

A long and winding road

Department of Labor's Fiduciary Rule 4.0 proposal

Fiduciary definition

Exemptions and investment advice

November 2023



Introduction

On October 31, 2023, following its announcement by President Biden, the US Department of Labor (DOL or Department) released its Proposal 4.0 regarding ERISA fiduciary investment advice, including amended exemptions for conflicted investment advice. This proposal resuscitates and expands upon the concepts of Rule 2.0 adopted by DOL in 2016, which the Fifth Circuit Court of Appeals vacated in 2018.

The package consists of a proposed new regulation defining fiduciary investment advice; amendments to PTE 2020-02, PTE 84-24, and several other exemptions; fact sheets from the White House and DOL; and a DOL press release.

Key elements of Proposal 4.0

Proposal 4.0 would be as far-reaching as vacated Rule 2.0.

- As in Rule 2.0, the proposed regulation would broadly treat financial services professionals as ERISA fiduciaries when engaging in individualized investment interactions with retirement investors.
 - Rollover advice would be explicitly included in the regulation as a form of fiduciary advice.
 - Disclaimers would be ineffective if the professional is positioned in the market as trustworthy.
- As in Rule 2.0, one exemption – PTE 2020-02, adopted in Rule 3.0 – would be the flagship DOL exemption providing relief for conflicted investment advice.
 - The proposal would add new disclosure and other conditions for relief, and replicate the QPAM ineligibility provisions that have proven so troublesome.
- As in Rule 2.0, the complex of other DOL exemptions for conflicted advice would be curtailed.
 - Relief would continue to be available for conflicted advice under the exemption for insurance transactions – PTE 84-24 – but would be limited to sales by independent producers and subject to additional conditions.
 - Otherwise, providers relying on other DOL exemptions for conflicted advice would be remitted to PTE 2020-02.
 - Statutory exemptions would remain in effect.
- As in Rule 2.0, elements of the proposal could potentially create the predicate for a private right of action by IRA owners.

Did you know?

17,956

Days from the enactment of ERISA to the release of Proposal 4.0

1,218

Days from the SEC Regulation Best Interest compliance date to the release of Proposal 4.0

487

Days from the full enforcement date for PTE 2020-02 to the release of Proposal 4.0

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For more information

For resources and commentary regarding this regulatory process, visit Eversheds Sutherland's [dolfiduciaryrule.com](https://www.eversheds.com/dolfiduciaryrule.com).

- Text of and supporting materials for Proposal 1.0, Rule 2.0, Rule 3.0 and Proposal 4.0
- Pleadings and decisions in the litigations challenging Rules 2.0 and 3.0
- Articles, presentations and client alerts
- Videocasts about Rule 2.0 and other matters

DOL fiduciary rule timeline

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
2010	Proposal 1.0			DOL releases Proposal 1.0
2011	DOL holds hearings		DOL announces withdrawal of Proposal 1.0	
2015	Rule 2.0	President Obama announces and DOL releases Proposal 2.0	DOL holds hearings	
2016		DOL adopts Rule 2.0 and exemptions including BICE	DOL issues FAQs	
2017	DOL issues FAQs	DOL delays compliance date for 60 days	DOL issues FAQs	DOL extends BICE transition period to July 2019
	DOL proposes insurance intermediary exemption	June 6 initial compliance date		
	White House directs DOL to restudy Rule 2.0	DOL issues RFI for additional public comments		
2018	Fifth Circuit vacates Rule 2.0	DOL announces temporary enforcement policy		
2020	Rule 3.0	Reg BI compliance date on June 30	DOL holds hearings	DOL adopts PTE 2020-02 and finalizes rollover position
		DOL releases Proposal 3.0		
2021	DOL confirms Rule 3.0 will take effect	DOL issues FAQs explicating Rule 3.0 and announcing future Proposal 4.0	DOL delays Rule 3.0 transition dates	
	February 16 effective date			
2022	Sunset of 2018 temporary enforcement policy on January 31	Rollover requirements of PTE 2020-02 fully enforceable as of July 1	NY district court declines to apply DOL rollover position retroactively and says one-time advice cannot be fiduciary advice	
2023	Proposal 4.0	Florida district court invalidates Rule 3.0 FAQ on "regular basis"		President Biden announces and DOL releases Proposal 4.0

Arrangements in scope of the proposal

The proposed definition of investment advice fiduciary applies not only to ERISA plans (including those §403(b) programs and employer-sponsored IRAs subject to ERISA), but also, by reason of Internal Revenue Code (IRC) §4975(e)(1), to the following non-ERISA arrangements:

- Traditional IRA accounts and annuities
- Roth IRAs
- Archer medical savings accounts
- Health savings accounts
- Coverdell education savings accounts

Section 403(b) and 457(b) plans generally are outside the legal scope of the proposal.

- Private sector 403(b) arrangements are in scope if they are subject to ERISA.
- As always, there is the possibility of a "knock on" effect for arrangements outside the legal scope of the proposal.

Commentary

Context and next steps

We are now in Year 14 – longer than the Trojan War, albeit shorter than the 100 Years War – of DOL's audacious undertaking to expand the circumstances in which financial intermediaries act as "investment advice fiduciaries" under the Employee Retirement Income Security Act of 1974, as amended (ERISA) and to set the standards for exemptions that permit fiduciaries to provide conflicted investment advice.

DOL's original regulation, defining investment advice fiduciary status through a 5-part test, was published fourteen months after enactment of the statute and has been standing since 1975. As the Fifth Circuit saw it in *Chamber of Commerce v. DOL* (2018)(vacating Rule 2.0, below):

The 1975 regulation captured the essence of a fiduciary relationship known to the common law as a special relationship of trust and confidence between the fiduciary and his client.... The regulation also echoed the then thirty-five-year old distinction drawn between an "investment adviser," who is a fiduciary regulated under the Investment Advisers Act, and a "broker or dealer" whose advice is "solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor."

Proposal 1.0, released in October 2010 and limited to an expansion of fiduciary status beyond that specified in the 1975 regulation, was substantially informed by inward-looking considerations. DOL's experience was that the 5-part test unduly impeded its ability to prosecute ERISA enforcement matters in a manner it deemed appropriate. (In the most aggravating example, DOL and the US Securities and Exchange Commission (SEC) had a joint enforcement matter that the SEC resolved in months but that took DOL years to conclude because of issues around fiduciary status.) DOL also argued that the shift in the private retirement system from predominantly defined benefit to predominantly defined contribution plans justified an expansion of that definition. Proposal 1.0 was criticized from bipartisan perspectives, and DOL abandoned it in September 2011.

Proposal 2.0, introduced in April 2015, was far more ambitious. Defended essentially as broad consumer protection against conflicted interests on the part of investment intermediaries, it constituted no less than an undertaking by DOL to restructure the banking, insurance and securities industries at least as they did business with retirement plans and investors, without reference to the pattern of heavy regulation established by statute for and to the rules adopted by the primary regulators of those industries. It extended fiduciary status in unprecedented ways including to rollover advice, announced "best interest" standards with which fiduciaries generally were obliged to comply as a practical matter, and created private rights of actions for individual retirement account (IRA) investors that did not exist under ERISA. [Final Rule 2.0](#) implementing the proposal was adopted in April 2016 with an initial compliance date of June 2017.

The financial services industries spent billions of dollars restructuring their business models and compliance processes before Rule 2.0 [was vacated by the US Fifth Circuit Court of Appeals](#) in March 2018 as regulatory overreach.

Proposal 3.0, offered in June 2020, formally reinstated the 5-part test, but accompanied by new and aggressive interpretive positions that would extend the reach of that test particularly for rollover advice (akin to vacated Rule 2.0). DOL also proposed and adopted in December 2020 a [new class PTE 2020-02](#) that allows investment advice fiduciaries to receive compensation when providing conflicted advice and to engage in certain principal transactions with a compensatory element, subject to impartial conduct standards intended to align with other bodies of regulation, advance disclosure requirements, conflict mitigation policies, retrospective compliance reviews, and other conditions. DOL extended its interpretive views in FAQ's issued in April 2021.

In September 2022, a New York district court declined to apply DOL's rollover position retroactively in private litigation and said that one-time advice could not be fiduciary advice. In February 2023, a Florida district court invalidated DOL's interpretation in the FAQ's of the regular basis prong of the 5-part test, which DOL did not appeal. A case is pending in Texas district court more broadly seeking to set aside the DOL's guidance on the 5-part test set forth in the preamble to PTE 2020-02.

For a variety of historical and analytic resources following these developments, please visit our [DOLFiduciaryRule.com](https://www.dolfiduciaryrule.com) website.

Proposal 4.0 continues the process DOL commenced in 2020 of resuscitating its vacated Rule 2.0, reclothed in the fashion of Rule 3.0 (which itself is receiving a cold reception in the courts). That is, DOL has resumed its mission to extend its jurisdiction and become the uber "standard of conduct" regulator for the financial services industries, restructuring their businesses as they operate at least in the retirement space including IRAs.

- The proposal would generally define any individualized investment interaction between a financial services professional and a retirement investor as ERISA fiduciary activity.
- To the extent the economic return to the professional or her enterprise varies with the choice made by the retirement investor, the proposal would require compliance with DOL exemptive conditions more onerous than any standard of conduct required by the primary regulator of any of those industries.
- Like Rule 2.0, the proposal therefore would adversely affect the choice of investment services available to retirement investors, particularly those with smaller account balances, and increase costs to the retirement system that are ultimately borne by retirement investors.

In particular, Proposal 4.0 would:

- Incorporate DOL's rollover advice interpretation from Rule 3.0 into its regulation defining fiduciary "investment advice";
- Extend that definition broadly to financial services interactions occurring in the retirement setting, beyond the scope of any understanding of "investment advice" fairly attributable to Congress when it enacted ERISA in 1974, and reaching recommendations provided as to investment of assets withdrawn from the retirement system;
- Merge the general fiduciary standards of ERISA into the separate, more specific prohibited transaction regime (which DOL finds more amenable to its enforcement efforts) through "impartial conduct" standards added to the prohibited transaction class exemptions financial service providers deemed "fiduciaries" would be obliged to follow when giving conflicted "investment advice" to retirement plans and investors;
- Contrary to the Congressional determinations reflected in the statute in 1974, functionally extend those general fiduciary standards to IRA's through their inclusion in the exemptions; and
- Although this is not admitted in the proposal, require additional statements and disclosures in those exemptions that could potentially create a predicate for a private right of action by IRA owners, contrary to the statute.

In its most recent regulatory agenda, DOL rebranded this project as its "retirement security" rule. For an agency whose entire raison d'être is retirement and welfare benefit security, this spin comes across as meaningless and even defensive.

Courts of course have the constitutional role to determine conclusively what existing law says. In Proposal 4.0, DOL makes a creative argument that it is observing the lessons of the Fifth Circuit opinion vacating Rule 2.0, but the proposal eviscerates the distinction between non-fiduciary brokerage recommendations and fiduciary investment advice that the Fifth Circuit found was embedded in and central to the statutory definition. It seems doubtful that the Fifth Circuit, or indeed other courts, will see the proposal as consistent with

the decision or Congressional intent, particularly given the direction of [the Supreme Court's 2019 decision on Auer deference to agency interpretations](#) and the two cases on *Chevron* deference the Court has scheduled for hearing in January 2024.

In sum, DOL functionally asserts in Proposal 4.0 that it has authority (i) to define ERISA investment advice fiduciary status without a check or balance from any other branch of government, and (ii) to restructure the fiduciary regime of the statute through the class exemption process. By claiming for itself the roles of both the legislative and judicial branches, DOL adds more fuel to long-burning separation of powers constitutional questions.

The proposal also includes a regulatory impact analysis that appears to observe in form the applicable technical requirements and, in the usual manner, bears no resemblance to the actual economic effects of the proposal on retirement investors and the retirement industry.

In particular, DOL is proceeding with Proposal 4.0 without any credible data on the state of the retirement market in 2023 and the current incidence of

DOL in effect continues to argue it is right as a policy matter and therefore justified in its proposal, which is proper for a legislature but omits the essential second step for a regulator – whether the proposal follows the statute.

In proof this undertaking has become unmoored from any attempt to discern the meaning of the statute, Proposal 4.0 includes at least the sixth distinct interpretation of the statutory text – "renders investment advice for a fee" – floated by DOL since 2010. DOL makes no effort to connect its proposal to ERISA §3(21) other than to say the statutory language is "broad" and is intended to reach "any trusted and confidential relationship," which apparently is meant to justify any definition DOL might

devise. Statutes do not, however, mean what the administering agency might prefer they mean 49 years after enactment. Statutory terms mean what Congress intended at the time of enactment, even in remedial statutes like ERISA, and the Fifth Circuit – the only appellate court to look past agency deference and seriously consider the merits – has already passed judgment on DOL's prior attempt to make new law on this point.

For example, the White House fact sheet notes with aspersion that, in the absence of the proposed rule, fixed indexed annuity sales in 2023 are up 25% over the prior year... when the proposal also was not in effect. No effort was made to substantiate that any of those sales were not in the best interest of the purchasers.

unfavorable outcomes for retirement investors due to conflicts inherent in the financial services industries as governed by their primary regulators. The empirical studies DOL (dubiously) relied on to justify Rule 2.0, and continues to reference in its Proposal 4.0 analysis, are out of date in light of (i) subsequent federal and state regulation (including vacated Rule 2.0), litigation and market expectations. DOL admits as much, and there of course has been insufficient time for any study reliably surveying the current state of the market to emerge, particularly as industry practices continue to evolve.

Further, the regulatory impact statement minimizes the proposal's counterproductive effects in respect of the investment choices afforded retirement investors, particularly those with smaller retirement savings; increased costs to providers and the retirement system; and job loss and contraction in the financial services industries that is particularly hard on smaller firms.

Proposal 4.0 thus rests not on an empirical basis for regulation, but on DOL's persistent belief that ERISA protections should be extended to all investment interactions relating to retirement plans and IRAs, based in part on perceived inadequacies in other bodies of regulation.

In connection with the promulgation of Rule 3.0, we wrote in December 2020:

- There is certainly an argument that the private retirement system would be better served by letting [Rule 3.0] stand for a test period and empirically evaluating its efficacy, before resuming the disruption and cost to the system of having this issue continuously in play.
- And it is beyond question that, at this point, public and private resources would be far better spent on issues far more material to the success of the private retirement system than on competing initiatives about conflicted investment advice (which, by DOL's estimate in 2016, costs the retirement system no more than 0.0025% of assets annually), such as, in no particular order after #1:
 1. Expanding the coverage of that system, and increasing the level of contributions particularly for lower- and middle-income workers [on which progress finally has recently emerged, due at least in part to legislative innovations in the tax qualification rules for retirement plans];
 2. Improving the efficiency with which plan sponsors and providers may operate plans, thereby reducing the friction directly or indirectly borne by plan participants;
 3. Addressing the funding crisis in multiemployer plans [for which, subsequently, the American Rescue Plan Act of 2021 provided conditional assistance];
 4. Professionalizing retirement plan administration and investments;
 5. Effectuating the use of lifetime income guarantees in defined contribution plans; and
 6. Improving the financial literacy of plan participants.
- Investing resources in any or all of those issues has more retirement security bang for the buck than continuing to compete on conflicted advice initiatives from Administration to Administration. The conflicted advice issue has drawn the attention of political actors [on top of the dedication of DOL staff], however, and there is no reason to expect them to disengage anytime soon. Accordingly, the next step for the regulated community likely will be responding to a request for another round of public comment letters – which would be, by our count, the 12th such (largely repetitive) request since DOL launched this undertaking in 2010.

Comment letters on Proposed Rule 4.0 are due January 2, 2024. The hearing will be held approximately 45 days after November 3, 2023, with details to follow in the Federal Register.



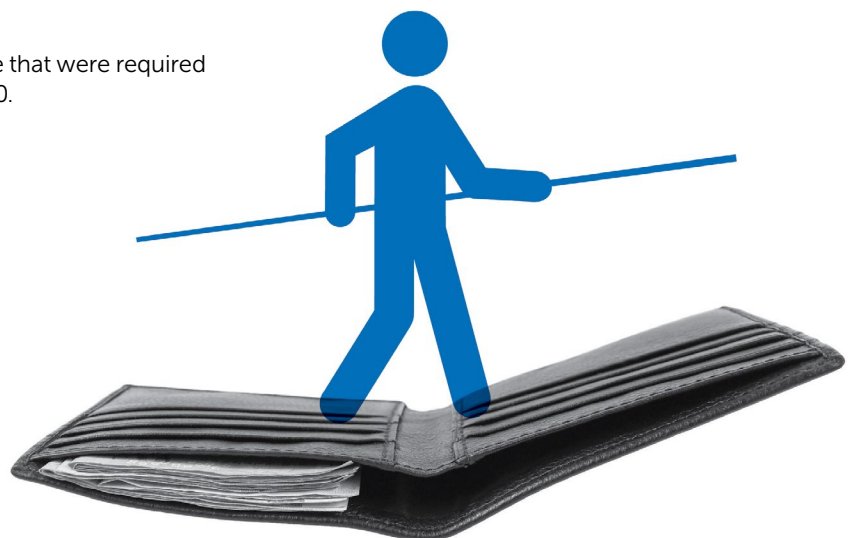
Commentary

Considerations for financial service providers

The proposal would widely impact financial service providers that do business bearing on retirement plans and IRAs, including the following individuals and organizations:

- Any provider that observes its primary regulator's standard of conduct when doing business in the retirement space, without taking account of ERISA considerations
- Any provider that (properly or improperly) operates on the basis it is not an ERISA fiduciary under the five-part test, or disclaims ERISA fiduciary status, when doing business in the retirement space, which may include
 - Any provider when making a sales pitch or responding to an RFP
 - Any provider that offers "one-time" advice or otherwise takes the position it is not offering advice on a "regular basis"
 - Any provider that takes the position its advice is not "the" primary basis for decisions by retirement investors
 - Any "sell side" provider – e.g., investment and commercial banks, institutional broker-dealers, futures commissions merchants and swaps dealers – doing business with the institutional plan market
 - Any provider that wholesales to financial intermediaries
 - Any provider that takes the position it is not acting as an ERISA fiduciary when dealing with sophisticated investors
- Any provider that relies on PTE 2020-02 as in full effect since July 1, 2022
- Any firm that provides robo-advice
- Any provider that assists in the retail market as to rollovers without observing PTE 2020-02
- Any provider that offers post-rollover services to IRA owners
- Any provider that assists with the disposition of a withdrawal from a retirement plan or IRA
- Any retirement or IRA platform provider
- Any provider that helps plan fiduciaries with the selection of investment products or services
- Any insurance agent or company or other provider that relies on PTE 84-24, other than in the independent producer channel
- Any insurance agent or company or other provider that relies on PTE 84-24 in the independent producer channel
- Any provider that relies on PTE 84-24 for advice with respect to nonproprietary mutual fund transactions
- Any provider that relies on PTE 77-4 with respect to the allocation by a discretionary or nondiscretionary investment fiduciary of proprietary mutual funds
- Any provider that relies on PTE 75-1 for advice with respect to plan purchases of new issues in syndicates
- Any provider that relies on PTE 86-128 for advice resulting in commissions for the execution of securities transactions by the fiduciary or for agency cross-transactions
- Any provider that relies on PTE 80-83 for advice with respect to the use of proceeds from the sale of securities to reduce or retire indebtedness
- Any provider that relies on PTE 83-1 for advice with respect to mortgage pool investment trusts

In many respects, these considerations are similar to those that were required in connection with the implementation of vacated Rule 2.0.



Commentary

Context and next steps

Although the proposal generally does not directly regulate most plan sponsor activity, it would likely have significant indirect effects on how plan sponsors interact with third-party service providers, as well as the experience of plan participants when taking rollovers and other distributions from employer-sponsored retirement plans. If finalized as proposed:

- The very broad definition of an investment advice fiduciary does not include an exception for discussions with large, sophisticated investors (such as employers and 401(k) plans), and it does not include an exclusion for activities of investment platform providers.
 - As a result, plan service providers may either seek to avoid fiduciary status or follow PTE 2020-02.
 - Sponsors may find that service providers such as recordkeepers are less willing to engage in conversations about plan investment options and that others, such as investment managers, are more cautious in conversations before they are formally engaged.
- Robo-advice is now in-scope for PTE 2020-02, meaning that sponsors may see changes in the disclosures and delivery of such advice as providers seek to take advantage of the exemption.
- The revised definition of an investment advice fiduciary excludes individuals who do not provide investment advice on a regular basis as part of their business. The DOL makes clear in the preamble to the proposed regulations that it intends for this to mean that human resources employees engaging in discussions with employees will not be investment advice fiduciaries.
- While the exception to fiduciary status for investment education remains in place, there will be more pressure than ever for service providers to ensure that investment education does not inadvertently cause the service provider to be an investment advice fiduciary.
- For plan sponsors and participants currently receiving PTE 2020-02 disclosure, the revised disclosure will include additional elements and concepts not currently present.
- Advisors providing guidance to plan participants with respect to plan rollovers or distributions will be considered investment advice fiduciaries in almost all scenarios. Furthermore, the DOL makes it clear that they view an advisor in this scenario to be a fiduciary with respect to the distributing employer-sponsored plan (as opposed to a fiduciary only with respect to the receiving IRA).
 - Treating the advisor as a fiduciary of the employer-sponsored plan expands the remedies available to a participant as compared to the advisor being a fiduciary with respect to an IRA.
 - This could result in advisors, such as representatives of a recordkeeper or third-party financial advisors, seeking to comply with PTE 2020-02, or in some cases it could result in fewer opportunities for plan participants to obtain rollover guidance to the extent that third parties conclude the additional risk of being an investment advice fiduciary does not justify providing the guidance.

ESsentials

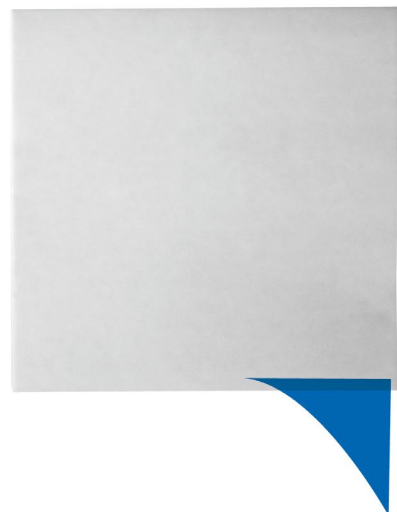
In some cases, a plan sponsor and a service provider may agree that the service provider is not intended to act in a fiduciary capacity. These types of mutual agreements may not be sustainable under the proposal in many situations, meaning that parties will not always be able to implement their preferred relationship structure.

SUN	MON	TUE	WED	THU	FRI	SAT
			58	59	60	61
62	63	64	65	66	67	68
69	70	71	72	73	74	75
76	77	78	79	80	81	82
83	84	85				

History: The many faces of DOL's "investment advice" definition

ERISA §3(21)(A)(ii): "[A] person is a fiduciary with respect to a plan to the extent... he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan...."

Original regulation (1975)	5-part test	For a direct or indirect fee, a person:	<ol style="list-style-type: none"> 1. Renders advice as to the value of securities or property, or makes 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 a plan fiduciary, that 4. Advice will serve as a primary basis for investment of plan assets, and 5. Advice will be individualized to particular needs of the plan 	
Proposal 1.0 (2010; withdrawn 2011)	"3x4" definition	Person meets at least one in each row, for a direct or indirect fee	Service	<ol style="list-style-type: none"> 1. Provides valuation advice or opinion 2. Makes recommendations as to the advisability of investing in, purchasing, holding, or selling securities or other property 3. Provides advice or makes recommendations as to the management of securities or other property
			Status	<ol style="list-style-type: none"> 1. Admitted fiduciary 2. Otherwise an ERISA plan administration or discretionary asset management fiduciary 3. Registered investment adviser 4. Provides service pursuant to an agreement, arrangement or understanding with a plan fiduciary that such advice may be considered in connection with making investment or management decisions with respect to plan assets, and will be individualized to the needs of the plan or participant



Proposal 2.0 (2015)	"4x2" definition	Person meets at least one in each row, for a direct or indirect fee (including to an affiliate)	Service	<ol style="list-style-type: none"> 1. Investment recommendation, including to take a distribution, or as to the investment of a rollover or distribution 2. Asset or investment property management or recommendation, including any recommendations regarding rollovers, transfers or distributions 3. Valuation of an asset in a specific transaction 4. Paid adviser recommendation
			Status	<ol style="list-style-type: none"> 1. Admitted fiduciary 2. Provides service pursuant to a written or verbal agreement, arrangement or understanding that the advice is individualized or specifically directed to the recipient for consideration in making an investment or management decision
Rule 2.0 (2016; vacated 2018)	"3x3" definition	Person meets at least one in each row, for a direct or indirect fee (including to an affiliate)	Service	Makes a recommendation regarding: <ol style="list-style-type: none"> 1. Acquiring, holding, disposing of or exchanging an investment in a plan/IRA 2. How an investment should be invested after rollover, transfer or distribution from a plan/IRA 3. Management of an investment in a plan/IRA
			Status	<ol style="list-style-type: none"> 1. Admitted fiduciary 2. Provides advice pursuant to written or verbal agreement, arrangement or understanding that the advice is based on the needs of the recipient 3. Directs advice to a recipient regarding a particular management or investment decision
Rule 3.0 (2020)	Reinstated 5-part test	5-Part test is reinstated, with new interpretations relevant to rollover advice and other matters		



Proposal 4.0: the scope of "investment advice" fiduciary status

DOL now proposes to replace the five-part definition of ERISA fiduciary investment advice, which was adopted shortly after the statute was enacted, with the following "1x2x3" test.

A PERSON IS AN "INVESTMENT ADVICE" FIDUCIARY IF:	
	For a fee , including to an affiliate,
As in Rule 2.0, " fee " is defined comprehensively.	THE PERSON
	Makes a recommendation of:
	<ol style="list-style-type: none"> any securities transaction or other investment transaction, or any investment strategy involving securities or other investment property,
As in Rule 2.0, " investment property " does not include health, disability or term life insurance policies, or other property to the extent it does not contain an investment component.	SERVICE to a retirement investor , including as to: <ul style="list-style-type: none"> acquiring, holding, disposing of or exchanging securities or other investment property, including providing a "select list" of investments; investment management, such as investment policies or strategies, portfolio composition, selection of account arrangements (e.g., brokerage vs. advisory), selection of third-party managers or advisers, and proxy voting; rolling over, transferring or distributing assets from a plan or IRA, including whether to engage in the transaction and the amount, form and destination of the rollover/transfer/distribution; and investment after a roll over, transfer or distribution from a plan or IRA;
Disclaimers of fiduciary status , or of any condition of the definition, are ineffective if inconsistent with marketing or other communications to or interactions with the retirement investor, or with applicable law.	
	AND THE PERSON:
	<ol style="list-style-type: none"> Either directly or indirectly (e.g., through or with an affiliate) has discretionary authority or control over the purchasing or selling of retirement or non-retirement investments of the retirement investor; or Either directly or indirectly (e.g., through or with an affiliate) makes investment recommendations to investors on a regular basis as part of their business and the recommendation is provided under circumstances indicating that the recommendation is based on the particular needs or individual circumstances of the retirement investor and may be relied on by the retirement investor as a basis for investment decisions that are in the retirement investor's best interest; or Represents or acknowledges that they are acting as a fiduciary when making investment recommendations.
This concept is not limited to a securities business and includes, e.g., an insurance business.	"CONTEXT"
	<ol style="list-style-type: none"> As in Rule 2.0, "recommendation" follows the SEC definition, and communications more tailored to the recipient are more likely to be recommendations
	<ol style="list-style-type: none"> "Retirement investor" is a plan, a plan fiduciary, participant or beneficiary, an IRA, or an IRA owner or beneficiary. Plan fiduciaries are an addition from Rule 2.0.
	<ol style="list-style-type: none"> Critically, the preamble contemplates that financial services professionals always meet this alternative, and thus are always fiduciaries when they give individualized recommendations to retirement investors.

Beyond the prohibition on disclaimers, the proposal includes fewer exceptions from fiduciary status than Rule 2.0.

EXCEPTIONS EMBODIED IN REGULATION

Securities Execution. The proposed fiduciary definition retains the traditional exception for the execution of transactions, as instructed by a plan fiduciary, by a securities firm.

Investment Education. The proposal retains DOL's investment education regulation without change, and comments favorably on the Rule 2.0 modifications to that regulation that were lost in the 2018 vacatur.

EXCEPTIONS DISCUSSED IN THE PREAMBLE

Car salespeople. The preamble makes a particular point of saying that car salespeople are not fiduciaries if they suggest paying for a car with a distribution from the purchaser's retirement savings.

HR communications. The employer's HR personnel are neither in the business of nor paid for providing investment recommendations.

General investment communications. Broad, generalized investment guidance does not constitute fiduciary advice.

Proxy communications. A proxy guideline provided on a non-individualized basis to a broad class of investors, or a voting recommendation addressed to all shareholders, is not fiduciary advice.

Swap transactions. DOL reconfirmed its guidance issued after the Dodd-Frank Act that disclosures required of swap counterparties would not be fiduciary recommendations, but cautioned that a swaps dealer could become a fiduciary by making specific investment recommendations to plan clients.

"Hire me" interactions. As under Rule 2.0, normal marketing and promotion of investment products or services to retirement investors would not be fiduciary advice, up to the point an investment recommendation is made.

Wholesaling. Wholesaling to financial services intermediaries generally would not be fiduciary advice, but wholesalers interacting directly with or providing individualized recommendations for retirement investors could become fiduciaries.

Platform Providers. Screening and monitoring available investments options against a plan's specifications for its menu is not fiduciary advice, but providing a selective list of possible investment options would be if "individually tailored" to the plan. The logic of the proposal, as under Rule 2.0, is that neither marketing and making available investment platforms to plans without regard to individualized plan/participant needs, nor responding to a plan RFP with respect to the investments available on a provider's platform, is an individualized recommendation that should be covered by the definition, but confirmation of those points in the final preamble would be appropriate.

Valuation Services. As in Rule 2.0, this issue is left for a separate rulemaking.

EXCEPTIONS NOT CARRIED OVER FROM RULE 2.0

Sophisticated investors. DOL specifically declined to provide an accredited investor/counterparty/ seller exception.

Investment experts. Similarly, there is no exception for interactions with persons with financial or investment expertise.



- In terms of outcomes, the proposed definition is comparable to vacated Rule 2.0, notwithstanding DOL's claim that it is "much more narrowly tailored."
 - As the preamble makes perfectly clear, DOL's desired outcome is financial services professionals of all stripes doing business in the retirement space should be legally accountable as ERISA fiduciaries because, as DOL sees it, (i) they hold themselves out as trustworthy experts, and (ii) plan participants/IRA owners are inadequately protected from conflicted interests by other bodies of regulation and incapable of protecting themselves.
 - Vacated Rule 2.0 produced that outcome by providing that any person who directs a paid individualized investment recommendation to a retirement investor is an ERISA fiduciary.
 - Proposal 4.0 functionally would add (as further discussed below) only the requirement that the recommendation provider be in the business of making investment recommendations – the "investment professional" alternative (Context #2 in the chart) – but that is largely a formality because, in general, only regulated financial services professionals are permitted under other bodies of law to make the recommendations described in Rule 2.0.
 - Consequently, it appears that any practical narrowing of outcomes under Proposal 4.0 as compared to vacated Rule 2.0 would be negligible.
 - The proposed 4.0 definition also expands the "admitted fiduciary" alternative (Context #3) from Rule 2.0 and adds a "discretionary manager" alternative (Context #1), but these alternatives functionally may not yield any incremental outcomes beyond the investment professional alternative.
- In service of its desired outcome, DOL argues that the statutory definition should be interpreted to effectuate the expectations of retirement investors and the protective purposes of the statute. That is, the method of statutory construction advocated by DOL assumes the result.
- In form, the proposed definition is agnostic across types of financial services and investments. According to the preamble, "[t]he proposal takes on special importance in creating uniform standards for investment transactions that are not covered by the Federal securities laws..., such as real estate, fixed index annuities, certificates of deposit, and other bank products." Digital assets, swaps and CD ladders are also referenced elsewhere in the preamble, and government officials have mentioned commodities.
- Like Rule 2.0, the proposed regulation is fulsome in describing the first element of the definition: the fees that are sufficient to make a recommendation fiduciary advice, "including, although not limited to, commissions, loads, finder's fees, revenue sharing payments, shareholder servicing fees, marketing or distribution fees, mark ups or mark downs, underwriting compensation, payments to brokerage firms in return for shelf space, recruitment compensation paid in connections with the transfers of accounts to a registered representative's new broker-dealer firm, expense reimbursements, gifts and gratuities, or other non-cash compensation" (the last item is an addition from Rule 2.0). A "but for" test would determine whether those fees are received in connection with the recommendation.
- The second element – the services that constitute fiduciary "investment advice" – again borrows the SEC's "recommendation" terminology, which under the securities laws connotes a very different undertaking and relationship than a fiduciary advisory relationship.
- In scope, the types of interactions and investment property described in Proposal 4.0 are conceptually comparable to, and in detail perhaps somewhat broader than, those in Rule 2.0.
 - In even more comprehensive terms than Rule 2.0, the proposal treats not only rollover or distribution recommendations as fiduciary advice, but also recommendations as to the destination and investment of funds even if outside of any arrangement subject to these rules.
 - The preamble further argues that, even if the investment advice fiduciary is engaged to provide advice only as to the investment of a rollover IRA once the rollover occurs, she has a fiduciary obligation to consider the current investment of those funds and advise if the retirement investor should retain them in the current retirement arrangement.
 - The proposal finally stakes out a litigation position (in an example included in the proposed regulation and in the preamble) that rollover recommendations would be treated as relating back to the plan, giving DOL enforcement jurisdiction. (We separately discuss below the implications for IRA owners.)
 - Otherwise, the proposed regulation retains the traditional provision that a fiduciary has responsibility only for the assets entrusted to her (subject to the ERISA co-fiduciary liability provision), and the preamble adds that the engagement of an investment advice fiduciary does not automatically include an ongoing duty to monitor.
 - It is unclear how the proposal would treat a recommendation as to the disposition of a required minimum distribution.



- The third element of the definition – the enumeration of “contexts” that cause a paid recommendation provider to be a fiduciary – is intended to identify the circumstances where the retirement investor might expect the recommendation provider to be acting impartially in a trusted capacity and in the investor’s best interest.
 - This element is extrapolated from the Fifth Circuit opinion, according to the preamble.
 - In this specific respect, the proposed definition is circular, and outcome-driven.
 - By focusing its definition on appearances and the investor’s expectations, rather than on the actual underlying legal relationships, DOL again sidesteps both the 1974 understanding of “investment advice” and the discontinuities its proposal creates with the legal duties financial services professionals sometimes owe to persons other than the retirement investor, e.g., the fiduciary duty under agency law an insurance agent owes to act in the best interest of the insurance company.
- With respect to the “discretionary manager” alternative, which is positioned as a variation on a provision in the 1975 definition separate from the five-part test, DOL’s proposal to leverage investment discretion over unrelated assets, including non-ERISA assets, would be an expansion from Rule 2.0.
- We see inconsistent signals in the preamble whether the “investment professional” alternative – essentially, a diluted variation on the five-part test – intends an objective or subjective analysis, and DOL invites comments on that point. If the latter, we are concerned about the recommendation provider’s inability to know the mind of the retirement investor and the invitation to perjury.
- In any event, since its earliest guidance on ERISA, DOL has maintained that ERISA fiduciary status is determined functionally and that titles are not controlling. In an unprecedented break from that position, the preamble suggests that the following titles are controlling in the investment professional context, if individualized recommendations are provided.
 - The preamble specifically asserts that “financial consultants, financial planners and wealth managers” would inherently be covered by the investment professional alternative.
 - It is clear from the discussion that DOL also contemplates that registered representatives of broker-dealers, insurance agents, and investment advice representatives also would always be covered.
 - It is unclear how call center personnel would be treated.
- Effectively, in the words of the proposal, being in the (regulated) business of making investment recommendations would universally mean that that an individualized recommendation “may be relied on by the retirement investor as a basis for investment decisions that are in the retirement investor’s best interest” for purposes of the definition.
- With respect to the “admitted fiduciary” alternative, an acknowledgement of fiduciary status under another body of law would suffice.
 - The proposal thus conflates fiduciary status for other purposes with ERISA fiduciary status, which the statute does not support, and ignores the material differences in conduct standards among various types of fiduciaries.
 - It is unclear whether a “best interest” admission would trigger this provision.
 - The prohibition on disclaimers – with its disruptive notion that marketing puffery should take binding legal priority over definitive written documentation and its invitation to perjury – reflects a longstanding disagreement between:
 - DOL, which sees disclaimers as a cynical “bait and switch” ploy, and
 - The regulated community, which views disclaimers as a legitimate tool for structuring a relationship when a financial services provider intends to serve the investor’s interest in accordance with its primary body of regulation but cannot commit to the more exacting standards of ERISA as implemented by DOL because of, e.g., a mandate from the investor or industry requirements.
- The prohibition therefore would reduce the choices available to retirement investors in the market, and would complicate the RFP process for investment services at the stage when plan sponsors are in need of a business proposal rather than fiduciary advice.
- More generally:
 - DOL continues to recommend that providers always provide an up-front statement they are acting as fiduciaries, which would certainly simplify DOL’s job in making enforcement cases but completely disregards the valid risk management concerns of providers dealing with a fact-based fiduciary definition.
 - Of the three accepted methods for resolving ERISA conflicted interest concerns – avoid fiduciary status, negate the conflict, or make use of an exemption – the proposal seems intent on minimizing the opportunity for a financial services firm to utilize the first method, short of limiting its business to investment education or leaving the retirement market.

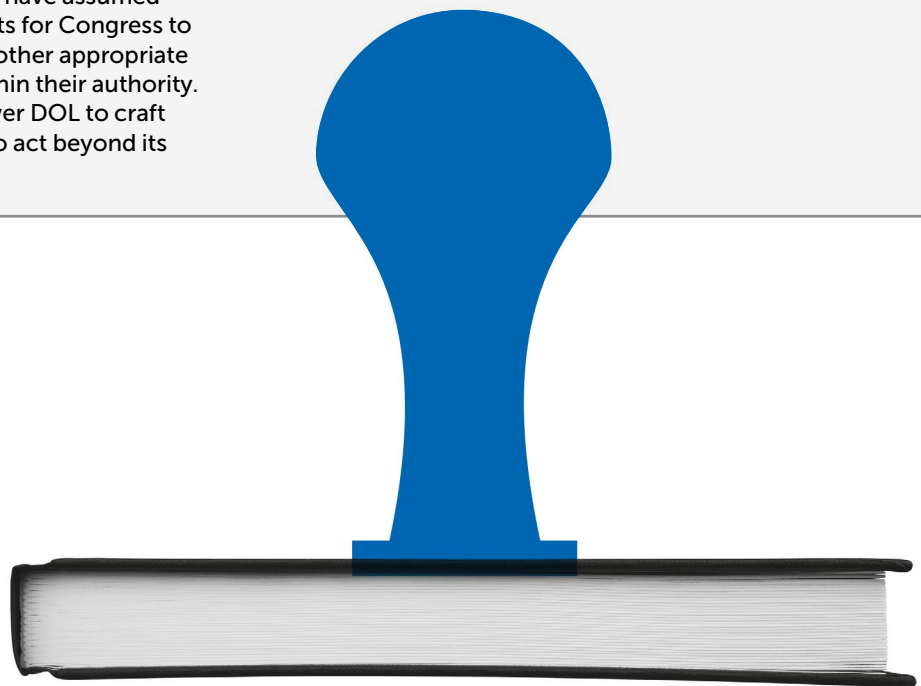


ESsentials

- ▶▶ DOL's justifications for its new regulation continue to fall short. For example:
 - At the time of enactment of ERISA, the defined benefit plan universe included a material population of small plans, and it was common (and sensible) for those plans to be invested in annuity contracts with bundled recordkeeping services – which were sold by insurance agents to small businesses.
 - ERISA not only created IRAs but made provision for IRA rollovers, so Congress could readily have included rollover advice within the scope of fiduciary advice if it so intended.
 - The preamble makes curious use of the enhanced best interest standards adopted by the SEC and the states. While those developments logically reduce the need for aggressive new DOL regulation to protect investors, the preamble instead makes a "me too" argument. That argument also neglects the fundamental difference between (i) strengthening standards of conduct for persons within an agency's jurisdiction, and (ii) expanding the range of persons subject to the agency's jurisdiction and conduct standards.
 - Most critically, to the extent DOL's arguments have merit, they are properly addressed to Congress, rather than by rewriting the statute through regulation.
- ▶▶ In any event, the Fifth Circuit had it right – "investment advice" had a commonly understood legal meaning when ERISA was enacted in 1974 – and the proposal goes substantially outside the bounds of that common meaning. DOL's creative attempt to extrapolate "any trusted relationship" from the statutory language as construed by the court, and to expansively build out that concept in the proposed regulation well beyond the limits of trust law and understood fiduciary relationships, would surely come as a surprise to the Fifth Circuit.
- ▶▶ Any claim that DOL is abiding by the court's decision thus does not bear inspection. As did Rule 2.0, in the language of the court's opinion, Proposal 4.0 "improperly dispenses with this distinction" understood in 1974 between "investment advisers, who were considered fiduciaries, and stockbrokers and insurance agents, who generally assumed no such status in selling products to their clients."*/
- ▶▶ In addition, as in Rule 2.0, the proposed extension of ERISA fiduciary responsibility to investments outside the scope of the statute made with proceeds distributed or rolled out of an ERISA-governed arrangement also would be an extraordinary expansion of the statute and of DOL's jurisdiction.

*/Chamber of Commerce v. DOL, 885 F.3d 360 (5th Cir. 2018).

That times have changed, the financial market has become complex, and IRA accounts have assumed enormous importance are arguments for Congress to make adjustments in the law, or for other appropriate federal or state regulators to act within their authority. A perceived "need" does not empower DOL to craft *de facto* statutory amendments or to act beyond its expressly defined authority.*/



An aside on statutory construction

With respect to DOL's central contention that the statutory definition should be broadly interpreted to effectuate the retirement investor's expectations and the protective purposes of the statute, the Supreme Court's 9-0 opinion in *Darden v. Nationwide Mutual Insurance Company*^{*/} – construing the ERISA definition of "employee," which is even more fundamental to the statute than "fiduciary" – very directly refutes DOL's argument.

In this case we construe the term "employee" as it appears in [ERISA], and read it to incorporate traditional agency law criteria for identifying master-servant relationships....

We have often been asked to construe the meaning of "employee" where the statute containing the term does not helpfully define it. Most recently we confronted this problem in *Community for Creative Non-Violence v. Reid*, 490 U. S. 730 (1989) Because [the statute in question in Reid] nowhere defined the term "employee," we unanimously applied the = "well established" principle that

"[w]here Congress uses terms that have accumulated settled meaning under ... the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms In the past, when Congress has used the term 'employee' without defining it, we have concluded that Congress intended to describe the conventional master-servant relationship as understood by common-law agency doctrine.

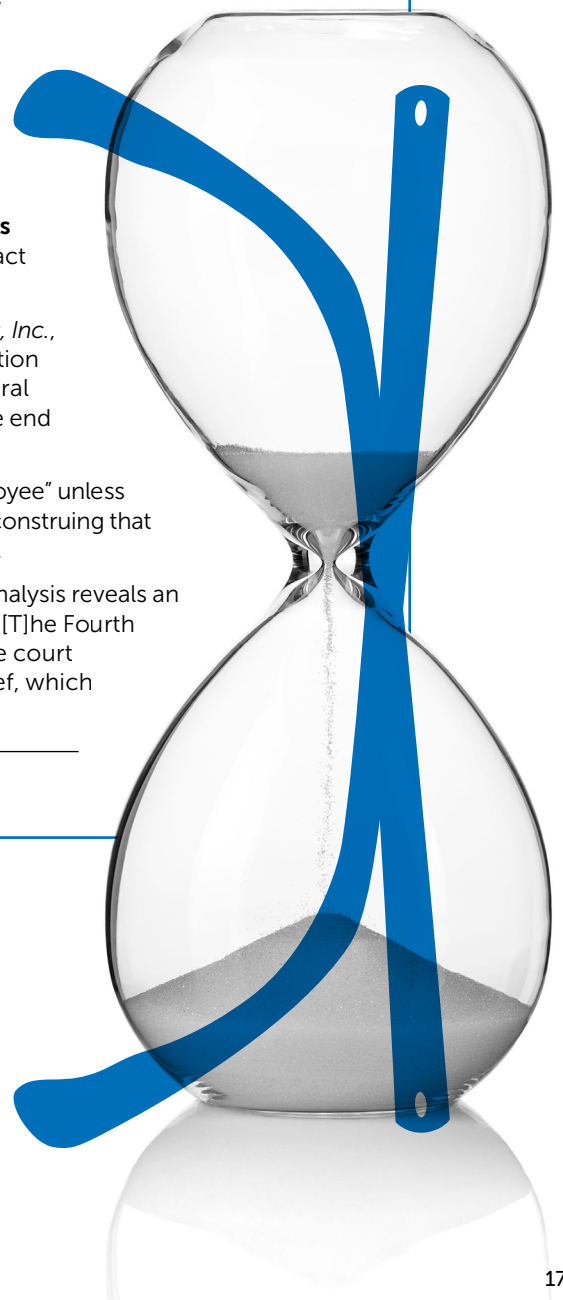
... [The Fourth Circuit, the appellate court below] found the traditional definition inconsistent with the "declared policy and purposes" of ERISA, and specifically with the congressional statement of purpose found in § 2 of the Act. It therefore held [paraphrasing § 2] that an ERISA plaintiff can qualify as an "employee" simply by showing "(1) that **he had a reasonable expectation** that he would receive [pension] benefits, (2) that **he relied on this expectation**, and (3) that he lacked the economic bargaining power to contract out of [benefit plan] forfeiture provisions."...

In taking its different tack, the Court of Appeals cited *NLRB v. Hearst Publications, Inc.*, 322 U.S., at 120-129, and *United States v. Silk*, 331 U. S., at 713, for the proposition that "the content of the term 'employee' in the context of a particular federal statute is 'to be construed "in the light of the mischief to be corrected and the end to be attained."'"

... Reid's presumption that Congress means an agency law definition for "employee" unless it clearly indicates otherwise signaled our abandonment of *Silk's* emphasis on construing that term "in the light of the mischief to be corrected and the end to be attained."..."

Quite apart from its inconsistency with our precedents, the Fourth Circuit's analysis reveals an approach infected with circularity and unable to furnish predictable results.... [T]he Fourth Circuit's test would turn not on a claimant's actual "expectations," which the court effectively deemed inconsequential, but on his statutory entitlement to relief, which itself depends on his very status as an "employee."

^{*/}503 US 318 (1992)(citations selectively omitted, emphases added).



Revisions to PTE 2020-02: Relief for conflicted fiduciary advice

By expanding the definition of fiduciary to, in general, treat any individualized investment interaction between a financial services professional and a retirement investor (including rollover interactions) as fiduciary activity, it is likely that far more investment advisors will need to rely on the exemption provided under PTE 2020-02. The current exemption, which will remain in effect until a final amendment is published, permits advisers to provide investment advice that would otherwise not be permitted, provided that they comply with the exemption terms. The terms generally require the investment advice fiduciary to act according to the best interest standards, charging no more than reasonable compensation and adopting certain compliance policies and disclosures.

As a broad overview, the proposed amendment to PTE 2020-02 contemplates an expanded affirmation of fiduciary status and the impartial conduct standards, additional disclosure requirements, new conditions or expanding of conditions through policies and procedures, and other changes (including potentially going back to the Best Interest Contract (BIC) website disclosure from Rule 2.0.) The preamble to the proposed amendment claims that the amendment does not create any new private causes of action; however, the amendment would cause PTE 2020-02 to look very much like the BIC but without a two-party contract.

A Note on Compliance Burdens:

The proposed amendments to PTE 2020-02 will require Financial Institutions to once again revise their systems, just 18 months after the latest changes demanded by DOL went effective. In its economic impact analysis, DOL vastly underestimates the time and costs this would entail. DOL is seeking comments on these estimates.

Covered transactions

As is the case with the current exemption, Covered Transactions would include compensation paid in connection with investment advice, including advice to roll over assets from a Plan to an IRA, from one IRA to another IRA, and between brokerage and investment accounts. The exemption would be expanded to cover advice provided by Pooled Plan Providers and their affiliates and to provide relief for Financial Institutions that provide investment advice through computer-generated models without an Investment Professional being involved (robo-advice). It would also continue to cover certain principal transactions (Covered Principal Transactions and Riskless Principal Transactions).

1. Investment advice to retirement investors

- While the DOL is not proposing substantive changes to the definition of Financial Institution, it has requested comments on whether additional clarifications would be helpful.
- The DOL is requesting specific comments on robo-advice, including:
 - Amending PTE 2020-02;
 - Whether Financial Institutions' current use of robo-advice is accomplished in a manner that does not require a prohibited transaction exemption;
 - Whether expanding PTE 2020-02 to include investment recommendations by computer models allows more conflicted investment advice; and
 - Whether Financial Institutions are currently using artificial intelligence to provide investment advice.
- The DOL also requests comments regarding the use of the statutory exemption for providing investment advice through a computer model under ERISA section 408(g).

ESsentials

▶▶ While the addition of robo-advice at first glance might appear to be a beneficial expansion of the exemption, this may in fact not be the case. The comments sought by the DOL in this regard indicate that it may also be looking at the statutory exemption of ERISA section 408(g).

▶▶ Although more insurance companies and agents would be required to use PTE 2020-02 due to the narrowing of PTE 84-24 coverage (described below), the DOL has not addressed the difficulties of an Insurance Company taking on the role of Financial Institution.

2. Covered principal transactions

The proposed amendment includes minor changes to the definition of Covered Principal Transaction and would add a separate definition of Riskless Principal Transaction to the exemption.

- A Riskless Principal Transaction would be a transaction in which a financial institution, after receiving an order from a retirement investor to buy or sell an asset, purchases or sells the asset for the financial institution's own account to offset the contemporaneous transaction with the retirement investor. The DOL would not limit the types of products that could be sold in a Riskless Principal Transaction. The DOL has requested comments on this definition.
- If it is later determined that a principal transaction was not eligible as a Covered Principal Transaction or a Riskless Principal Transaction, the transaction would not be eligible for the exemption. The preamble indicates that the transaction may need to be reversed if it not compliant.
- While the Proposal currently does not include this change, the DOL has requested comments as to whether to amend the definition of Covered Principal Transaction to include only transactions "for cash." In particular, the DOL asks whether eliminating in-kind assets would reduce the complexity and conflicts of interest involved in these transactions.

ESsentials

▶ The DOL provides no support for its suggestion that in-kind transactions are somehow more conflicted than cash transactions.

▶ The suggestion that a non-compliant transaction may need to be reversed is part of a troubling trend of DOL interfering with private contractual rights through the administrative exemption process. In contrast, ERISA and the IRC clearly contemplate monetary corrections of non-exempt prohibited transactions particularly when those amounts can be reasonably calculated.

Conditions

1. Impartial conduct standards

Under the current framework of PTE 2020-02, Financial Institutions and Investment Professionals must adhere to Impartial Conduct Standards requiring them to provide advice in a prudent manner; act with loyalty towards Retirement Investors when making recommendations by not placing their own interests ahead of the Retirement Investor's; charge no more than reasonable compensation and comply with Federal securities laws regarding "best execution;" and avoid making misleading statements about investment transactions and other relevant matters.

- Proposal 4.0 retains the Best Interest Standard and would add in the operative text an example illustrating that it is impermissible for an Investment Professional to recommend a product that is worse for the Retirement Investor because it is better for the Investment Professional's bottom line.
- The preamble also clarifies that compliance with the Best Interest Standard does not disqualify an Investment Professional nor a Financial Institution from being paid on a transactional basis, nor does it foreclose investment advice on proprietary products or investments that generate third-party payments, or advice based on investment menus that are limited to such products.
- Under Proposal 4.0, a recommendation to enter into a fee-based arrangement may be inconsistent with the Best Interest Standard if an Investment Professional recommends that a Retirement Investor continue to receive advice, and hold assets subject to an ongoing advisory fee, in circumstances where the investor has low trading activity. The DOL indicates such activity would violate the Impartial Conduct Standards and would not be covered by this exemption.
- Like any other advice arrangement, Financial Institutions relying on computer models or providing robo-advice would have to satisfy the exemption's Best Interest Standard and other protective conditions in order to satisfy PTE 2020-02.

2. Disclosures and fiduciary acknowledgement

DOL builds on the existing fiduciary acknowledgement and disclosure requirements of current PTE 2020-02 in a number of ways. The Proposal would require the following additional disclosure:

- An unqualified acknowledgement of fiduciary status. DOL is dissatisfied with current acknowledgements that are tied to determinations under applicable law, notwithstanding that the law has been fluid, and that these determinations are transactional and fact-based.
- A written statement of the Best Interest standard of care. DOL provides model language for the fiduciary acknowledgement and statement of the Best Interest Standard.

- Additional fee disclosure that would include not only the amount the Retirement Investor will directly pay for such services but also the amounts the Financial Institution and Investment Professional receive from other sources, including through third-party payments.
- Information regarding a new right for the Retirement Investor to obtain specific information regarding costs, fees, and compensation that is described in dollar amounts, percentages, formulas, or other means reasonably designed to present materially accurate disclosure of their scope, magnitude, and nature. This is intended to inform the Retirement Investor of the “significance and severity of the conflict of interest.”
- As an addition to the existing disclosure for rollover advice, an explanation of the assumptions used when current plan information is not available.

The DOL is also seeking comment on whether to revive Proposal 2.0’s controversial website disclosure under the BICE. If incorporated in the final rule, this change would require Financial Institutions to maintain a public website containing the pre-transaction disclosure, a description of the Financial Institution’s business model, associated conflicts of interest (including arrangements that provide third-party payments), and a schedule of typical fees. The DOL anticipates the development of this website will take 8 hours of a computer programmer’s time.

ESsentials

- ▶▶ *In the usual manner, while additional disclosures tend to make regulators more comfortable, they signify very little to the disclosure recipients, and thus increase costs and burdens to providers to no productive end.*
- ▶▶ *These changes would require all existing PTE 2020-02 disclosures to be rewritten and redistributed. The DOL expects that it would take a legal professional at a Financial Institution, on average, a total of **ten minutes** to update the existing fiduciary disclosures, and **30 minutes** to update existing fee disclosures.*
- ▶▶ *In discussing the need for a revised and unqualified fiduciary acknowledgement, the DOL asserts in the preamble that a Financial Institution has to decide upfront whether it and the Investment Professionals are acting as fiduciaries. This is in stark contrast to its assertions in the fiduciary definition proposal that fiduciary status is to be determined on a transaction by transaction basis, and the clear statutory language that a person acts as a fiduciary only “to the extent” it is performing fiduciary acts. Because fiduciary status is transactional, an unqualified acknowledgement will often be overbroad, and lead to difficulties for both Retirement Investors and providers.*
- ▶▶ *The DOL is seeking comments on appropriate benchmarks for assumptions to be used in rollover disclosures when actual plan information is not available. Providers have spent extensive amounts of time and money attempting to comply with the current requirements. This request for comments indicates that providers may ultimately need to redo this work under new standards.*
- ▶▶ *The DOL estimates the additional documentation for each rollover recommendation will require **30 minutes** for a personal financial advisor whose firms currently do not require rollover documentations and an additional **five minutes** for financial advisors whose firms already require them to do so.*
- ▶▶ *We speculate below on who will actually make use of the right to request additional PTE 2020-02 compliance information, as proposed.*

3. Policies and procedures

As it currently stands, PTE 2020-02 requires Financial Institutions and Investment Professionals to adopt policies and procedures prudently designed to ensure compliance with the Impartial Conduct Standards and to mitigate conflicts of interest that could potentially violate such standards. The proposed amendment would clarify, by adding examples to the operative text, some actions that Financial Institutions may not take. The proposed amendments would supplement the current exemption by providing more specificity, including additional guidance on how Financial Institutions that construct their investment menus with reference to proprietary products or third-party payments can comply with the exemption.

The preamble adds that policies and procedures must be prudently designed to protect Retirement Investors from recommendations to make excessive trades; to buy investment products, annuities, or riders that are not in the Retirement Investor’s Best Interest; or to allocate excessive amounts to illiquid or risky investments. In that regard, the preamble lists compensation practices which presumably the policies and procedures would be expected to prohibit:

- Financial Institutions may not use quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation, or other similar actions or incentives that are intended, or that a reasonable person would conclude are likely, to encourage Investment Professionals to make recommendations that are not in the Retirement Investor’s Best Interest.

- A Financial Institution may not offer incentive vacations, or even paid trips to educational conferences, if the desirability of the destination is based on sales volume and satisfaction of sales quotas. The preamble appears to couch this as an absolute prohibition, regardless of whether the structure would encourage recommendations that violate the Best Interest standard.
- The Financial Institution would be expected to address any conflicts of interest that may exist within the Financial Institution itself. The preamble states that paying level compensation to Investment Professionals may not be sufficient to mitigate conflicts, if the Financial Institution receives more compensation for particular products. The DOL is of the view that when Financial Institutions provide “level” compensation percentages, they are effectively transmitting a conflict of interest to the Investment Professional, as the Investment Professional’s compensation may be increased in direct proportion to the profitability of the investment to the firm.
- The preamble provides guidance for Financial Institutions that offer a restricted menu of proprietary products or a limited universe of investment recommendations. It states that policies and procedures should:
 - Document in writing conflicts of interest associated with any limitations on the universe of recommended investments, providing for receipt of third-party payments or associated with the sale or promotion of proprietary products;
 - Reasonably conclude (including the bases for such conclusions) that such potential conflicts of interests will not cause the Financial Institution or its Investment Professionals to recommend imprudent investments;
- Clearly explain fees, compensation, and associated conflicts of interest to the Retirement Investor in plain English;
- Ensure that all recommendations are based on the Investment Professional’s considerations of factors or interests such as investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investors;
- At the time of recommendation, require that the amount of compensation and other consideration reasonably anticipated to be paid, directly or indirectly, to the Investment Professional, Financial Institution, or their Affiliates or Related Entities for their services in connection with the recommended transaction is not in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2); and
- Ensure that the Investment Professional’s recommendations reflect the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would act in regard to acting in the Retirement Investor’s best interest.
- The DOL is proposing to require Financial Institutions to provide their complete policies and procedures to the DOL within 10 business days of a request.
- The DOL requests comments on whether additional guidance is needed regarding a Financial Institution or Investment Professional’s recommendations of proprietary products to a Retirement Investor, and, if so, the type of guidance that would be most useful.

ESsentials

- ▶▶ *The preamble goes beyond Proposal 2.0 in its apparent intent to impose a complete prohibition on certain forms of compensation and compensation models. Attempting to comply with these new prohibitions within the very short effective date period would severely disrupt the investment advice industry.*
- ▶▶ *The requirement to provide all policies and procedures to the DOL within 10 days of a request would be very difficult to comply with. The DOL may contemplate a set of binders with the policies sitting pristinely on an shelf, but in reality these policies and procedures are living documents that are embedded into electronic systems across departments and business areas.*
- ▶▶ *The concept that leveling compensation may be insufficient to mitigate conflicts is highly significant. It has long been the DOL’s position that by leveling compensation at the point of investment advice, prohibited transactions may in some cases be avoided altogether.*
- ▶▶ *DOL’s new position on leveled compensation requires analyzing the Financial Institution’s compensation. However, in many cases, it may be impossible to determine the Financial Institution’s compensation for a particular product before the fact.*

4. Retrospective review

The DOL is proposing to retain and clarify the requirement that Financial Institutions conduct a retrospective review.

- The DOL clarified that it would be expected that the retrospective review cover compliance with each exemption condition.
- The amendment to PTE 2020-02 would impose a new obligation to regularly review and update, as necessary, the policies and procedures to reflect changes in business and the law. The DOL expects this would be done at least annually.
- The amendment also intends to make clear that the requirement to maintain prudent policies and procedures includes a mechanism to properly modify the policies and procedures. This will require an additional certification from the Financial Institution's Senior Executive Officer that such mechanisms are in place.
- Under the amendment, the Senior Executive Officer would also need to:
 - Certify the Financial Institution has filed (or will file timely, including extensions) Form 5330 to report any non-exempt prohibited transactions discovered in a review; and
 - Review transactions, correct violations and pay any required excise taxes.
- The DOL's basis for this expanded retrospective review is that upon review of self-correction notifications summarizing the Financial Institution's annual retrospective review, the DOL has found certain compliance issues.

ESsentials

- ▶▶ *Where a large number of de minimis errors are discovered, e.g., due to a systems problem, it is unreasonable to expect a Senior Executive Officer to review every Form 5330 and certify that it has been filed.*

5. Self-correction

The amendment would retain the self-correction program for non-compliance where there are no resulting investment losses to retirement investors, or where the Financial Institution makes the retirement investor whole for any losses.

- "Losses" to the Retirement Investor are not limited to being left with fewer assets than originally invested, but also include those attributed to the Financial Institution's fees if such fees are deemed to be excessive.
- The proposed amendment would require that the Financial Institution actually report and pay any excise tax that could be imposed in connection with non-exempt prohibited transactions.
- Likely due to the number of questions the DOL has received regarding the types of violations that may be self-corrected, the DOL has requested comment on whether additional clarification is needed.

ESsentials

- ▶▶ *We question the DOL's authority to require the filing of Form 5330 and the payment of excise taxes as a condition of an exemption. Moreover, this condition effectively eliminates the self-correction provision. Paying the excise tax and correcting the transaction in and of itself resolves any non-exempt prohibited transaction without the need for utilizing the exemption's self-correction program.*
- ▶▶ *Under existing law, a taxpayer need not file Form 5330 if it believes the excise tax is not due. The high stakes involved in complying with the exemption mean that Financial Institutions will likely self-report and correct marginal compliance issues, even if they reasonably believe a non-exempt prohibited transaction did not occur. It seems that the exemption terms could be construed as overriding Treasury Regulations and imposing unnecessary burdens on the IRS.*

Eligibility

The amendment also retains and modifies the eligibility provision that identifies circumstances in which an Investment Professional or Financial Institution will become ineligible to rely on the exemption. The ineligibility period lasts for 10 years.

- The DOL expands ineligibility to include the Affiliates of Financial Institution. This differs from the current exemption, which is limited to a member of the Financial Institution's controlled group.
- The DOL proposes listing specific crimes (including foreign crimes) that would cause ineligibility, which is intended to broaden the provision. The DOL has requested comments on this change.
 - Under the current exemption, only the conviction of crimes arising out of such Financial Institution or Investment Professional's provision of investment advice to Retirement Investors would cause ineligibility.
 - The rule would be expanded under the amendment to include enumerated crimes regardless of whether the conduct arose in connection with providing retirement investment advice.
- The amendment would institute ineligibility for a systematic pattern or practice of failing to correct and report on Form 5330 prohibited transactions, and to pay the associated excise taxes.
- All entities would become ineligible six months after a conviction date, or the date of the DOL's written ineligibility notice, as applicable. This significantly shortens the one-year wind down period provided under the current exemption.

ESsentials

- ▶▶ *One of the virtues of current PTE 2020-02 is that it does not replicate the needlessly overbroad eligibility provisions of the QPAM exemption as to criminal convictions.*
- ▶▶ *The proposal would apply the ineligibility provisions even if the bad actor is involved in activity unrelated to retirement advice and outside the United States. It is not clear why the conviction of an employee of a foreign affiliate that is completely disconnected from the Financial Institution and Investment Professional is relevant to, e.g., advice to a take a rollover.*
- ▶▶ *Corporate restructuring and acquisitions often result in new affiliates joining the group, and as a result, Financial Institutions and Investment Professionals may unexpectedly lose their ability to rely on the exemption and provide much needed investment advice to retirement plans and their participants. In such situations, they may not even be aware of convictions involving new affiliates of the enterprise.*
- ▶▶ *Where does this leave the Retirement Investor? It can be expected that "trusted" relationships that are serving the Retirement Investor's best interest would be disrupted in situations where there is no corruption from the distant criminal activity, thus reducing the ability of Retirement Investors to obtain sound investment advice.*



Recordkeeping

Under the current framework of PTE 2020-02, Financial Institutions and Investment Professionals must maintain records documenting compliance with the exemption, including documentation of the specific reason that any rollover recommendations are in the Retirement Investor's Best Interest. Currently, the recordkeeping provisions of PTE 2020-02 allow only the DOL and the Treasury Department to inspect those records.

In the preamble to Proposal 4.0, the DOL requests comments on possible amendments to the recordkeeping provisions in PTE 2020-02, Section IV that would allow plan participants and other parties to review the applicable records. The amendments are not reflected in the proposed revisions to PTE 2020-02, but presumably the DOL would consider adding them in the final PTE or at some later point.

- The DOL notes that Proposal 4.0 also modifies PTE 2020-02 to add additional disclosure requirements that would provide Retirement Investors with certain information on exemption compliance without needing to request records.
- The possible amendments posited by DOL would:
 - Allow plan fiduciaries, participants, and unions to request records from Financial Institutions demonstrating compliance with PTE 2020-02.
 - Require that the records be reasonably available at their customary location during business hours.
 - Exclude from disclosure records specific to other Retirement Investors and other trade secrets.
- DOL requests comments on the burden to Financial Institutions and the benefits to Retirement Investors of being able to access this information on request.
- The amendment would institute ineligibility for a systematic pattern or practice of failing to correct and report on Form 5330 prohibited transactions, and to pay the associated excise tax.
- All entities would become ineligible six months after a conviction date, or the date of the DOL's written ineligibility notice, as applicable. This significantly shortens the one-year wind down period provided under the current exemption.

ESsentials

► *It seems predictable that the most common requestor of records under this proposed regime would be plaintiffs' attorneys, who will have the ability to bypass discovery by inspecting records relating to any Retirement Investors that they represent, as well as numerous other documents reflecting compliance with the PTE. The DOL noted in the preamble that it had received this comment previously.*

An aside on a private right of action for IRA owners

A principal flaw leading to the vacatur of Rule 2.0 was the invention in the Best Interest Contract Exemption (BICE) of a private right of action for IRA owners that was not provided in ERISA. As the Fifth Circuit's opinion concludes:

Fifth, the BICE provisions regarding lawsuits also violate the separation of powers.... Only Congress may create privately enforceable rights, and agencies are empowered only to enforce rights Congress creates.... Congress authorized private rights of actions for participants and beneficiaries of employer sponsored plans... but it did not so privilege IRA owners.... DOL may not create vehicles for private lawsuits indirectly through BICE contract provisions where it could not do so directly. [Citations omitted.]

We take DOL at its word that Proposal 4.0 is not intended to give rise to privately enforceable claims for IRA owners, but are concerned that it nonetheless may do so, in two ways.

- DOL's argument that rollover advice relates back to the plan, and to bootstrap that argument into a provision of the proposed regulation, is intended to invoke DOL's enforcement power under section 502 of ERISA. That section is not limited to public enforcement, however. Section 502 also provides legal remedies for plan participants and beneficiaries and, if DOL is right that rollover recommendations should be related back to the plan for section 502 purposes, it then may follow that IRA owners also have section 502 rights of action as plan participants in respect of those recommendations, possibly even for recommendations limited to the post-rollover investment of funds inside an IRA.
- In adopting PTE 2020-02 in Rule 3.0, DOL dismissed commentators' concerns that the required disclosures could provide a basis for private lawsuits by IRA owners, contending that no such right of action was intended and that the disclosures did not constitute a contract – which seemed a weak response for an issue that loomed so large in the Fifth Circuit's opinion. The enhanced disclosures required by Proposal 4.0, particularly including the unqualified acknowledgement of fiduciary status and the recitation of the conditions of the exemption, doubles down on that risk – which of course is not limited to contract claims – and the proposed delivery on request of PTE 2020-02 compliance materials will be of far more interest to the plaintiffs' bar than to any plan participant or IRA owner.

Proposed limits to PTE 84-24

PTE 84-24 is one of the first administrative class exemptions issued by DOL after the enactment of ERISA. Since 1977, it has provided relief for conflicted advice by financial professionals who, in the process of selling insurance products and proprietary mutual funds, inadvertently became "investment advice" fiduciaries under the five-part test. It also provided relief for various technical section 406(a) violations by the insurance companies and principal underwriters in connection with those transactions. Effective 60 days after adoption, the proposal would narrow (a) the scope of the exemption's relief for conflicted advice to sales of insurance products in the independent producer channel, and otherwise require resort to PTE 2020-02 in circumstances previously covered by PTE 84-24 and (b) add conditions comparable to PTE 2020-02 but intended to reflect the particular circumstances of that channel.

Structure of PTE 84-24 as amended

If Proposal 4.0 is adopted, PTE 84-24 would provide relief in three tranches:

- Section 406(a) and 406(b) relief for a specified range of transactions before the effective date of the original iteration of PTE 84-24 in 1977, subject to a limited set of conditions;
- Section 406(a) and 406(b) relief for that range of transactions after the 1977 effective date, subject to a broader set of conditions. It appears intended that this relief would remain in effect for persons who are not fiduciaries, including directed trustees, after the effective date of Proposal 4.0; and
- Section 406(a)(1)(D) and 406(b) relief for commissioned insurance sales by independent producers after the effective date of Proposal 4.0, with all prior relief for conflicted advice sunsetting on that date other than for ongoing compensation in connection with recommendations made before that effective date or pursuant to systematic purchase program established before that date.

ESsentials

- ▶ In this respect, there may be imperfections in the drafting of the proposed amendments to PTE 84-24 that will require further attention. Notably, the amendment would add language excluding investment advice fiduciaries from the second tranche of relief that, literally read, might revoke that relief retroactively to 1977. More clarity in these provisions (Section II of the exemption) would be helpful.
- ▶ DOL also proposes to exclude from PTE 84-24 relief not only for ERISA section 3(38) investment managers, but also persons with discretionary investment management authority that has been conferred orally. Inasmuch as we understand ERISA to disallow oral delegations of investment discretion, it is unclear to us what case DOL is contemplating, although there must be one because this change is positioned as a clarification rather than a revision.
- ▶ It also appears that the proposed amendments would retroactively limit relief to insurance and mutual fund commissions defined to exclude revenue sharing payments or 12b-1 fees, administrative fees or marketing payments, payments from third parties, and similar amounts. DOL asserts that the relief has always been so limited, but that is revisionist history and certainly contrary to the understanding in the regulated community.



Covered transactions

The prospective relief for conflicted investment advice would be substantially narrowed to cover only:

The receipt, directly or indirectly, by an **Independent Producer** of an **Insurance Sales Commission** as a result of the provision of investment advice within the meaning of ERISA section 3(21)(A)(ii) and IRC section 4975(e)(3)(B), regarding the purchase of a **non-security annuity contract or other insurance product not regulated by the Securities and Exchange Commission (SEC)** of an Insurer that is not an Affiliate, including as part of a rollover from a Plan to an IRA as defined in IRC section 4975(e)(1)(B) or (C).

- An **“Independent Producer”** is a person or entity that is licensed under the laws of a state to sell, solicit or negotiate insurance contracts including annuities, and that sells to Retirement Investors products of multiple unaffiliated insurance companies, but is not an employee of an insurance company (including a statutory employee under IRC section 3121).
- **“Insurance Sales Commission”** means a sales commission paid by the Insurance Company or an Affiliate to the Independent Producer for the service of recommending and/or effecting the purchase or sale of an insurance or annuity contract, including renewal fees and trailing fees, but excluding revenue sharing payments, administrative fees or marketing payments, payments from parties other than the insurance company or its Affiliates, or any other similar fees. The definition of “Mutual Fund Commission” would be similarly limited prospectively.
- There is no definition of a “non-security annuity” or “insurance product not regulated by the SEC.” This exclusion presumably includes such products as variable annuities and registered index-linked annuities (RILAs). PTE 2020-02 would be the only exemptive solution for the payment of compensation in connection with those products.

ESsentials

- ▶ *Proposal 4.0 would send all sales of proprietary or SEC-registered insurance products and all mutual fund sales to PTE 2020-02.*
- ▶ *The DOL estimates that only ten entities currently rely on PTE 84-24 with respect to mutual fund commissions.*
- ▶ *PTE 84-24 relief for conflicted advice would be limited to non-SEC registered insurance products sold in the independent producer channel because DOL has accepted that, in that channel, insurance companies are unable to execute fully the PTE 2020-02 Financial Institution responsibilities.*
- ▶ *Exclusions would remain in effect for in-house plans or if the independent producer is acting as a fiduciary discretionary manager or plan administrator.*
- ▶ *It remains unclear how insurance companies would satisfy PTE 2020-02 for Independent Producer sales of SEC-registered products.*
- ▶ *There are also complexities in insurance sales structures that do not neatly divide into this dichotomy and could produce incongruous results, which will merit comment to and further attention from DOL.*
- ▶ *Relief for other forms of compensation would be available under PTE 2020-02, if permitted under the Impartial Conduct Standards.*
- ▶ *Finally, to the extent the insurance company is itself a fiduciary, it would be obliged to rely on PTE 2020-02 for relief even in the independent producer channel.*

Conditions

1. In general

The post-amendment relief for commissioned insurance sales by Independent Producers would be subject to the following conditions, some of which parallel PTE 2020-02.

- As under PTE 84-24 currently, the transaction is effected by the Independent Producer and insurance company in the ordinary course of business, is as favorable to the plan as an arm’s-length transaction, and combined fees do not exceed reasonable compensation.
- The Independent Producer’s advice at the time is in the retirement investor’s best interest under impartial conduct standards.
- The transaction is not subject to certain exclusions, including those noted above.
- The Independent Producer receives only Insurance Sales Commissions, as defined above.
- A series of disclosures, including newly required disclosures, is provided to an independent plan fiduciary or IRA owner.
- The Independent Producer’s statements to the retirement investor are not misleading.
- The independent plan fiduciary or IRA owner acknowledges in writing receipt of the disclosures and approves the transaction.
- The insurance company establishes, maintains and enforces certain policies and procedures, including initial diligence on each Independent Producer and supervision of each sale. These activities, without more, do not cause the insurance company to become an ERISA fiduciary.

- The insurance company conducts a retrospective compliance review at least annually, including ongoing diligence on each Independent Producer, which is certified by a senior executive officer. The insurance company must report any prohibited transaction excise tax due on Form 5330, advise any Independent Producer of violations and resulting excise taxes, and notify DOL of violations.
- Either the Independent Producer or the insurance company self-corrects any violations.
- Neither the Independent Producer nor the insurance company have been disqualified from reliance on the exemption under new eligibility provisions.
- Certain recordkeeping requirements are met.

We discuss certain of these conditions below. Our comments on comparable proposals for PTE 2020-02 are equally applicable here.

2. Disclosures

The required disclosures prior to sale would include:

- Any limitation on the Insurance Producer's ability to recommend insurance or annuity contracts by reason of her agreement with the insurance company.
- The Insurance Sales Commission for the recommended contract as a percentage of gross premiums and in dollar terms, for the first year and each succeeding renewal year. (As proposed, this cumulative disclosure appears in two different sections of the amended exemption.)
- A description of any contract charges, fees, discounts, penalties or adjustments in connection with the purchase, holding, exchange, termination or sale of the contract.
- A written acknowledgement that the Independent Producer is an ERISA or IRC fiduciary, as applicable.
- A written statement of the Best Interest Standard of care.
- A written description of the services to be provided by the Independent Producer, including the specific insurance companies and insurance products available for recommendation by the Independent Producer.
- A written statement that the Retirement Investor has the right to request certain other information, as under amended PTE 2020-02.
- Documentation of the Independent Producer's conclusions as to whether the recommended annuity is in the best interest of the Retirement Investor. This documentation must also be provided to the insurance company.
- In connection with a rollover recommendation specifically, documentation of the Independent Producer's conclusions as to whether the rollover is in the best interest of the Retirement Investor, taking account of factors comparable to PTE 2020-02. This documentation must also be provided to the insurance company.

As for PTE 2020-02, DOL offers a model form for the certain disclosures.

With respect to the disclosures, the proposal permits both the Insurance Producer and the insurance company to rely in good faith on information and assurances from unaffiliated persons, including each other. Disclosures otherwise prohibited by law are not required.

As with PTE 2020-02, the proposal raises the possibility of public website disclosure by the Independent Producer.

ESsentials

- ▶▶ *It seems improbable that disclosure at this scale and level of detail will be useful to any Retirement Investor.*
- ▶▶ *Advance disclosure of the dollar amount of commissions, before the Retirement Investor has committed to the initial premium payment and is free to modify or not make future premium payments, always is problematic and potentially misleading.*
- ▶▶ *Disclosure of every insurance company the Insurance Producer is authorized to represent, and each company's full book of available products, could be both voluminous and subject to frequent change.*
- ▶▶ *Existing guidance allows PTE 84-24 disclosures to be provided through multiple documents, including any general disclosure document for the insurance contract.*

3. Policies and procedures

An insurer would be required to adopt and implement protective policies and procedures, and to “carefully police” recommendations of its own investment products. The DOL clarifies in the preamble that it is not requiring the insurers to police Independent Producers’ recommendations of competitors’ products.

- Compliance with these policies and procedures would be the responsibility of the insurance company, not the Independent Producer.
- The insurance company would be required to review the Independent Producer’s recommendation for compliance before the annuity is issued to the Retirement Investor, in a manner similar to current suitability reviews, and would be required to take into account other products the insurance company has available and the compensation those products offer to the Independent Producer.
- The policies and procedures must mitigate conflicts of interest in a manner comparable to PTE 2020-02, and in particular must “identify and eliminate quotas, appraisals, bonuses, contests, special awards, differential compensation, riders and or [sic] other similar features” that a reasonable person would conclude are likely to incentive recommendations not in the Retirement Investor’s best interest. Qualification for incentive trips or even educational conferences could not be based on sales volume or quotas.
- The policies and procedures would be expected to include a prudent process for taking action to protect Retirement Investors from Independent Producers who might fail to adhere to the Impartial Conduct Standards, or who lack necessary education, training, or skill. The DOL explains that this requirement is consistent with, but more protective than, the NAIC model regulation, which requires an insurer to verify that the producer has completed the required annuity training course.
- The policies and procedures thus must include robust initial diligence of each Independent Producer at the time of initial contracting, and ongoing diligence as part of the retrospective review. The preamble expresses an expectation that an insurance company “would not work” (although surely that is meant to mean make use of the exemption) with an Independent Producer who has been barred by any regulator from selling insurance or annuities (even if still licensed in other jurisdictions) or is ineligible under either PTE 2020-02 or PTE 84-24.

ESsentials

- ▶▶ *In its requisite Federalism Statement, the Department expressed its intent that the proposed exemption is not intended to “change the scope or effect of ERISA section 514, including the savings clause in ERISA section 514(b)(2) (A) for State regulation of securities, banking, or insurance laws.” The Department’s view is that the proposed exemption “has no substantial direct effect on the States, on the relationship between the National government and the States, or on the distribution of power and responsibilities among the various levels of government.”*
- ▶▶ *Nevertheless, Proposal 4.0 represents DOL’s most intrusive undertaking to regulate the inner workings of the life insurance industry.*
- ▶▶ *The preamble effectively reflects a judgement call by DOL that the conflicts created by certain compensation practices cannot be mitigated and must be eliminated, including “differential compensation.” The intent and consequences of that mandate will require further elaboration, including whether it is intended to ban these practices for non-retirement sales because that might corrupt rollover or distribution advice.*
- ▶▶ *The bar on qualification standards for an educational conference (which is hardly considered a perk in the industry) is particularly perplexing. It is surely reasonable for an insurance company not to pay for an Independent Producer’s attendance at an educational conference if she has not sold any of the company’s products for a period of time.*
- ▶▶ *No guidance is offered as to the diligence required for existing relationships with Independent Producers at the effective date of the proposal.*

4. Retrospective review and self-correction

The insurers, not the Independent Producers, would be required to conduct the retrospective review. In contrast, Independent Producers could implement self-correction. Self-correction would be allowed in cases when either (1) the Independent Producer has refunded any charge to the Retirement Investor or (2) the insurer has rescinded a "mis-sold" annuity, canceled the contract, and waived the surrender charges. The DOL notes that this form of self-correction differs from PTE 2020-02, which is focused on investment losses.

ESsentials

- ▶▶ *While the proposed amendment incorporates the self-correction program of 2020-02, there are important differences – in particular, the concept of rescission of an annuity contract.*
- ▶▶ *The preamble does not consider the possibility of a retirement investor who prefers to retain the contract.*

5. Eligibility

The proposed amendment would impose eligibility criteria similar to that of PTE 2020-02, under which an Independent Producer or insurer would become ineligible to rely on the exemption for 10 years in the event that the Independent Producer or insurer violated the applicable criteria. In the preamble the DOL acknowledges that an insurer would not necessarily commit a prohibited transaction if it does not comply with the terms of the exemption, so their eligibility to rely on this exemption would not be linked to engaging in a systematic pattern or practice of failing to correct prohibited transactions, report those transactions to the IRS on Form 5330, and pay excise taxes.

The DOL explains in the preamble that if an insurer or Independent Producer becomes ineligible to rely on PTE 84-24, it may be able to rely on a different exemption. While PTE 2020-02 could be a solution, "the Department may, as part of its eligibility determination process, determine that an entity is not eligible for either PTE 2020-02 or PTE 84-24." In that case, an insurer could apply for an individual exemption but "any resulting exemption would likely require the insurer to be a fiduciary and acknowledge fiduciary status."

ESsentials

- ▶▶ *While the proposed amendments to PTE 84-24 as a whole reflect a misunderstanding of the the business of insurance companies as product manufacturers, this disconnect is particularly disturbing in the proposed eligibility provision.*
- ▶▶ *There is no explanation -- and we cannot conceive of one -- as to why a conviction of a distant affiliate has any bearing on the design of an insurance product, which is required to be reviewed and approved by state regulators before being offered for sale to the public, or the conduct of its regulated insurance business. The general question of the relevancy of distant affiliate behavior is also there in PTE 2020-02, but is particularly irrelevant here because the insurer is not considered a fiduciary, so the stated rationale for the expansion is not present.*
- ▶▶ *The warning that, in the event of ineligibility under the class exemption and as a condition for an individual exemption, DOL would compel an insurance company to accede to fiduciary status where it does not otherwise exist, seems an abuse of both the terms of the statute and DOL's exemptive authority (as broad as it is), and we trust DOL will reconsider that position.*
- ▶▶ *The Department has requested comments about this process as a whole.*

Partial revocation and modification of other exemptions

The proposed amendments would remove fiduciaries providing investment advice, as defined under ERISA and in proposed regulations, from the relief provided in PTEs 75-1, 77-4, 80-83, 83-1 and 86-128. Investment advice fiduciaries would be required to rely on the amended PTE 2020-02 for exemptive relief for investment advice transactions.

Although unrelated to investment advice fiduciaries, the DOL is taking this opportunity to propose additional amendments to certain of the exemptions, as indicated in the chart below. Of particular note are proposed amendments that would require entities to maintain "records necessary to determine whether the conditions of [the] exemption have been met" and provide access to those records not only to the DOL and IRS, but also to any fiduciary, contributing employer or employee organization whose members are covered by the plan, any participant, beneficiary or IRA owner, and their "duly authorized representatives." Trade secrets and other confidential information would not need to be disclosed. In addition, the existing recordkeeping requirements of these exemptions would be shifted to the Financial Institutions.

EXEMPTION	COVERED ACTIVITY	ADDITIONAL CHANGES
PTE 75-1, PART I(b) and (c)	Certain non-fiduciary services in connection with securities transactions	Revoked as duplicative with PTE 408(b)(2)
PTE 75-1, PART II (2)	Sales of nonproprietary mutual funds by broker-dealer	Revoked as determined not to be protective of Retirement Investors and to have been applied broadly beyond its intent.
PTE 75-1, PARTS III, IV	Underwritings and market-making	Recordkeeping access amendment
PTE 75-1, PART V	Extension of credit to a plan/ IRA in connection with a securities transaction	Amendment to require additional pre-transaction disclosures Recordkeeping access amendment
PTE 77-4	Allocation by discretionary or nondiscretionary investment fiduciary to proprietary mutual funds	None
PTE 80-83	Use of proceeds from sale of securities to reduce or retire indebtedness	None
PTE 83-1	Mortgage pool investment trusts	None
PTE 86-128	Commissions for the execution of securities transactions by a fiduciary; agency cross-transactions	Extension of conditions regarding pre-transaction disclosure and written authorizations, confirmation slips / transaction summaries annual summary disclosures and/or agency cross transaction disclosures to IRAs and to plans without employees Recordkeeping access amendment

ESsentials

- ▶ In form, this change differs from the corresponding change in Rule 2.0, which in general added impartial conduct standards to these exemptions but otherwise permitted their continued use by investment advice fiduciaries.
- ▶ By requiring affected providers to resort instead to amended PTE 2020-02 in full, the proposal would require more extensive changes in disclosures, practice and procedures.
- ▶ That the DOL does not understand the significance of what it is proposing is evidenced by its cost estimates associated with removing fiduciary investment advice from these exemptions: "The Department believes that since investment advice providers were already required to provide records and documentation under PTE 2020-02, **this amendment would not result in additional costs.**"
- ▶ The new recordkeeping access amendments are problematic in the same way as discussed in connection with similar proposed amendments being contemplated for PTE 2020-02. Presumably the "duly authorized representative" will be construed as meaning a plaintiffs' attorney.
- ▶ Extending the cumbersome authorization and disclosure conditions of PTE 86-128 to IRAs would not seem to be a productive step in protecting individual retirement investors, particularly because investment advice fiduciaries would no longer be able to utilize the exemption.

Effective date, coordination and severability

Effective date and transition period. As proposed, both the new fiduciary definition and the revisions to the complex of exemptions dealing with conflicted investment advice would take effect 60 days after publication of the final rule in the Federal Register. No transition or compliance period is on offer.

ESsentials

- ▶ *DOL will of course insist on a nominal 60-day effective date, to manage its "midnight regulation" problem should the White House change hands in January 2025, but that does not answer the separate question of a transition or compliance period.*
- ▶ *We infer that DOL's opening position is that financial service providers need no time to assimilate ERISA prudence, that it will be a short lift from their current compliance practices to these long-standing ERISA principles, and that these essential ERISA protections for retirement investors should not be further delayed.*

We respectfully disagree.

- ▶ *There is no empirical evidence that Retirement Investors are currently suffering adverse outcomes due to the absence of ERISA regulation on the scope proposed by DOL.*
- ▶ *The proposal would cover a very large number of investment interactions that have not been treated as ERISA fiduciary advice since the vacatur of Rule 2.0.*
- ▶ *The preamble itself outlines a number of the differences between standards of conduct under other bodies of financial services law and DOL's requirements.*
- ▶ *The Considerations for Financial Service Providers discussion above offers an incomplete sense of the range of providers that would be affected by the proposal.*
- ▶ *Even providers that are currently making use of PTE 2020-02 would be obliged to reconsider material portions of their compliance procedures and reissue existing disclosures.*

Coordination with other agencies and federalism. The preamble recites that DOL coordinated with a number of other federal and state agencies in the development of the proposal, and even did our firm the honor of citing in the regulatory impact analysis our publication on the "patchwork quilt" of standards of conduct for financial services companies.

ESsentials

- ▶ *Like Rule 2.0, DOL's current proposal gets deep into the weeds of matters – e.g., standard of care, compliance practices and procedures, and compensation systems – that otherwise have been understood to be the province of other federal and state regulators, and would force substantial changes in industry practices.*

- ▶ *The expenditure of government resources to develop overlapping standards of conduct at the federal and state level, all aimed at investor/consumer protection, has been staggering.*
- ▶ *The expenditure of industry resources to comply with one set of standards, only to rework that compliance for the next set of standards to be issued, has been even more staggering.*

Severability. The preamble notes DOL's intent that "discrete aspects of this regulatory package" would be severable even if "certain aspects of the proposal were struck down by a court," in order to serve the text and purpose of ERISA. By way of example, DOL suggests that the proposed new fiduciary definition should survive even if a court vacated the proposed amendments to the exemptions. Comments on severability are invited.

By way of background, in 2018, the Administrative Conference of the United States, an independent federal agency that considers improvements for the federal regulatory system, issued a recommendation on severability, following up on a 2015 Yale Law Journal article.

If a court holds portions of a rule unlawful, and the agency has been silent about severability, then the default remedy is to vacate the entire rule, including those portions that the court did not hold unlawful.... This Recommendation suggests best practices for agencies in addressing severability in a rulemaking. Addressing severability is not appropriate in every rulemaking. Indeed, if agencies include severability clauses without a reasoned discussion of the rationale behind them and how severability might apply to a particular rule, the courts will be less likely to give them much weight. By contrast, addressing severability can be particularly valuable when an agency recognizes that some portions of its proposed rule are more likely to be challenged than others and that the remaining portions of the rule can and should function independently.

ESsentials

- ▶▶ *To the extent raising the possibility of severability signals that DOL recognizes the likelihood of a court challenge upon adoption of Proposal 4.0, that consideration is warranted.*
- ▶▶ *It seems improbable to us that any such challenge would be limited to only "some portions" of the proposal.*
- ▶▶ *It also seems to us that the proposal is sufficiently integrated that vacatur in its entirety again would be appropriate.*

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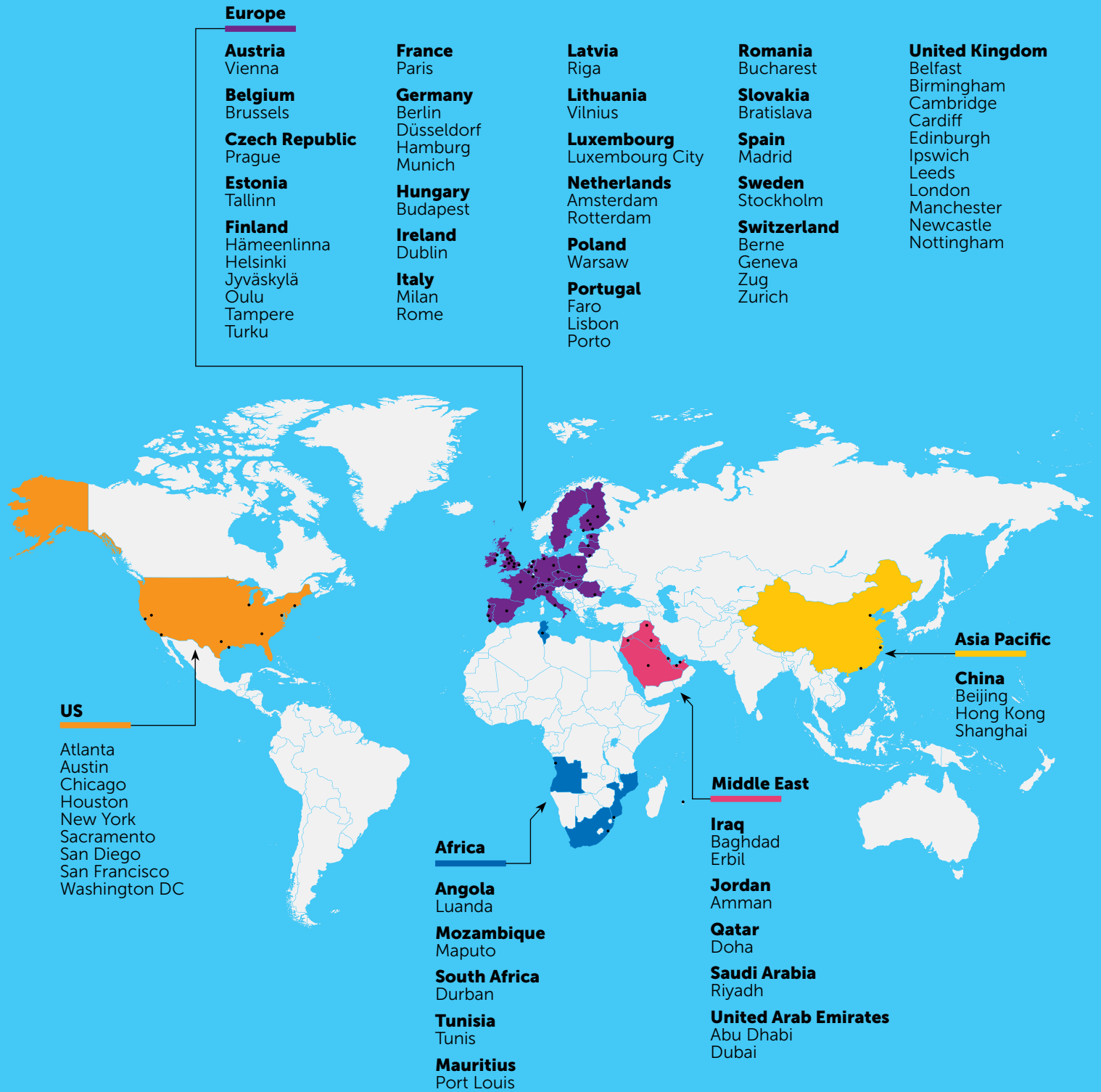
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