

# Retirement **Spotlight**

Illuminating current industry news and events

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## **DOL Releases Additional Investment Advice Guidance**

Objective investment advice. Simple concept, right? And most everyone agrees that every saver and retirement investor is entitled to this. But ensuring that individuals have access to objective investment advice is easier said than done. In fact, the Department of Labor (DOL) has been trying to make this happen since the 1970s, when it first released a five-part test to help determine whether investment professionals owed their clients a duty to provide objective advice.

### **Background**

This five-part test was created in 1975 to define investment advice under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code. Since then, regulations have been issued, revised, and vacated. Another round of guidance came in July 2020, when the DOL issued proposed prohibited transaction exemption (PTE) 2020-02 and a technical amendment to DOL Regulations 2509 and 2510. Then in December 2020, the DOL finalized [PTE 2020-02](#), a class exemption and interpretation, entitled *Improving Investment Advice for Workers & Retirees*. The final PTE outlines the factors that determine when investment professionals are considered fiduciaries—which gives rise to certain duties—and shows how fiduciaries must comply with these responsibilities.

In February 2021, the DOL confirmed that PTE 2020-02 would take effect as scheduled on February 16, 2021. At the same time, the DOL indicated that “in the coming days” it would publish related guidance for retirement investors, employee benefit plans, and investment professionals. This happened on April 13, 2021, when the DOL released two new pieces of guidance. The first piece, entitled [New Fiduciary Advice Exemption: PTE 2020-02 Improving Investment Advice for Workers & Retirees Frequently Asked Questions](#), contains a detailed set of frequently asked questions (FAQs) for investment professionals and financial organizations.

The second piece, [Choosing the Right Person to Give You Investment Advice: Information for Investors in Retirement Plans and Individual Retirement Accounts](#), contains a list of questions that retirement savers should consider asking their investment professional *before* following their recommendations.

While some of this information is new, most of it was previously released in PTE 2020-02. For the most part, the DOL has simply released the same guidance in a new, more accessible format. The rest of this article summarizes the main takeaways from this latest round of guidance.

### **FAQs for Investment Advice Fiduciaries**

This first piece of guidance contains FAQs that are separated into four main sections.

- 1) Background

- 2) Compliance Dates
- 3) Definition of Fiduciary Investment Advice
- 4) Compliance with PTE 2020-02

There is only one Q&A in the *Background* section, which provides some context and explains why the DOL issued PTE 2020-02.

### **Compliance Dates**

The *Compliance Date* section explains that the DOL considered delaying the February 16, 2021, effective date. But it believes that the PTE's core components provide "fundamental investor protections" that will benefit retirement investors. The DOL also states that it will not delay its new interpretation related to rollover recommendations. Although the DOL now rejects the original analysis provided in Advisory Opinion 2005-23A (the "Deseret Letter"), the DOL reiterates that it will not pursue claims for breach of fiduciary duty or prohibited transactions between the 2005 release of the Deseret Letter and February 16, 2021, for recommendations that would have been considered "nonfiduciary conduct under the reasoning in the Deseret Letter." (The Deseret Letter stated that advice to roll assets out of an ERISA plan did not constitute investment advice.)

The DOL mentions in Q&A 5 that it anticipates issuing additional investment advice guidance, possibly by amending or revoking other class exemptions and by amending PTE 2020-02 and the investment advice regulation. This approach will allow the DOL to update current guidance without delaying enforcement of the PTE's core components, such as the policy and procedure requirements.

### **Definition of Fiduciary Investment Advice**

In this section (Q&A 7), the DOL explains the point at which the advice to roll over assets meets the "regular basis" requirement for the five-part test. This prong of the five-part test is satisfied when an investment professional recommends rolling over plan assets to an IRA—either at the beginning of an ongoing relationship with the retirement investor or after a relationship has already been established.

Q&A 8 addresses the "mutual agreement, arrangement, or understanding" element of the five-part test. The DOL emphasizes that, although statements containing fiduciary disclaimers may be considered when determining whether this prong of the test has been met, the statements alone will not insulate from fiduciary liability. Instead, the DOL will consider the "reasonable understandings" of each party, based on the overall situation. This is meant to prevent organizations and investment professionals from using written disclaimers to avoid becoming a fiduciary.

Q&A 9 describes what financial organizations and investment professionals must do to receive relief under the PTE when providing rollover recommendations. For example, financial organizations and investment professionals must make "diligent and prudent efforts to obtain information about the existing employee benefit plan." If this information is not readily available, then the organization or investment professional may rely on other public data sources, such as the current plan's most recent Form 5500.

### **Compliance with PTE 2020-02**

This section (which is the largest) explains how financial organizations and investment professionals can comply with PTE 2020-02. In Q&A 13, the DOL explains why a written fiduciary acknowledgment is required. The DOL believes that this requirement will help all parties taking advantage of the PTE to make a conscious, up-front determination that they are acting as a fiduciary. The DOL provides sample language that financial organizations and investment professionals can use to meet the written fiduciary acknowledgement requirement.

Q&A 14 requires financial organizations and investment professionals to disclose any conflicts of interest that they create based on their services or recommended investment transactions. The DOL warns that these disclosures cannot be a mere "check-the-box" transaction. Retirement investors must receive "meaningful information" that will help them assess the financial organization's conflicts of interest.

Q&A 15 discusses documentation requirements for rollover recommendations. Financial organizations and investment professionals must document the factors they considered when determining whether a rollover was in the retirement investor's best interest. When making a rollover recommendation, financial organizations and investment professionals should focus on more than just the retirement investor's existing investment allocation: they should consider *all* investment options in both the current plan and the new arrangement.

Financial organizations must have policies and procedures in place to reduce any conflicts of interest. Q&A 16 describes how financial organizations can meet this mitigation standard. The DOL explains that policies and

procedures must be designed to protect retirement investors. They must prevent recommendations to make excessive trades, to choose investments that are not in the investor's best interest, or to allocate excessive amounts to illiquid or risky investments.

The conflict mitigation requirement extends not only to investment professionals but also to the financial organization's own interests—including interests in proprietary products and limited menus of investment options that generate third-party payments (e.g., revenue-sharing arrangements). The DOL points out that financial organizations must comply with the PTE's requirements to obtain relief from the prohibited transaction rules: there is *no* safe harbor for an organization that solely complies with other regulators' standards.

A financial organization's compensation structure must avoid any quotas, bonuses, prizes, or performance standards that a reasonable person would conclude are likely to encourage recommendations that are not in a retirement investor's best interest. The DOL acknowledges that financial organizations cannot eliminate all conflicts of interest, but it stresses the need to lessen conflicts. For example, if a financial organization offers mutual funds, it could provide the same level of compensation regardless of which mutual fund the investment professional recommends.

An organization's policies and procedures must include supervisory oversight of investment recommendations. Financial organizations should carefully monitor recommendations involving certain key liquidity transactions (such as rollovers), and recommendations that are at or near compensation thresholds. They should also closely monitor recommendations to invest in assets that are prone to conflicts (such as proprietary products). These requirements were previously mentioned in PTE 2020-02 and align with options identified by the U.S. Securities and Exchange Commission.

Q&A 17 revives some familiar concepts that financial organizations should consider when designing payout grids that determine an investment professional's compensation.

- Financial organizations that profit more from certain investments should not shift this potential conflict to their investment professionals by rewarding them with higher commissions on such products.
- Grids with modest or gradual increases are less likely to create impermissible incentives. Financial organizations should be careful about using grids that disproportionately increase compensation at specified thresholds. These may cause investment professionals to favor their own interests above the client's.
- When an investment professional reaches a compensation threshold on the grid, any increase in the compensation rate should be made prospectively: the new rate should apply only to *new* investments after the threshold is met.
- To encourage recommendations that are made in the retirement investor's best interest, financial organizations using escalating pay grids should monitor and supervise investment professional recommendations. Financial organizations should ensure that the thresholds do not create inappropriate sales incentives.

Q&A 18 speaks to how the insurance industry can comply with PTE 2020-02. An insurance company (as the supervisory financial organization) must ensure compliance with the PTE's terms. Alternatively, the insurance company can work with insurance intermediaries (such as independent marketing organizations), which can assist with its independent obligations under the PTE. Insurers and agents may also rely on PTE 84-24, which provides relief for a smaller range of compensation practices.

Q&A 19 discusses the annual retrospective review requirement. To ensure accountability, senior executive officers must thoroughly review the report before certifying compliance with the PTE: certifying compliance without reviewing the report would violate the PTE.

The DOL explains how to correct PTE violations in Q&A 20. A financial organization can correct violations within 90 days after it learns (or should have learned) about the violation. Both the violation and correction must be included in the retrospective review's written report.

The DOL concludes this section (Q&A 21), by explaining its PTE enforcement process. The DOL plans to investigate and enforce ERISA-plan compliance. But participants, beneficiaries, and fiduciaries can also pursue fiduciary breaches and prohibited transactions under ERISA Section 502. For IRAs and other non-ERISA plans, the DOL has "interpretive authority" to determine whether the PTE requirements have been met. If the requirements have not been met, the DOL can report any noncompliance to the IRS, which can then enforce any applicable penalties.

## Questions for Retirement Investors to Consider

The DOL's second piece of guidance contains a list of questions that retirement investors should consider asking their financial professionals before following their investment recommendations. The publication also contains a list of FAQs about PTE 2020-02. Overall, this publication is designed to educate retirement investors about a fiduciary's roles and responsibilities—and why it's important to know whether an investment professional is, in fact, a fiduciary.

### Questions to Ask an Investment Advice Provider

The DOL believes that retirement investors should consider asking these fundamental questions of investment professionals before following a recommendation.

- Are you a fiduciary?
- Can I have a written statement that you are a fiduciary (and if not, why)?
- Are you and your organization complying with PTE 2020-02? If not, are you relying on another exemption, or do you believe that you do not have any relevant conflicts? (If an investment professional indicates that it is a fiduciary but is not relying on the new exemption or a previously issued exemption, the DOL recommends asking why.)
- What fees will I be charged? Can you give me a list of those fees?
- What conflicts of interest do you have? Do you or your organization pay anyone else if I follow your recommendations?
- Are there limitations on the investments you will recommend?
- Will you monitor the investments in my account? If yes, how frequently?
- Why are you recommending that I roll money out of my 401(k) plan? (The DOL reminds retirement investors that there are many factors to consider before completing a rollover. Retirement investors should ask multiple questions to ensure that they understand the reasons for the recommendation.)

### Questions About PTE 2020-02

To help educate retirement investors about PTE 2020-02, the DOL includes the following Q&As.

- How do I know if my investment advice provider is relying on the exemption?
- I received a Client or Customer Relationship Summary from my investment professional. Is that document required by PTE 2020-02?
- What does it mean to have investment advice provided in my best interest?
- Is my investment professional automatically on the hook if I lose money?
- Does my investment professional have to identify the *best* investment for me?
- Does PTE 2020-02 contain protections related to rollovers? (The DOL explains that investment professionals must give retirement investors a written document explaining why the rollover is in the investor's best interest.)

### Additional Resources, Online Publications, and Appendix

The last few sections provide a list of additional online resources that retirement investors may find helpful. There is also an appendix that defines common terms that retirement investors should be familiar with.

The DOL stresses the importance of hiring an investment professional who is a fiduciary (as opposed to a nonfiduciary) when getting investment recommendations on retirement accounts. Hiring a fiduciary will help retirement investors protect their interests from harmful conflicts of interest. The DOL also reminds retirement investors to consider hiring a different investment professional if their current investment professional says that they are not a fiduciary with respect to the investor's retirement account, or that they have conflicts of interest but are not relying on PTE 2020-02.

## The Takeaway

This latest DOL guidance package presents helpful information in a more understandable format. Investment professionals and plan sponsors should review this guidance and take any necessary steps to comply with it. They should also make sure that clients and plan participants know and understand their rights under PTE 2020-02.

Ascensus will continue to analyze any new guidance as it is released. Visit [ascensus.com](https://ascensus.com) for the latest developments.