosing and to retain choice as to how they pay for financial services and products.
- Many commenters addressed the impact of the proposal on access to investment advice and products in the retail market. Some commenters believed that the rule would lead to advice providers imposing account minimums or raising their fees.
- Imposing ERISA fiduciary protections on advice and recommendations to retirement investors would lead to a decrease in commission-based arrangements and related access to certain investment products.
- commission-based arrangements provide a valuable source for investment advice and information, and that a reduction in such arrangements would negatively impact retirement investors who may not be best suited for a fee-based investment advice arrangement.

EXHIBIT B: PTE 2020-02[9]

In 2020, the Department also adopted a new, Improving Investment Advice for Workers & Retirees, also known as PTE 2020–02. This exemption is available to Financial Institutions[10] and Investment Professionals[11] that provide fiduciary investment advice to Retirement Investors. Under the exemption, Financial Institutions and Investment Professionals can receive a wide variety of payments that would otherwise violate the prohibited transaction rules, including, but not limited to, commissions, 12b–1 fees, trailing commissions, sales loads, mark-ups and mark-downs, and revenue sharing payments from investment providers or third parties.

The exemption's relief extends to prohibited transactions arising as a result of investment advice to roll over assets from a Plan to an IRA. The exemption also allows Financial Institutions to engage in principal transactions with Plans and IRAs in which the Financial Institution purchases or sells certain investments from its own account[12]. Also, fiduciaries who use their authority to cause themselves or their affiliates or related entities to receive additional compensation violate the prohibited transaction provisions unless an exemption applies.

The exemption's principles-based approach is rooted in the Impartial Conduct Standards for fiduciaries providing investment advice. The Impartial Conduct Standards include a best interest standard, a reasonable compensation standard, and a requirement to make no misleading statements about investment transactions and other relevant matters.

The Department acknowledges that a single instance of advice to take a distribution from a Title I Plan and roll over the assets would fail to meet the regular basis prong. Likewise, sporadic interactions between a financial services professional and a Retirement Investor do not meet the regular basis prong. However, advice to roll over plan assets can also occur as part of an ongoing relationship or an intended ongoing relationship that an individual enjoys with his or her investment advice provider. In circumstances in which the investment advice provider has been giving advice to the individual about investing in, purchasing, or selling securities or other financial instruments through tax-advantaged retirement vehicles subject to

[9] https://www.govinfo.gov/content/pkg/FR-2020-12-18/pdf/2020-27825.pdf

[10] Financial Institutions - registered investment advisers, broker dealers, banks, and insurance companies.

[11] Investment Professionals –individual employees, agents, and representatives of Financial Institutions.

[12]Title I and the Code include broad prohibitions on self-dealing. Absent an exemption, a fiduciary may not deal with the income or assets of a Plan or an IRA in his or her own interest or for his or her own account, and a fiduciary may not receive payments from any party dealing with the Plan or IRA in connection with a transaction involving assets of the Plan or IRA. As a result, fiduciaries who use their authority to cause themselves or their affiliates 18 or related entities 19 to receive additional compensation violate the prohibited transaction provisions unless an exemption applies.

Title I or the Code, the advice to roll assets out of a Title I Plan is part of an ongoing advice relationship that satisfies the regular basis prong.

However, advice to roll over plan assets can also occur as part of an ongoing relationship or an intended ongoing relationship that an individual enjoys with his or her investment advice provider. In circumstances in which the investment advice provider has been giving advice to the individual about investing in, purchasing, or selling securities or other financial instruments through tax-advantaged retirement vehicles subject to Title I or the Code, the advice to roll assets out of a Title I Plan is part of an ongoing advice relationship that satisfies the regular basis prong.

Similarly, advice to roll assets out of a Title I Plan into an IRA where the investment advice provider has not previously provided advice but will be regularly giving advice regarding the IRA in the course of a more lengthy financial relationship would be the start of an advice relationship that satisfies the regular basis prong. It is clear under Title I and the Code that advice to a Title I Plan includes advice to participants and beneficiaries in participant-directed individual account pension plans, so in these scenarios, there is advice to the Title I Plan—meaning the Plan participant or beneficiary—on a regular basis.

A separate informational summary is available regarding the modified PTE 2002-02 on our website at www.experientialwealth.com.

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