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Final Exemption: Improving Investment Advice for Workers & Retirees

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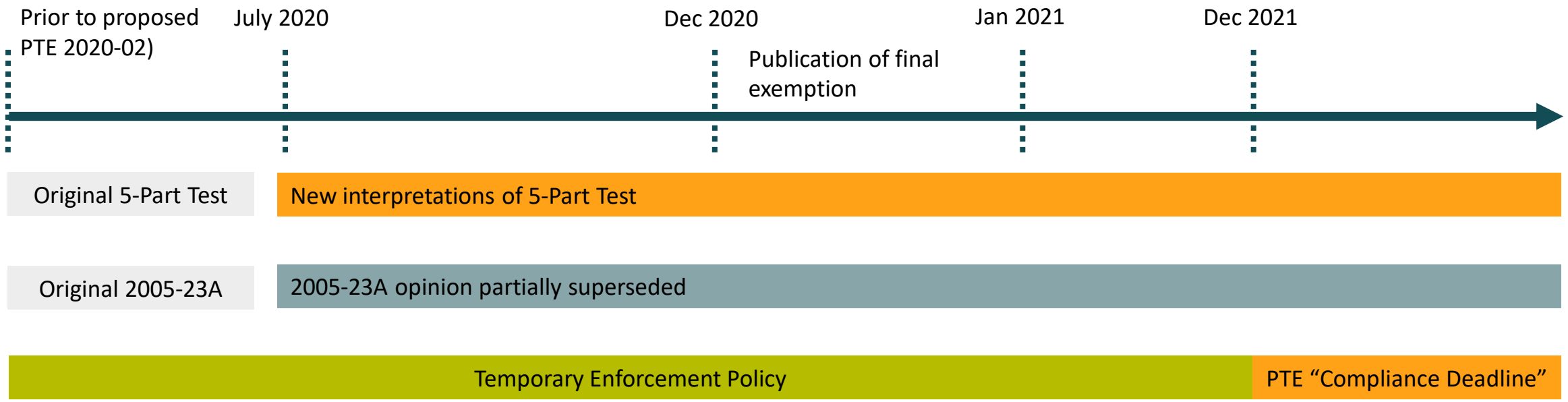
Agenda

- Executive Summary
- Significant Changes from Proposal
- Key Definitions
- Scope of Relief, Covered Transactions & Exclusions
- Definition of Fiduciary & New Interpretations of 5-part Test for "Investment Advice"
- Conditions
- **Self-Correction**
- Eligibility
- Next Steps & Action Items

Executive Summary

- Effective 60 days after publication (mid-to-late Feb. 2021)
- Applicability Date / end of DOL's Temporary Enforcement Policy (PTE 18-02) is Feb. 2022
- Applies to "investment advice" only (not discretion) provided to Retirement Investors
- Covers rollover advice if fiduciary relationship existed prior to or post recommendation
- Covers solicitors and other recommendations to third-party advisors and/or managers
- Allows "a wide variety of payments that would otherwise violate [PT] rules" e.g., commissions, 12b-1 fees, trailing commissions, sales loads, mark-ups and mark-downs, and revenue sharing
- **2005-23A is superseded, in part, in 60 days after publication and the test for "regular basis" advice has been significantly expanded**

Timeline



New Administration Changes?

- Interpretations likely remain and become floor of new definition of "investment advice"
- Conditions of PTE 2020-02 are likely to change

Executive Summary (Cont')

Even if the exemption is delayed, we recommend firms adopt many of the conditions given **that the broader interpretation of "regular basis" advice will be, for a time, the latest guidance from DOL.**

Additionally, 1) the "Temporary Enforcement Policy" requires good faith compliance with Impartial Conduct Standards, which includes advice be in clients' best interests; 2) the SEC interpreted standard of care for RIAs to be best interest and provided broker-dealers a roadmap for rollover advice that is substantially similar to that required under the exemption; and 3) any time a regulator gives you a roadmap, you are well served to follow it!

To be clear, we are not recommending firms adopt all requirements (e.g., written fiduciary acknowledgment, formal retrospective review, etc.), however, unless and until required.

Key Definitions

- **Best Interest** = Duty of Prudence + Duty of Loyalty;
- **Conflict of Interest** = an interest that might, consciously or unconsciously, cause a Financial Institution or Investment Professional to make a recommendation not in the Best Interest of the Retirement Investor;
- **Financial Institution** = not barred from making investment recommendations + employs the Investment Professional and is: RIA, BD, Bank, or Insurance Company;
- **Investment Professional** = fiduciary of Plan or RIA by reason of providing investment advice under ERISA or Code + works for / on behalf of Financial Institution;
- **Retirement Investor** = one of the following:
  1. Participant or beneficiary of a Plan with ability to direct investments or take distributions; ***OR,***
  2. Beneficial owner of an IRA acting on behalf of the IRA; ***OR,***
  3. Fiduciary of a Plan or IRA.
- **Senior Executive Officer = any of the following: CCO, CEO, president, CFO, or one of the three most senior officers of the Financial Institution.**

Significant Changes from Proposal

- Recordkeeping requirements "narrowed" to allow only the DOL and IRS to obtain access to a Financial Institution's records as opposed to plan fiduciaries and other Retirement Investors;
- **Disclosure requirements now include written disclosure to Retirement Investors of the reasons that a rollover recommendation was in their best interests;**
- Retrospective review can now be signed by "any Senior Executive Officer" (vs. CEO as was proposed); and
- Self-correction provision was added.

More to Come …

"… to the extent public comments were based on concerns about compliance and interpretive issues with the final exemption or the Act, the Department intends to support Financial Institutions, Investment Professionals, plan sponsors and fiduciaries, and other affected parties, with compliance assistance following publication of the final exemption."

Specifically, a "covered transaction" is defined to include:

1) The receipt of reasonable compensation [by Financial Institutions, Investment Professionals, and their affiliates and related entities, including as part of a rollover from a Plan to an IRA, as a result of providing "investment advice"]; and

2) The purchase or sale of an asset in a riskless principal transaction or a Covered Principal Transaction, and the receipt of a mark-up, mark-down, or other payment.

Exclusions

The proposed exemption would not apply if:

(1) Financial Institution or Investment Professional or any affiliate is the plan sponsor, named fiduciary or plan administrator;

(2) Advice is generated solely by a robo-advisor; or

(3) The transaction involves the Investment Professional acting in a fiduciary capacity other than as an investment advice fiduciary (e.g., discretionary manager or third-party administrator).

Definition of Fiduciary under ERISA

A person is a fiduciary if he/she….

- Has any discretionary authority in the administration of the plan;
- Exercises discretion over the management of the plan or plan assets;
- Renders investment advice to a plan or plan participant for compensation.

See ERISA Sec. 3(21)

A person is a NOT a fiduciary with respect to other services provided, which are authorized, even if the person is acting as an ERISA fiduciary with respect to one or more of the above functions.

Prohibited Transactions for ERISA Fiduciaries

Fiduciaries are prohibited from…

- Self dealing – providing advice that will increase the compensation paid to the advisor, his/her supervising firm and/or any affiliate(s);
- Dual representation – acting on behalf of or representing a party dealing with the plan in a transaction involving the assets of the plan; or
- Third party payments – receiving any consideration for his/his own personal account from any party dealing with the plan in connection with a transaction involving the assets of the plan.

Definition of Investment Advice = 1975 Regulation (a.k.a. five-part test)

Will Remain Intact …

… Subject to New "Interpretations"

New Interpretations of 1975 Regulation Defining Investment Advice

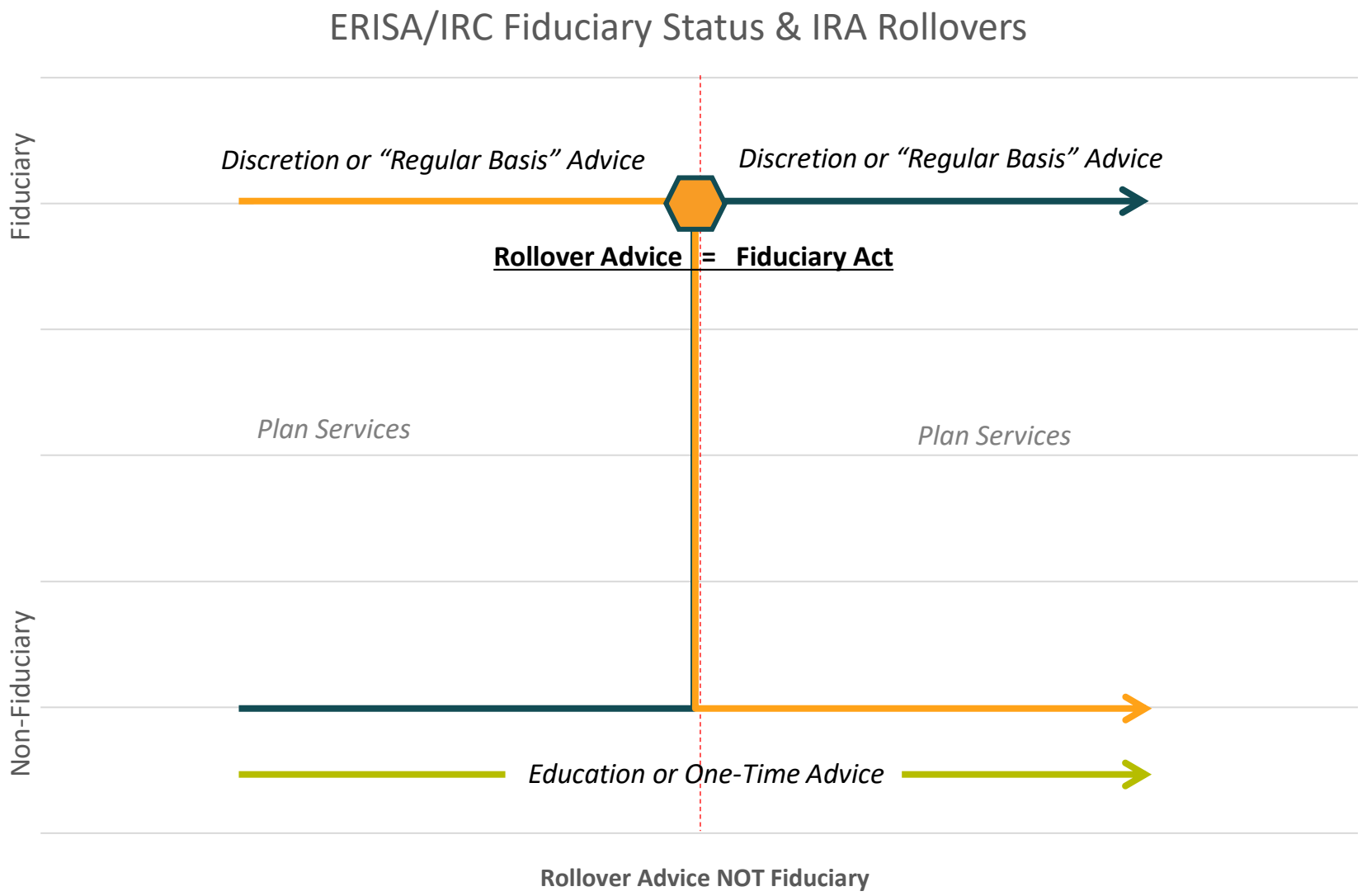
- **Advisory Opinion 2005-23A (superseded in part)** = rollover advice is now fiduciary advice if regular basis and the rest of the five-part test was met prior (e.g., plan- or participant-level advice or discretion) or post rollover advice (e.g., regular basis advice or discretion will be provided to the IRA).
- **Advice Re: Plan Distributions, IRA-to-IRA Rollovers, Plan-to-Plan "Roll-ins" and Account Type** = fiduciary act if five-part test is satisfied pre- or post-rollover recommendation
- **Advice Concerning 3rd-Party Advisors/Managers** = fiduciary act if five-part test is satisfied; exemption would cover compensation received as a result of investment advice as to persons the Retirement Investor may hire to serve as an investment advice provider or asset manager.

New Interpretations (Regular Basis)

"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."

See Preamble at p. 34.

New Interpretations (Regular Basis)



New Interpretations (Regular Basis)

"… the Department … believes the term 'regular basis' broadly describes a relationship where advice is recurring, non-sporadic, and expected to continue. When insurance agents or broker-dealers frequently or periodically make recommendations to their clients on annuity or investment products or features, or on the investment of additional assets in existing products, they may meet the 'regular basis' prong of the five-part test, and are appropriately treated as fiduciaries, assuming that they meet the remaining elements of the fiduciary definition."

See Preamble at pp. 40 -41.

New Interpretations (Mutual Agreement / a Primary Basis)

"… the Department intends to consider the reasonable understanding of each of the parties, if no mutual agreement or arrangement is demonstrated. Written statements disclaiming a mutual understanding or forbidding reliance on the advice as a primary basis for investment decisions will not be determinative, although such statements will be appropriately considered in determining whether a mutual understanding exists. … the Department also intends to consider marketing materials in which Financial Institutions and Investment Professionals hold themselves out as trusted advisers, in evaluating the parties' reasonable understandings with respect to the relationship."

See Preamble at pp. 36-37.

New Interpretations (Mutual Agreement / a Primary Basis)

"While financial services professionals may contractually disclaim engaging in activities that trigger elements of the five-part test, such as rendering advice that can be relied upon as a primary basis for the Retirement Investor's investment decisions, they must do so clearly and act accordingly to demonstrate that there is in fact no mutual agreement, arrangement, or understanding to the contrary."

See Preamble at p. 48.

Four conditions for Investment Professionals & Financial Institutions =

1. **Impartial Conduct Standards;**
2. Disclosure;
3. Policies & Procedures;
4. Retrospective Review.

Conditions: Impartial Conduct Standards

1. Investment advice, at the time it is provided, is in Best Interest of the Retirement Investor:
   - ✓ Duty of prudence; and
   - ✓ Duty of loyalty.
2. Financial Institutions, Investment Professionals, their affiliates and related entities Receive no more than reasonable compensation, directly or indirectly.
3. Financial Institutions' and Investment Professionals' statements to the Retirement Investor about the recommended transaction and other relevant matters are not, at the time the statements are made, materially misleading.

Conditions: Disclosure

Financial Institutions must provide to the Retirement Investor:

- A written acknowledgement that the Financial Institution and its Investment Professionals are fiduciaries under ERISA and the Code, as applicable, with respect to any investment advice provided by the Financial Institution or Investment Professional to the Retirement Investor;

- A written description of the services to be provided and the Financial Institution's and Investment Professional's material Conflicts of Interest that is accurate and not misleading in all material respects; and

- **Prior to engaging in a rollover recommended pursuant to the exemption, the Financial Institution provides the documentation of specific reasons for the rollover recommendation to the Retirement Investor (see Sec. II(c)(3)).***

  ** Sec II(c)(3), Policies and Procedures, also requires documentation re: i) rollover from plan to another plan; ii) from an IRA to a plan; iii) from an IRA to another IRA; or iv) from one type of account to another (e.g., commission to fee-based).*

Model Language for Fiduciary Acknowledgement:

"When we provide investment advice to you regarding your retirement plan account or individual retirement account, we are fiduciaries within the meaning of Title I of the Employee Retirement Income Security Act and/or the Internal Revenue Code, as applicable, which are laws governing retirement accounts. The way we make money creates some conflicts with your interests, so we operate under a special rule that requires us to act in your best interest and not put our interest ahead of yours."

See Preamble at p. 129

Conditions: Disclosure

When it comes to recommendations to roll assets out of a Plan and into an IRA …

"the factors that a Financial Institution and Investment Professional should consider and document include the following:

- *the Retirement Investor's alternatives to a rollover, including leaving the money in his or her current employer's Plan, if permitted, and selecting different investment options;*
- *the fees and expenses associated with both the Plan and the IRA;*
- ***whether the employer pays for some or all of the Plan's administrative expenses**; and*
- *the different levels of services and investments available under the Plan and the IRA."*

"For rollovers from another IRA or changes from a commission-based account to a fee-based arrangement, a prudent recommendation would include consideration and documentation of the services that would be provided under the new arrangement."

See Preamble at p. 147.

Impartial Conduct Standards (Cont')

The Department expects that Investment Professionals and Financial Institutions …

"will make diligent and prudent efforts to obtain information about the existing Title I Plan and the participant's interests in it. In general, such information should be readily available as a result of DOL regulations mandating disclosure of Plan-related information to the Plan's participants (see 29 CFR 2550.404a-5). If the Retirement Investor is unwilling to provide the information, even after a full explanation of its significance, and the information is not otherwise readily available, the Financial Institution and Investment Professional should make a reasonable estimation of expenses, asset values, risk, and returns based on publicly available information. The Financial Institution and Investment Professional should document and explain the assumptions used and their limitations. In such cases, the Investment Professional could rely on alternative data sources, such as the most recent Form 5500 or reliable benchmarks on typical fees and expenses for the type and size of Plan at issue."

Three requirements regarding Policies & Procedures =

1. Establish, maintain and enforce written policies & procedures prudently designed to ensure that the Financial Institution and Investment Professionals comply with the Impartial Conduct Standards;
2. Policies & procedures 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 a Financial Institution or Investment Professional to place their interests ahead of the interest of the Retirement Investor; and
3. Document the specific reasons that any recommendation to roll over assets from a Plan to another Plan or IRA, from an IRA to a Plan, from an IRA to another IRA, or from one type account to another (e.g., from a commission-based account to a fee-based account) is in the Best Interest of the Retirement Investor.

Retrospective Review Requirements

Five requirements regarding a retrospective review =

1. Conduct a retrospective review, at least annually, reasonably designed to assist the Financial Institution in detecting and preventing violations of, and achieving compliance with, the Impartial Conduct Standards and the policies and procedures governing compliance with the exemption;

2. Methodology & results of the retrospective review are reduced to a written report provided to a **Senior Executive Officer**;

3. That certifies, annually, that: A) s/he has reviewed the report; B) policies and procedures are in place to achieve compliance with conditions of the exemption; and C) a prudent process is in place to modify such policies and procedures as business, regulatory, and legislative changes and events dictate, and to test their effectiveness on a periodic basis, the timing and extent of which is reasonably designed to ensure continuing compliance with the conditions of the exemption;

4. The review, report and certification are completed no later than six months following the end of the period covered by the review; and

5. The report, certification and supporting data is retained for a period of six years and are made available to the Department within 10 business days of request.

Self-Correction

Self-Correction is available for Financial Institutions, provided:

1. Violation did not result in losses to the Retirement Investor or the Financial Institution made the Retirement Investor whole for resulting losses;
2. Financial Institution corrects the violation and notifies DOL of the violation and correction with 30 days of the correction;
3. Correction occurs no later 90 days after the Financial Institution learned of the violation or reasonably should have learned of the violation;
4. Financial Institution notifies the person(s) responsible for conducting the retrospective review and the violation and correction is specifically set forth in the written report required by the exemption.

An Investment Professional or Financial Institution will be ineligible to rely on the exemption for 10 years following:

1. Conviction of any crime described in ERISA Section 411 arising out of investment advice to Retirement Investors;
2. Receipt of a written ineligibility notice issued by DOL for:
   A. Engaging in a systematic pattern or practice of violating the conditions of this exemption;
   B. Intentionally violating the conditions of this exemption;
   C. Providing materially misleading information to DOL in connection with the Financial Institution's or Investment Professional's conduct under the exemption.

Next Steps & Action Items

- Educate financial professionals and supervisors as to new interpretations
- Evaluate solicitor arrangements and recommendations regarding third-party advice providers/managers
- Implement process to determine whether rollovers are recommended or not
    - If not, get attestation signed by client
    - If so, document basis upon which it is in client's best interest
- Watch for updates on this exemption and/or new rules
- Contact us with any questions

Questions & Additional Resources

PENSION-RESOURCES.COM

@PensionResource

RETIREMENTLAWGROUP.COM

@RetirementLaw

Eligibility

An Investment Professional or Financial Institution will be **ineligible** to rely on the exemption for 10 years following:

1. Conviction of any crime described in ERISA Section 411 arising out of investment advice to Retirement Investors;
2. Receipt of a written ineligibility notice issued by the Department for:
   A. Engaging in a systematic pattern or practice of violating the conditions of this exemption;
   B. Intentionally violating the conditions of this exemption;
   C. Providing materially misleading information to the DOL in connection with the Financial Institution's or Investment Professional's conduct under the exemption.

DOL: Improving Investment Advice for Workers & Retirees, page 286.

Eligibility: Timing & Scope of Ineligibility

1. An Investment Professional shall become ineligible immediately upon:
   A. Date of trial court's conviction of a covered crime, regardless of whether that judgment is under appeal;
   B. Date the DOL issues written notice to the Investment Professional;
2. A Financial Institution shall become ineligible following:
   A. The 10th business day after the conviction of the Financial Institution (or another Financial Institution in the Controlled Group)[1] of a covered crime, regardless of whether that judgment is under appeal;
   B. 21 days after the date of the written ineligibility notice is issued to the Financial Institution (or another Financial Institution in Control Group).

DOL: Improving Investment Advice for Workers & Retirees, page 286-287..

[1] *A Financial Institution is in the same Controlled Group with another Financial Institution if it would be considered in the same "controlled group of corporations" or "under common control" with the Financial Institution, as those terms are defined in Code section 414(b) and (c), in each case including the accompanying regulations.*

One-Year Winding Down Period for Ineligible Financial Institutions

Financial Institutions who become ineligible:

- Will have a one-year winding down period during which relief is available under the exemption subject to the conditions of the exemption other than eligibility;
- After the one-year period expires, the Financial Institution may not rely on the relief provided in this exemption for any additional transactions.

DOL: Improving Investment Advice for Workers & Retirees, page 287-288.

Winding Down Period: Opportunity to be Heard

DOL has created an "opportunity to be heard":

- If Financial Institution (or another Financial Institution in the same Controlled Group) is convicted of a crime:
  - Petition must be submitted to the DOL within 10 business days after the date of the conviction;
  - E-mail to IIAWR@dol.gov;
  - DOL has sole discretion whether to grant the petition.
- If Financial Institution or Investment Professional received written ineligibility notice:
  - DOL will provide a written warning identifying specific conduct and providing a six-month "cure period";
  - After six months, if conduct persists, opportunity to be heard, in person or in writing or both, **before** ineligibility notice is issued.

DOL: Improving Investment Advice for Workers & Retirees, page 287-289.