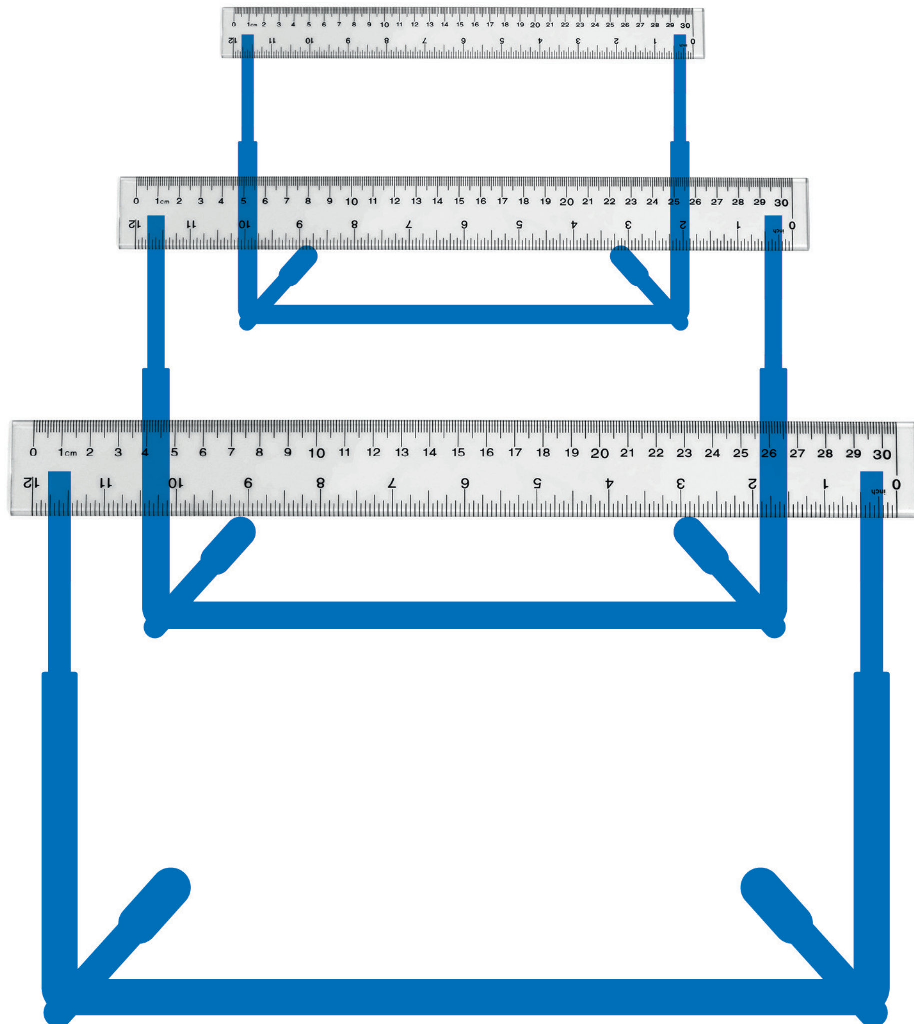
EVERSHEDS SUTHERLAND

Department of Labor's Fiduciary Proposal 3.0

Exemption and investment advice fiduciary definition



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Did you know?

$25.5 trillion
Assets in the US retirement plan system at December 2019 that could be impacted by Proposal 3.0.

3,550 days
Days since Proposal 1.0 (Oct 22, 2010) to the release of Proposal 3.0.

$5 billion
Estimated compliance costs for the Final Rule prior to vacatur.

Introduction

More than 3,500 days have passed since the US Department of Labor (DOL) upended the financial services industries with its first, self-initiated proposal to redefine "investment advice fiduciary" for purposes of the Employee Retirement Income Security Act of 1974, as amended (ERISA). That initiative, together with the Dodd-Frank Act mandate that the Securities and Exchange Commission (SEC) reconsider the standard of conduct to which broker-dealers should be subject, accelerated more than a decade of reevaluation of and, as a business planning and compliance matter, uncertainty about the duties financial services providers owe to investors, specifically including retirement investors.

- DOL's Proposal 1.0, released in October 2010 and limited to an expansion of fiduciary status beyond that specified in a 1975 ERISA regulation, was substantially informed by inward-looking considerations. DOL's experience was that the 5-part test adopted in the 1975 regulation unduly impeded its ability to prosecute ERISA enforcement matters in a manner it deemed appropriate. (In the most aggravating example, DOL and the 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 a variety of perspectives, and DOL abandoned it in September 2011.
- Proposal 2.0, offered in April 2015, was far more ambitious. Defended essentially as broad-ranging 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. This proposal extended fiduciary status in unprecedented ways, 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. Proposal 2.0 became the single most politicized issue under ERISA since the enactment of that law. The Final Rule implementing the proposal was adopted in April 2016 with an initial compliance date in June 2017. The financial services industries spent billions of dollars restructuring their business models and compliance processes before the Final Rule was vacated by the US Fifth Circuit Court of Appeals in March 2018 as regulatory overreach.

For a variety of historical and analytic resources following these developments, please visit our DOLFiduciaryRule.com website.

As expected, DOL has now released its Proposal 3.0, quite neatly in conjunction with the compliance date of Regulation Best Interest (BI) adopted by the SEC pursuant to its Dodd-Frank mandate. Much has changed since Proposal 1.0. In addition to the SEC's work, a limited number of states have adopted "best interest" standards under their insurance or securities laws. For more information on these developments, see our Fiduciary and Regulatory Compliance website.

The financial services industries are coming to terms with the trending expectation, variously expressed in legislation, regulation, litigation and the market, that in serving investors they should answer to a heightened standard of conduct. Many of those providers have by this time internalized some form of those principles, including practices developed to comply with the Final Rule and retained after its vacatur. At the same time, it now is more widely understood that:

- There can be no financial services business model that is unconflicted in the absolute sense that ERISA presumes fiduciaries can be; and
- At least in part, these conflicts arise from the industry's function in our financial system and are shaped by the primary pattern of regulation to which that industry is subject.

Because those financial services are indispensable to the operation of the private retirement system, ERISA's share of the regulation of those industries must accommodate to those realities.

That is the backdrop against which Proposal 3.0 was developed and is to be measured. As we wrote in connection with the vacatur of the Final Rule:

> It may be inevitable, in (i) a federal system with (ii) national rulemaking authority divided among multiple agencies, that plan sponsors and providers will be compelled to deal with a patchwork of federal and state "best interest" standards of differing scope and content, with its attendant burden on compliance programs, increase in costs to the retirement system, and confusion among retirement investors. It would be well, however, if the various rulemaking authorities could take a broader, less parochial view in deciding if and how to regulate these issues.

Headlines for plan sponsors

- *Unlike the vacated Final Rule, Proposal 3.0 does not broadly expand the circumstances in which plan product and service providers are acting as ERISA fiduciaries to the plan or participants, and it does not mandate new contracts between fiduciaries and plans or participants.*
- *Soliciting and advising plan participants regarding rollovers to IRAs would be considered fiduciary activity under Proposal 3.0. In many cases this will impact the actions of plan investment advisers and recordkeepers with respect to plan participants.*
- *In many situations, Proposal 3.0 would require plan fiduciaries to (i) provide plan sponsors with disclosure of their status, services, and material conflicts and (ii) actively manage and mitigate any conflicts embedded in the provider's business model.*
- *The question of whether valuation services are fiduciary services remains deferred.*

Headlines for retirement product and service providers

- *Proposal 3.0 reverts to the 5-part test to determine ERISA investment advice fiduciary status, but importantly with an extensive explanation by DOL that it no longer agrees with its prior guidance regarding rollover advice, and that rollover advice will be fiduciary in nature in many circumstances.*
- *The centerpiece of Proposal 3.0 is a new prohibited transaction exemption (PTE) intended to permit existing compensation structures, including both transaction-based and fee-based compensation. A key requirement of the proposed exemption is an impartial conduct standard, which includes a "best interest" concept that can generally be satisfied by following SEC regulatory standards.*
- *The proposed exemption also requires disclosure of fiduciary status and services, and demands that statements by the provider to the retirement investor must not be materially misleading, but it does not require a contract between the fiduciary and the plan or plan participant.*
- *Product and service providers will be required to establish or enhance policies and procedures to (i) mitigate the risk of conflicts, (ii) document rollover advice, and (iii) annually review on a retrospective basis their compliance with the exemption, including its conflict mitigation and other requirements, and report to their CEO who must provide a compliance certification.*

2010	2011
Oct-DOL issues Proposal 1.0	**Mar**-DOL holds hearings on Proposal 1.0 **Sept**-DOL announces withdrawal of Proposal 1.0

2015	2016	2017	2018
April-DOL releases Proposal 2.0 **Aug**-DOL holds hearings on Proposal 2.0	**April**-DOL adopts Final Rule and exemptions DOL issues FAQs in Oct 2016, Jan 2017 and Aug 2017	**Jan**-DOL proposes insurance intermediary exemption **Feb**-White House directs DOL to restudy Final Rule **April**-DOL delays compliance date for 60 days **June**-Initial compliance date **June**- DOL issues RFI for additional public comments **Nov**-DOL extends BICE transition period to July 2019	**March**-Fifth Circuit vacates Final Rule **May**-DOL announces temporary non-enforcement policy

2019	2020
June-SEC adopts Regulation Best Interest	**June**-Regulation BI compliance date **June**-DOL issues Proposal 3.0

Summary of Proposal 3.0 and next steps

Proposal 3.0 is reflected in a package of documents including a press release, fact sheet, technical amendment, and proposed ERISA class prohibited transaction exemption.

The proposal actually starts with a fait accompli. Consistent with the authority of the Fifth Circuit decision, DOL issued a "technical amendment" that officially restores to the Code of Federal Regulations its 1975 investment advice regulation (the so-called 5-part test) and its 1996 investment education guidance, both of which were removed in 2016 in favor of the Final Rule, and reinstates its pre-2016 complex of ERISA class exemptions. That action is effective immediately, although the legal effect is of course retroactive. In the preamble, however, DOL announced that it now believes its 2005 advisory opinion on rollover advice was incorrectly reasoned, and that rollover advice is fiduciary investment advice if and when it meets the terms of the 5-part test. In what is likely a preview of a new enforcement and litigation position, DOL explained how it would now see the "regular basis" and "primary basis" parts of that test operating in the rollover setting.

DOL complemented the reinstatement of the 5-part test with a proposed new exemption from ERISA's conflict of interest rules. That PTE would allow investment advice fiduciaries to receive compensation when providing conflicted advice and to engage in certain principal transactions with a compensatory element, on terms intended to be agnostic as to the fiduciary's business model or form of compensation. Subject to limited exclusions (including for robo-advice without human interaction), relief would be available to banks, broker-dealers, insurance companies and registered investment advisers, along with their employees, independent contractors, agents and representatives. Key conditions under the proposed exemption include:

- Impartial conduct standards that the investment advice is in the best interest of the retirement investor at the time provided (measured by a variation on the ERISA prudence standard and by an obligation not to place the provider's interest ahead of the retirement investor's), that the compensation received by the provider and related parties does not exceed reasonable compensation, that the provider seek best execution as required by the federal securities laws, and (in a seemingly self-evident condition that likely reflects DOL's enforcement experience) that the provider does not make materially misleading statements to the retirement investor. Compliance with the SEC's Regulation BI and fiduciary standards for broker-dealers and registered investment advisers, respectively, would be deemed compliance with the impartial conduct standards of the exemption;
- Advance written disclosure to the retirement investor of the provider's ERISA and/or Internal Revenue Code fiduciary status, the services to be provided, and the provider's material conflicts of interest. DOL took pains to state its intention that this disclosure does not create a new private right of action for IRA owners that was not included in ERISA;
- Written policies and procedures "prudently designed" to mitigate conflicts, reinforced annually by an in-house retrospective compliance review and certification by the provider's CEO; and
- A specific documentation requirement for rollover advice and account type recommendations.

Financial institutions and individual investment professionals would become ineligible to rely on the exemption for a 10-year period automatically upon conviction for certain crimes arising out of investment advice provided to retirement investors, or upon DOL's finding of intentional violation of the exemption, a systematic pattern or practice of violation, or the provision of materially misleading information to DOL in connection with conduct under the exemption. On petition, DOL may waive that ineligibility for financial institutions.

Next Steps. Comments to DOL on Proposal 3.0 are due August 6, 2020. Those comments will no doubt include requests from some commentators for a public hearing on the proposal. Given the extensive commentary and public hearings on Proposal 1.0 and Proposal 2.0, it seems doubtful that more can be said on this initiative that would necessitate a third hearing to amplify the written comments that will be submitted, but it is of course DOL's responsibility to make that determination.

DOL then will take the commentary it receives into account in finalizing the proposal and, if DOL determines to proceed, resubmitting it for review by the White House Office of Management and Budget. The new PTE would be available to financial institutions and investment professionals 60 days after publication in the Federal Register. Depending on the timing of that process and the outcome of the November election, any adoption of Proposal 3.0 could potentially be subject to review and reversal by a new Administration as a "midnight regulation" or the new Congress under the Congressional Review Act.

For more information

For resources and commentary regarding this regulatory process, visit Eversheds Sutherland's dolfiduciaryrule.com.

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

Eversheds Sutherland commentary

The approach to regulation in Proposal 3.0 is very different from that underlying the vacated rule. As noted above, the Final Rule had as its ambition nothing less than the restructuring of the banking, insurance and securities industries at least as they did business with retirement plans and investors, and without reference to the pattern of heavy regulation to which those industries were otherwise subject. That regulatory overreach fundamentally led to the vacatur of the Final Rule by the Fifth Circuit.

The new proposal continues to respect ERISA as an independent source of law for financial services companies in the retirement space, but purposefully undertakes to align with these other bodies of regulation. This is most clearly the case for securities firms, which both DOL and SEC Chair Jay Clayton acknowledged and which is evident from the attention these firms receive in the preamble to the proposed exemption. Similarly, when consumer advocates charge that Proposal 3.0 waters down ERISA, they principally have in mind broker-dealer firms. But if transaction-based compensation is to be allowed for investment advice fiduciaries – and even the Final Rule admired by consumer advocates did so – then ERISA statutory standards necessarily will be "watered down." This is the very reason Congress made provision for prohibited transaction exemptions in the first place; to quote the legislative history, "some transactions which are prohibited ... nevertheless should be allowed in order not to disrupt the established business practices of financial institutions ... consistent with adequate safeguards to protect employee benefit plans."[1] In developing Regulation BI, the SEC gave explicit and specific attention to the protection of retirement investors as informed by a deep understanding of the broker-dealer industry, including of its function, business models, regulation and conflicts, and there is no reason to think DOL has the expertise to make a better job of it; indeed, the Final Rule proves the opposite.

In a welcome departure from past practice, DOL also makes regular reference to the insurance industry in Proposal 3.0. Because of the absolute necessity of making lifetime income solutions available to defined contribution plan participants and IRA owners, it is crucial that Proposal 3.0 function effectively in that setting. There are, of course, no federal standards of conduct to which insurance providers are subject, and state standards are as always a patchwork. Accordingly, the proposed exemption may entail a greater deviation from insurance regulation than from securities regulation, with the understanding that PTE 84-24 remains available in its pre-2016 form and has provided a useful solution for the industry since 1977.

The banking industry draws the least discussion in Proposal 3.0. DOL even goes so far as to ask for commentary on whether there are circumstances in which banks may be acting as investment advice fiduciaries and may need relief. Proposal 3.0 itself provides the start of an answer to that question; as DOL sees it, banks may be investment advice fiduciaries in the rollover setting. At least with respect to their trust and certain other operations, banks have always been subject to care and loyalty standards under common law or banking law; for example, the Office of the Comptroller of the Currency provides detailed guidance (all of which was recently updated) for national banks and thrift institutions with respect to conflicts of interest, personal fiduciary activities, and retirement plan products and services. As needed, perhaps this alignment warrants more focus as a final exemption is considered. Existing exemptions for banking activities, including the ERISA §408(b)(6) exemption for ancillary bank services, also figure into this analysis.

In the end, the objections of plan sponsors and financial services companies to the Final Rule had less to do with the policy objective that investment intermediaries be legally responsible for putting the interest of retirement investors before their own business interest, and more to do with the execution of that objective and the costs it imposed on the retirement system. While Proposal 3.0 will necessitate changes in business practice and increase costs – for the usual reasons, DOL's aggregate cost estimate for compliance with the proposed PTE of $44 million in the first year and $42 million in subsequent years will prove materially low, and also does not count the cost consequences of DOL's new positions under the 5-part test – DOL seems right to regard those consequences as incremental in light of industry changes in response to the Final Rule (much of which was retained), the SEC's work, and other developments. This may be a proposal with which all concerned can work.

1 H.R. REP. NO. 93-1280, at 309-310 (1974) (Conf. Rep.).

Arrangements in the ambit of Proposal 3.0

The proposal is relevant 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 §4975(e)(1), to the following non-ERISA arrangements:

- Traditional IRA accounts and annuities;
- Roth IRAs;
- Archer medical savings accounts;
- Health savings accounts; and
- 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.
- There is the possibility of a "knock on" effect for arrangements outside the legal scope of the proposal, however.

History: When is a person acting as an ERISA investment advice fiduciary?

	Proposal 1.0		**Proposal 2.0**		**Proposal 3.0**
1975 – "5-Part test"	**2015 – Proposed "3 x 4 definition"**		**2016 – Final "3 x 3 definition"**		**2020 – Reinstatement of "5-Part Test"**
For a direct or indirect fee, a person:	Person meets at least one in each column, for a direct/indirect fee		Person meets at least one in each column, for a direct/indirect fee (including to an affiliate)		
	Service	**Status**	**Service**	**Status**	
1. Renders advice as to the value of securities/ 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.	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	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.	Makes a recommendation regarding: 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	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	5-Part Test is reinstated, with new commentary on rollover advice and other matters

Technical Amendment: The scope of "investment advice" fiduciary status

In its technical amendment, DOL reinstated the 5-part test under the 1975 regulation and its Interpretive Bulletin (IB) 96-1 on investment education to the Code of Federal Regulations, as perforce required by the Fifth Circuit opinion. As under the Final Rule, the 5-part test applies only if the person involved is not otherwise an ERISA §3(21) fiduciary by reason of having discretionary administrative authority over the plan or discretionary authority over the investment of some or all of its assets.

- *In the investment adviser setting, for example, advisers may technically be treated as "investment advice" fiduciaries with respect to non-discretionary advisory accounts, but not with respect to discretionary accounts if those advisers are separately discretionary asset management fiduciaries in that arrangement.*
- *Consider the routine example where a firm is providing discretionary management of an account subject to these rules other than with respect to any proprietary products, which are carved out of the firm's discretion and about which the firm only provides advice. In this situation, the firm is acting as a discretionary asset management fiduciary with respect to the non-proprietary assets in the account and as an investment advice fiduciary with respect to the proprietary assets.*
- *This distinction does not make a difference in terms of the ERISA care and loyalty standards to which the adviser is subject, but can make a difference to (i) the exemptive relief available to the adviser and (ii) the plan fiduciaries' reliance on the adviser as a §3(38) investment manager.*
- *As before, the mere execution of securities trades on specific directions from the retirement investor or another adviser does not constitute fiduciary investment advice.*

The regulations on investment advice fiduciary status and investment education thus revert to their pre-2016 content, without modification in form. In the preamble, however, DOL stated that its views on certain interpretive issues under the 5-part test have shifted, including in the respects discussed below.

- *These new positions may in part reflect DOL's concerns about perceived impediments to its own enforcement process created by the 5-part test, which informed Proposal 1.0 in particular. The Fifth Circuit opinion afforded DOL little or no leeway to refine the terms of the 5-part test even in narrow respects, so a change in interpretive position seems to be its only available alternative.*
- *These new interpretations are functionally an announcement of DOL's enforcement and litigation position going forward. DOL is to be commended for laying out that position in advance, rather than surprising the investment community with regulation by enforcement. It is also clear that DOL employs capable lawyers who can be creative in arguing for the results DOL seeks to obtain. As discussed below, DOL may or may not be able to sustain these positions in the event of litigation, but affected parties will need to take them into account in evaluating their compliance alternatives in light of Proposal 3.0.*

"Regular Basis" and "Primary Basis." The 5-part test requires in part that the adviser is providing the requisite advice on a "regular basis" and pursuant to a mutual agreement, arrangement or understanding with the plan, participant or IRA owner that the adviser's services will serve as "a primary basis" for investment decisions under the plan. DOL has long emphasized that "***a*** primary basis" purposefully is not limited to "***the*** primary basis" for an investment decision.

In the preamble to the proposed exemption, DOL discusses these two parts of the 5-part test in detail. That discussion is framed with reference to rollover advice specifically, but potentially appears to be more broadly applicable.

"Primary basis"	DOL reads a gloss into the regulatory language that the mutual agreement, arrangement or understanding be "reasonable," and contends that the parties should reasonably understand that recommendations made by a financial services professional, particularly if made within the ambit of Regulation BI or another regulatory requirement to provide individualized advice, will always serve as at least a primary basis for the investment decision.
"Regular basis"	DOL argues that a regular basis relationship can arise from a pre-existing advice relationship with respect to assets unrelated to those involved in a particular transaction (which might encompass non-ERISA assets) or, retroactively, from an initial interaction that grows over time into an ongoing advice relationship. This argument creates the possibility of "springing" or "retroactive" fiduciary status arising from future events but backdated to that initial interaction.

To provide context, we note that DOL officials, in public comments outside any rulemaking proceeding, have often cited with disapproval the example of an adviser that promotes in its marketing that it is committed to the investor's best interest but then, in "fine print" in the legally operative document for the arrangement, "disclaims" that it is providing advice on a regular basis or that its advice serves as a primary basis for any investment decision. To date, DOL has not brought litigation challenging that fact pattern. Proposal 3.0 sets up the analytic predicate for, and serves as notice that DOL may bring, that case in the future.

- *The treatment in Proposal 1.0 and in the Final Rule of persons who represent or acknowledge they are ERISA fiduciaries would have provided DOL a more direct path to litigate cases like this.*
- *The functional nature of the ERISA fiduciary definition has always created the problem of the "inadvertent fiduciary" – a person who is knowingly providing services in the plan/IRA setting and on the facts is acting as an ERISA fiduciary, but who does not appreciate at the time (or perhaps ever, short of enforcement activity or litigation) that its activities confer fiduciary status.*
- *This is the first time DOL has suggested, in addition, the possibility of a springing or retroactive fiduciary – a person who on the facts is not acting as a fiduciary at the time that activity occurs, but is retroactively imbued with fiduciary status because of subsequent events.*
- *It is not clear to us that DOL has a winning argument on these positions under the terms of the 5-part test.*
- *For example, while regular basis relationships can no doubt grow out of a series of discrete interactions, it does not seem consistent with the regulation that fiduciary status should attach prior to the time that trusted, ongoing relationship emerges, that is, before the time the adviser actually "[r]enders any advice described [in the regulation] on a regular basis." The springing nature of that status also seems difficult to defend as a policy matter, given the attendant responsibilities and legal exposures.*
- *Also, DOL's primary basis argument, among other things, turns the 5-part test into a 4-part test, collapsing (as did the Final Rule) the primary basis and individualized advice components of that test.*
- *Certainly these positions differ in important respects from the common understanding of the 5-part test prior to the Final Rule.*
- *We also have a different perspective on the fact pattern DOL tends to disparage. There may be in practice instances of intentional acts of "bait and switch" on fiduciary status, and that should matter in any facts and circumstances analysis of that status. Our experience, however, is that this fact pattern reflects, with refreshing transparency, an honest attempt to communicate that:*
  - *As a matter of business or professional practice or pursuant to its primary regulation, the adviser strives to serve the best interest of the retirement investor, but*
  - *Because of the conflicts inherent in its business model, the adviser cannot be legally accountable as an ERISA fiduciary on the unconflicted basis DOL requires, and accordingly does not commit to provide advice on a regular basis and instead cautions the investor that adviser's conflicted advice in and of itself should not be relied as any basis for the ultimate decision made by the investor.*

In all events, it will be important for providers to take account of DOL's positions in evaluating how best to structure their relationships with retirement investors going forward.

Attribution. On a related interpretive point, the preamble includes at least two new instances of attribution pertinent to the determination of fiduciary status.

Solicitation	The preamble asserts in a footnote that the initial interaction with a retirement investor by a paid solicitor for a registered investment adviser may be attributed to the firm if the firm provides ongoing fiduciary advice to that investor.
Plan-level advice	It also takes the position that a person providing fiduciary investment advice to the plan is deemed to be providing advice to plan participants as well, creating the factual predicate for a pre-existing regular basis relationship at the participant level. This is a point that will matter to plan platform providers/recordkeepers, among others.

Again, neither of these views is consistent with the common understanding of or practice under the 5-part test prior to 2016.

Rollover Advice. The most immediate impact of DOL's positions arises in the rollover setting. In the preamble, DOL declares that Advisory Opinion 2005-23A (the Deseret letter) – concluding that rollover advice is generally non-fiduciary distribution advice rather than fiduciary investment advice – was wrongly decided, inasmuch as a rollover entails the disposition of investments held under the existing retirement arrangement and acquisition of investments under the new arrangement. DOL's view now is that rollover advice is fiduciary investment advice if and when it meets the terms of the 5-part test.

DOL acknowledged that rollover advice can be a one-time, independent transaction that is not a part of a regular basis relationship, and seemed most accepting of that possibility in the context of the purchase of an insurance product. In cases where the adviser has an ongoing relationship with the retirement investor unrelated to the rollover assets, for example, or where the rollover advice retrospectively proves to be the initial step of a continuing relationship with respect to the investment of the IRA, DOL is prepared to assert that the regular basis requirement is satisfied and the rollover advice is fiduciary investment advice if the 5-part test is otherwise met.

- *To return to the investment adviser example discussed above, this is another situation where a firm otherwise serving as a discretionary asset management fiduciary might instead act as an investment advice fiduciary with respect to the rollover advice.*
- *Given the level of asset transfer from ERISA-covered plans to IRAs occurring with the aging of the baby boom generation, DOL's impulse to reconsider its rollover position is understandable at the policy level.*
- *Nonetheless, this position on rollovers is a significant departure from the pre-2016 understanding of the 5-part test.*
- *It is, of course, not terribly feasible to operate a retroactive rollover compliance system upon the retroactive attachment of fiduciary status. Possible responses to DOL's position might include:*

- *Limiting rollover interactions to investment education only. There was some industry practice of taking this approach under the Final Rule. It would seem, however, that regulators should be encouraging more robust support for retirement investors considering rollovers, rather than discouraging it; or*
- *Treating all rollover interactions as fiduciary investment advice, to manage the risk of springing fiduciary status. This approach has its own complications, including under the new proposed class exemption and particularly in the cases where fiduciary status does not eventuate.*

- *DOL gave no indication of the timetable for asserting its new position on determining rollover investment advice fiduciary status.*

Gating Interactions – The "Hire Me" Issue. Proposal 3.0 includes no direct discussion of the treatment of gating interactions, i.e., the business interactions between a retirement investor and a potential provider, in an RFP setting or otherwise, regarding whether the investor should engage the provider and, if so, which of the services on offer from the provider the investor should select. The Final Rule generally treated these interactions as fiduciary investment advice, an outcome that was unclear in Proposal 2.0 and was not clarified until the Final Rule was published. Other than occasional, indirect comments – for example, in the rollover setting, that the cost of the adviser's service arrangement should be taken into account in providing rollover advice, and that a recommendation to change from one type of account to another (as from a brokerage account to an advisory account) is subject to the rollover documentation requirement of the proposed exemption (discussed below) – Proposal 3.0 does not offer any express view on this issue.

- *Given the attention this issue received in the development and implementation of the Final Rule, it seems improbable that the absence of direct discussion of this point was an oversight.*
- *Prior to 2016, the common understanding was that gating interactions with prospective retirement clients were pre-fiduciary business interactions rather than (in alignment with the Investment Advisers Act of 1940) fiduciary investment advice because they did not involve "recommendations as to the advisability of investing in, purchasing, or selling securities or other property," in the words of the 5-part test. In this view, fiduciary status (as applicable) attached upon the opening of the arrangement selected by the investor, including to investments that may have been contemplated during the "hire me" phase. The prior interactions leading to the opening of the account were viewed as arm's-length business discussions, and necessarily so; when inquiring about the provider's services, the investor is asking for a business proposition rather than for fiduciary advice and, in offering its services and fees, the potential provider must be able to take account of its own business requirements.*
- *It seems to us that, in developing Proposal 3.0, DOL was mindful of and responsible about the scope of its regulatory authority as detailed in the Fifth Circuit opinion. To be sure, DOL has staked out the aggressive new interpretive positions discussed above that arguably resurrect elements of the Final Rule vacated by the Fifth Circuit, and in time DOL may be required to defend those positions as consistent with the letter and spirit of the Fifth Circuit opinion. In our judgment, however, any proposed "discovery" by DOL in 2020 that the 5-part test extended to gating interactions would entail risk of an entirely different magnitude.*
- *Accordingly, we prefer to regard the absence of any direct discussion of this issue in the proposal as concurrence that gating interactions remain outside the reach of the 5-part test, other than as necessary for logical consistency in implementing DOL's new understanding of rollover advice.*

Investment Education. Proposal 3.0 formally reinstates IB 96-1, which clarifies the distinction between fiduciary investment advice and non-fiduciary investment education. Under IB 96-1, a plan sponsor or service provider generally will not be considered to be acting in a fiduciary capacity when providing the following:

- Plan information
- Asset allocation models
- General financial and investment information
- Interactive investment materials

The Final Rule included a helpful and uncontroversial clarification that information about income needs past retirement and the associated risks (e.g., longevity and inflation risk), and information about managing those risks, would be considered investment education. It would be a benefit to plan participants if DOL reconfirmed this clarification in future interpretive guidance.

By reverting to IB 96-1, Proposal 3.0 allows asset allocation models and interactive materials to continue to reference specific investments available under a plan or IRA, with appropriate caveats that other investments are also available. This contrasts with Proposal 2.0, which initially prohibited educational information from referencing any specific investments as an output of an asset allocation model or interactive material. The Final Rule relented on this point with respect to employer-sponsored plans, but continued to prevent references to specific investments with regard to IRAs. IB 96-1 permits references to specific investments for all types of plans, consistent with long-standing industry practice.

Section 408(b)(2) Disclosures. To the extent the fiduciary status of a provider changes as a result of Proposal 3.0, in the rollover setting or otherwise, an update to its current section 408(b)(2) disclosure for plan sponsors may be needed reflect that change. Our sense is that providers may have addressed the recent period of uncertainty in different ways in these disclosures, so Proposal 3.0 provides a ready opportunity for a reset. Also, for a provider making use of the proposed PTE, coordination of the disclosure it requires with the provider's section 408(b)(2) disclosure should also be considered (although that timing may prove less felicitous).

Under the applicable regulation, a change in fiduciary status must be incorporated in the provider's section 408(b)(2) disclosure as soon as practicable but not later than 60 days from the date on which the provider is informed of the change. There is, of course, no effective date for the interpretive positions DOL has revised in Proposal 3.0, but surely it is unreasonable to expect any revisions to section 408(b)(2) disclosures until after any final adoption of the proposal, which will bear on providers' response to those new DOL positions. Plan sponsors should be prepared for another round of updates to these disclosures.

Proposed Exemption: Relief for conflicted fiduciary advice

ERISA's conflict of interest prohibited transactions, applicable to fiduciaries of both ERISA plans and IRAs (through largely parallel provisions of the Internal Revenue Code), prohibit a fiduciary from dealing with the plan's assets for its own interest or with a conflicted interest, or from receiving compensation from a third party with regard to those assets. As a result, fiduciaries (including IRA fiduciaries) commit a prohibited transaction if they cause themselves or their affiliates to receive additional compensation.

Structurally, the proposed "Improving Investment Advice for Workers & Retirees" exemption (Proposed Exemption) would serve the same function as the now vacated Best Interest Contract Exemption (BICE) did in the 2016 final rule: a principles-based exemption that covers conflicted investment advice and is not tied to any particular investment product. Its terms and approach are substantially different from those of the BICE, however. Most notably, the conditions of the Proposed Exemption expressly represent an attempt to align with requirements imposed by the financial provider's primary regulator.

- *Financial Institutions and Investment Professionals will be free to rely on any other available exemption (which have been reinstated to their pre-2016 text) rather than the Proposed Exemption. Insurance companies, for example, may find it preferable to continue to rely on PTE 84-24 if systems are already in place for compliance with that exemption.*
- *On the other hand, the Proposed Exemption might offer a compliance solution for fact patterns where one was not available in the past, absent an individual PTE. Indeed, the Proposed Exemption may provide an alternative to or obviate the future need for at least certain of the individual exemptions for investment advice, purchases of assets from a plan or IRA, and other transactions granted in the past. For more information on these exemptions, see our Guide to Individual ERISA Prohibited Transaction Exemptions.*

Covered transactions

The Proposed Exemption would permit the receipt of all forms of otherwise prohibited compensation with regard to two types of transactions.

Relief for investment advice arrangements. The Proposed Exemption would permit "Financial Institutions" and "Investment Professionals"— both defined terms — and their affiliates and related entities to receive reasonable compensation resulting from conflicted investment advice so long as they comply with enumerated Investment Advice Arrangement conditions and are eligible to use the exemption. According to the preamble, investment advice specifically includes advice regarding securities transactions, rollovers and recommendations of financial advisers.

A Financial Institution is an entity that (i) is not disqualified or barred from making investment recommendations by any insurance, banking, or securities law or regulatory authority (including any self-regulatory organization); (ii) employs the Investment Professional or otherwise retains such individual as an independent contractor, agent or registered representative, and (iii) is:

- Registered as an investment adviser under the Investment Advisers Act of 1940 or under state law;
- A bank or similar financial institution supervised by the United States or a state, or a savings association;
- An insurance company qualified to do business under the laws of a state, provided that it (A) has obtained a Certificate of Authority from the insurance commissioner of its domiciliary state which has neither been revoked nor suspended; (B) undergoes an annual examination by an independent certified public accountant or has undergone a financial examination by the state's insurance commissioner within the preceding five years, and (C) is domiciled in a state whose law requires an annual actuarial review of reserves to be reported to the appropriate regulatory authority; or
- A broker or dealer registered under the Securities Exchange Act of 1934.

Other entities not specifically named may apply for an individual PTE to be treated as a Financial Institution.

- *DOL's efforts to coordinate with the SEC are evident in the Financial Institution definition.*
- *DOL is specifically seeking comments on any refinements to this definition that might be necessary or helpful for the banking and insurance industries, and in particular on whether certain independent insurance intermediaries should be added as Financial Institutions.*

An Investment Professional is defined as follows.

A fiduciary of a Plan or IRA by reason of the provision of investment advice with respect to the assets of the Plan or IRA involved in the recommended transaction	Who is an employee, independent contractor, agent, or representative of a Financial Institution, and
	Who satisfies the federal and state regulatory and licensing requirements of insurance, banking, or securities laws (including self-regulatory organizations) with respect to the covered transaction, as applicable, and who is not disqualified or barred from making investment recommendations by any insurance, banking, or securities law or regulatory authority (including any self-regulatory organization).

Relief for principal transactions. The Proposed Exemption would also permit the purchase or sale of an asset in a "Riskless Principal Transaction" or a "Covered Principal Transaction," and the receipt of a mark-up, mark-down or other payment in connection with that transaction. The Proposed Exemption would not be available for other principal transactions that do not fit within these defined terms.

Riskless Principal Transaction		A transaction in which a Financial Institution, after having received an order from a retirement investor to buy or sell an investment product, purchases or sells the same investment product for the Financial Institution's own account to offset the contemporaneous transaction with the Retirement Investor.
Covered Principal Transaction: a principal transaction involving the enumerated types of assets.	**For sales to a plan or IRA**	A US dollar-denominated debt security issued by a US corporation and offered pursuant to a registration statement under the Securities Act of 1933; a US Treasury Security; a debt security issued or guaranteed by a US federal government agency other than the US Department of Treasury; a debt security issued or guaranteed by a government-sponsored enterprise; a municipal security; a certificate of deposit; or an interest in an unit investment trust.
	For purchases from a plan or IRA	Any securities or investment property.

Reflecting an apparent conclusion that Covered Principal Transactions present heightened conflicts of interest as compared to Riskless Principal Transactions, DOL proposed certain additional conditions on the availability of the Proposed Exemption for Covered Principal Transactions. The Proposed Exemption's definition of Covered Principal Transaction incorporates two conditions applicable to a sale to a plan or IRA.

- The first condition is that the transaction must involve a Financial Institution's sale of the enumerated types of assets.
  - *If a Financial Institution wishes to sell from its own inventory a security or investment property that is not one of these enumerated types, it must do so on a riskless basis in order to rely on the Proposed Exemption.*
- The second condition is that recommendations of debt securities must be made pursuant to written policies and procedures requiring any recommended debt securities to be investment grade.

These conditions do not apply to principal transactions where the Financial Institution purchases assets from a Plan or IRA. Such purchases do, however, have to comply with the general conditions of the Proposed Exemption in order to be eligible for the relief it provides.

The Proposed Exemption would not, however, apply in the following circumstances.

Exclusions from the Proposed Exemption	The Investment Professional, Financial Institution or any affiliate is an employer of employees covered by an ERISA Plan, or a named fiduciary or plan administrator with respect to the Plan (unless selected by an independent fiduciary). *This type of exclusion has been common in class PTE's.*
	The transaction is a result of "robo-advice" without any personal interaction with an Investment Professional. *In this exclusion, DOL deferred to the statutory exemption enacted for "pure" robo-advice.* *The Proposed Exemption would, however, provide a solution for the common situation where robo-advice is combined with the individual judgment and expertise of an Investment Professional.*
	The transaction involves the Investment Professional acting in a fiduciary capacity other than as an investment advice fiduciary. *This is the provision that makes the exemption unavailable to discretionary asset management fiduciaries.* *This exclusion may prove problematic for financial institutions considering the sponsorship of a pooled employer plan pursuant to the SECURE Act.*

Investment advice arrangement conditions

The conditions for a covered investment advice arrangement are largely designed to align with guidelines imposed by the Financial Institution's primary regulator. In addition to an alignment of impartial conduct standards, the conditions are in the nature of disclosure, prudent policies and procedures, and supervisory requirements.

Impartial conduct standards. The Proposed Exemption's impartial conduct standards include a best interest requirement plus additional conduct-related standards, with an important twist from the Final Rule – compliance with Regulation BI for broker-dealers, or with SEC fiduciary standards applicable to registered investment advisers, should ensure compliance with at least the best interest component of the impartial conduct standards. The preamble makes clear that these standards are not intended to foreclose advice regarding proprietary products or those for which the provider receives payments from third parties. In addition, the standards do not themselves establish a monitoring requirement, although DOL notes that some investments by their nature might require monitoring in order to be prudent.

- *Note that Regulation BI requires no such monitoring with respect to investments. The Proposed Exemption thus goes beyond Regulation BI, and if followed it could cause broker-dealers relying on the broker-dealer exclusion from the Investment Advisers Act to cross the line into investment advisory activity for securities law purposes.*

There are four components to the impartial conduct standards.

Best interest	Investment advice must be in the best interest of the retirement investor at the time provided. Best interest is defined using a variation of the traditional ERISA prudent expert standard, combined with an express obligation not to place the provider's interest ahead of the retirement investor's. DOL notes that this standard is to be interpreted and applied consistently with the standard set forth in the Regulation BI and the SEC's interpretation regarding the conduct standard for registered investment advisers. ▸ *As did the BICE, this condition extends an ERISA fiduciary standard to IRAs.* ▸ *This best interest articulation aligns with Regulation BI, the Investment Advisers Act fiduciary duty, and the NAIC Annuity Suitability Model Regulation, in that all four standards will require that a firm "not put its own interests ahead of the interests of the investor," or "subordinate the investor's interests to their own."* ▸ *In its terms, it is an important reversal from the BICE's "without regard to" language, which was the source of significant uncertainty and controversy.* ▸ *For providers regulated by the SEC, this condition also functionally conditions ERISA compliance on securities law conduct standard compliance. With that said, certain activities of broker-dealers that are outside of the scope of Regulation BI would come within the direct scope of this proposed best interest standard. These activities would include retirement interactions that do not involve "retail investors" as that term is defined under Regulation BI (i.e., recommendations to plan sponsors other than sponsors of micro-plans) or advice that does not involve a securities transaction but is ERISA fiduciary investment advice.*
Reasonable compensation	Compensation received by the Financial Institution, the Investment Professional, and any affiliates and related parties (e.g., affiliates that offer proprietary products) must not exceed reasonable compensation within the meaning of ERISA section 408(b)(2). The preamble provides some additional color for this requirement. – The reasonableness of compensation is a facts and circumstances determination, measured at the time of the fiduciary interaction by the market value of the particular services rendered, the complexity of the product, and the scope of monitoring being provided. No single factor is determinative. – Reasonable compensation does not necessarily mean the lowest cost. In fact, DOL states in the preamble that the consideration of cost alone could violate the conditions of the exemption. – With regard to bundled products/services including annuities, it is appropriate to consider the value of any guarantees or other benefits under the contract. ▸ *This is an example of an important element of Proposal 3.0 where DOL incorporated a long-standing ERISA regulatory practice that has not uniformly been replicated under other bodies of law. The preamble's discussion on this point is therefore important to all providers considering the Proposed Exemption.* ▸ *While the preamble provides a brief explanation of the ERISA concept of reasonable compensation, a question remains as to the extent to which Financial Institutions and Investment Professionals are obliged to determine whether their own compensation is reasonable. Traditionally, the reasonable compensation determination has been within the purview of the independent plan fiduciary. After all, the point of the 408(b)(2) disclosure requirement is to provide sufficient information for plan fiduciaries to compare and evaluate the fees and services of their providers.*

Best execution	Best execution must be obtained as required by the federal securities laws. Thus: – Financial Institutions that are FINRA members would satisfy this requirement if they comply with applicable FINRA rules; – Financial Institutions acting as brokers to execute purchases or sales of municipal bonds would satisfy this requirement by complying with applicable MSRB rules; and – Financial Institutions acting in an investment adviser capacity when recommending these transactions would satisfy this requirement if they comply with the Investment Advisers Act's duty to seek best execution.
No materially misleading statements	The provider must not make materially misleading statements to the retirement investor, as determined at the time of the transaction. – Material statements include those regarding fees/compensation, material conflicts of interests and any other fact that reasonably could be expected to affect the investment decision. – Material omissions as well as material misstatements would violate this condition. – The preamble also states DOL's position that exculpatory statements in violation of ERISA section 410 and IB 75-4 would be deemed materially misleading statements. ▶▶ *As noted above, we surmise this condition reflects DOL's enforcement experience, including its "bait and switch" concerns.* ▶▶ *Plan providers would be well advised to check indemnification provisions in customer agreements.* ▶▶ *Query whether the point about exculpatory statements should extend to IRAs, which are not covered by ERISA section 410.*

Disclosure. Written disclosures must be provided to the retirement investor prior to engaging in the covered transaction. The Proposed Exemption does not prescribe a particular form for the disclosure, and the preamble notes that any form of disclosure or combination of disclosures that is required by other regulators can comply, provided that three items are covered:

- Acknowledgement of the Financial Institution's and Investment Professional's fiduciary status under ERISA and/or the Internal Revenue Code;
- The services to be provided; and
- Any material conflicts of interest.

▶▶ *Providers relying on the Proposed Exemption for plan sponsor advice might consider how this notice might be incorporated in their section 408(b)(2) disclosures.*

▶▶ *For advice to plan participants and IRA owners, consideration might be given to whether this disclosure might be consolidated with other existing disclosures, e.g., the IRS-required IRA Disclosure Statement to the extent it is provided in advance of the transaction for which prohibited transaction relief is required.*

▶▶ *DOL stated in multiple places its intention that this disclosure does not create a new private right of action for IRA owners that was not included in ERISA. This is a welcome and (in light of the Fifth Circuit opinion) sensible development, although further consideration seems warranted of possible extra-contractual exposures this disclosure might create.*

▶▶ *While DOL asked for commentary on other approaches to the disclosure, e.g., whether the impartial conduct standards should be recited, any expansion of the disclosure would increase the risk of inadvertently creating a private right of action for IRA owners.*

Policies and procedures. Financial Institutions would be required to adopt certain "prudently designed" policies and procedures, as follows. The "prudence" standard applicable to the design of these policies and procedures has not been explicated at this point.

Financial Institution and Investment Professional compliance with the impartial conduct standards	This policies and procedures requirement is intended to mitigate financial conflicts with supervisory oversight of advice; as the provider's business model entails more variation in compensation or other conflicts, greater supervisory oversight of advice should be adopted in policies and procedures. The preamble also clarifies that: – Insurance companies are responsible only for their own products, which addresses a problem under the Final Rule; and – Properly designed policies and procedures, together with disclosure, will satisfy the impartial conduct standard in connection with proprietary products and limited investment menus.

Conflict mitigation	Policies and procedures and incentive practices, when viewed as a whole, must be "prudently designed" to avoid misalignment of interests. DOL expects implementation of other regulators' mitigation strategies may be necessary to satisfy this requirement, and therefore Financial Institutions not otherwise subject to these standards "are encouraged to adopt similar standards." In particular, the DOL views product-specific quotas, non-cash compensation and sales contests that other regulators have prohibited as inherently non-prudent. ▸▸ *The Proposed Exemption appears to require mitigation of all conflicts, not just financial professional-level conflicts or conflicts that arise out of material limitations. This would be an enhancement over Regulation BI, which generally requires only disclosure of firm-level conflicts (unless they arise out of material limitations).* ▸▸ *In the preamble, DOL defers to other regulators on mitigation techniques. It then goes through the same list of non-exhaustive examples of mitigation techniques set forth in the Regulation BI adopting release. As distinguished from the Final Rule, Financial Institutions are not required to undertake any specific mitigation measure, but rather have the option of selecting the approach that best suits their particular circumstances.* ▸▸ *The Proposed Exemption will align with Regulation BI and the NAIC Model on the issue of impermissible product-specific sales contests.*
Documentation requirements for rollover advice and account type recommendations	Policies and procedures must require documentation of the specific reasons why a rollover is in the best interests of a retirement plan investor. This documentation must reflect the following: – Consideration of alternatives to the rollover, including leaving the account in the employer-sponsored plan given the plan's fees/expenses and different levels of service; and – Diligent and prudent efforts to obtain pertinent information about the plan. If that effort is unsuccessful, that information should be estimated. Notably, this documentation requirement would also apply to a recommendation to move at least IRA assets from a commission-based to a fee-based account, or vice versa. ▸▸ *These are requirements, not simply suggestions or best practices. In this respect, the Proposed Exemption is more demanding than Regulation BI.* ▸▸ *In particular, by specifically requiring documentation of comparative consideration of the existing plan's cost or if not available, an estimate of such costs, the Proposed Exemption would go further than Regulation BI, which has no such explicit requirement, but would provide more clarity than the comparable conditions of the BICE.*
Covered Principal Transactions	If the recommended investment is a debt security, the security must be recommended pursuant to written policies and procedures adopted by the Financial Institution that are reasonably designed to ensure that the security, at the time of the recommendation, has no greater than moderate credit risk and sufficient liquidity that it could be sold at or near carrying value within a reasonably short period of time. ▸▸ *As with IRA rollovers, substantive conditions are embedded in this policies and procedures requirement.*

Retrospective Compliance Review. Finally, the Proposed Exemption requires the Financial Institution to conduct a retrospective compliance review at least annually, and document the methodology and results of that review in a written report to its CEO and CCO. The CEO would be required to certify that (i) the officer has reviewed the report of the retrospective review; (ii) the Financial Institution has in place policies and procedures prudently designed to achieve compliance with the conditions of the exemption; and (iii) the Financial Institution has in place a prudent process to modify such policies and procedures as business, regulatory and legislative changes and events dictate, and to test the effectiveness of such policies and procedures on a periodic basis, the timing and extent of which are "reasonably" designed to ensure continuing compliance with the conditions of the exemption. This process must be completed within six months of the close of the review period.

- *The retrospective review requirement aligns with Regulation BI and FINRA rules in one way, but not in another. More specifically, the requirement to sample transactions for compliance with the best interest standard likely aligns with Regulation BI's compliance obligation and FINRA Rule 3120. The requirement to prepare a written report for presentation to the firm's CEO, as well as the CEO's annual certification, is an additional and unique requirement.*
- *There is no indication that the certification is intended to confer any status on the CEO that leads to personal ERISA liability.*
- *The Financial Institution must make the report, certification and supporting data from up to the prior six years available to DOL within ten business days of any such request from DOL. While there is no specific requirement to provide these materials to plans or individual retirement investors, it may be within the scope of documents they can request under the recordkeeping requirement of the Proposed Exemption.*

Loss of eligibility for relief

Financial institutions and Investment Professionals could lose eligibility to rely on the Proposed Exemption for a period of 10 years upon conviction of certain crimes in connection with providing investment advice or upon DOL's finding of specified misconduct with respect to compliance with the Proposed Exemption.

- *This provision apparently models PTE 84-14 (the QPAM exemption) in that a conviction of an affiliate in the same control group (here, an 80 percent control definition) triggers ineligibility for the Proposed Exemption, although the limitation that the conviction relate to advice for retirement investors under US plans is a significant improvement over PTE 84-14.*
- *For example, as we recall the facts underlying the numerous individual exemptions requested by various financial institutions and granted to permit continued reliance on QPAM relief notwithstanding one of the specified convictions, often of a foreign affiliate, none of those financial institutions would be ineligible to rely on the Proposed Exemption.*
- *The 80 percent threshold mirrors Internal Revenue Code rules for determining when employees of multiple corporations should be treated as employed by the same employer, and differs from the QPAM affiliation definition. DOL has specifically asked for comments on the 80-percent ownership standard and whether it should apply to all types of financial institutions.*

In addition, ineligibility would be triggered by the receipt of a written ineligibility notice issued by DOL's Office of Exemption Determinations. The disqualifying misconduct includes:

- A systemic pattern or practice of violating the conditions of the Proposed Exemption;
- An intentional violation of the conditions of the Proposed Exemption; and
- Provision of materially misleading information to DOL with respect to compliance with the Proposed Exemption.

Before issuing the notice, the Director of the Office of Exemption Determinations would issue a warning to the Financial Institution or Investment Professional and a six-month opportunity to cure. At the end of the six-month period, if DOL determines that the conduct continued, it would then provide an opportunity to the party to be heard, in person or in writing, before the notice is issued. The Proposed Exemption spells out procedural requirements around this determination.

For Investment Professionals, access to the Proposed Exemption would be automatically and immediately revoked in the specified circumstances. Financial Institutions would have a one-year transition period and an opportunity to petition DOL for continued reliance before they became ineligible for the exemption.

- *This aspect of the Proposed Exemption has the potential to cause an inadvertent disconnect between DOL and other regulatory agencies. Consider, for example, securities firms routinely subject to examinations from the SEC or a self-regulatory agency such as FINRA. As noted below, the potential of losing reliance on the exemption could affect the firm's attitude about those examinations to the extent they implicate best interest standards under securities law. Therefore, Proposal 3.0 might benefit from comments explaining this issue and seeking clarification of the extent to which routine examination activity will not generally disqualify the Financial Institution from eligibility for the exemption.*

The crimes must arise in connection with investment advice provided to retirement investors and are those described in ERISA section 411, including:

- Robbery, bribery, extortion, embezzlement, fraud, grand larceny, burglary, arson, murder, rape, kidnapping, perjury, assault with intent to kill;
- Felony violation of federal or state law involving controlled substances;
- Felonies and misdemeanors involving the purchase or sale of securities; or arising from conduct as an underwriter, broker-dealer or investment advisor; or as an affiliated person, salesperson, or employee of an investment company, bank, or insurance company as described in section 9(a)(1) of the Investment Company Act of 1940;
- Violation of any provision of ERISA;
- Violation of section 302 of the Labor-Management Relations Act of 1947;
- Violation of federal mail fraud prohibitions;
- Any violation involving kickbacks from public works employees;
- Making false statements and concealing facts in documents required by ERISA;
- The obstruction of justice by influencing or injuring an officer or juror; obstructing proceedings before departments, agencies, and committees; the theft or alteration of any record, writ, process, or other proceeding in any part of the United States; and the obstruction of criminal investigations;
- Any racketeering violations;
- Any violation of the Labor-Management Reporting and Disclosure Act of 1959;
- Felony involving abuse or misuse of a person's labor organization or employee benefit plan position or employment; and
- Conspiracy or attempt to commit any of these crimes, or of a crime in which any of these crimes is an element.

Recordkeeping

As is standard for prohibited transaction exemptions, the Proposed Exemption contains a six-year recordkeeping requirement, and those records must be available on reasonable request (i) by DOL or (ii) by plan fiduciaries, any contributing employer or employee organization, or any plan participant, beneficiary or IRA owner variously implicated by an investment transaction for which the Proposed Exemption provides relief. Given the nature of the Proposed Exemption, DOL has limited the general availability of these records. In particular, no person or entity (other than DOL itself) would be entitled to examine records related to another retirement investor, including identifying information, or to trade secrets or privileged commercial or financial information of the Financial Institution.

Enforcement

Status of temporary enforcement policy. Shortly after the Final Rule was vacated, DOL published in Field Assistance Bulletin (FAB) 2018-02 a temporary enforcement policy pending issuance of regulations, exemptions or other guidance. Under that policy (which is not binding on private litigants), DOL does not pursue prohibited transaction claims against investment advice fiduciaries that are working diligently and in good faith to comply with the impartial conduct standards of the vacated BICE and Principal Transaction Exemption. Similarly, the IRS is not applying prohibited transaction excise taxes in circumstances to which the DOL enforcement policy applies.

Pursuant to the preamble for the Proposed Exemption, the temporary enforcement policy remains in place following the publication and any future finalization of Proposal 3.0. DOL said it does not envision the enforcement policy as a permanent solution but offered no plan or timetable for sunsetting that policy. Also, because it views the Proposed Exemption as based on and formalizing the FAB, DOL opined in its fact sheet on Proposal 3.0 that financial services companies that implemented compliance programs meeting the terms of the enforcement policy would be able to continue those programs to satisfy the impartial conduct standard of the Proposed Exemption.

- *It is plainly right that the enforcement policy should remain in place at least for some transition period. It is highly improbable that any financial institution will be in a position to comply with the Proposed Exemption on its effective date 60 days after publication in the Federal Register.*
- *We suspect DOL is overly optimistic that compliance practices adopted under the enforcement policy can be continued without refinement under the Proposed Exemption.*
  - *At least in form, the impartial conduct standards in the BICE and the Proposed Exemption are not identical.*
  - *Of course, the Proposed Exemption also includes conditions beyond those required under the enforcement policy.*
  - *At some point, presumably after a compliance assistance period, DOL will expect technical compliance with the terms of the Proposed Exemption, as distinguished from the diligent, good faith effort allowed under the enforcement policy.*

Coordination among regulatory agencies. The consequences of the alignment of the Proposed Exemption with other bodies of regulation merit consideration from an enforcement perspective. To take the most obvious example, DOL and the SEC have for some years maintained a joint enforcement protocol and routinely referred relevant matters to the other agency. Assume, for example, that an SEC examination, or even a FINRA arbitration, finds that a firm was not in compliance with Regulation BI as to one or more retirement investors.

- *Will that finding automatically translate into a determination that the impartial conduct standards of the Proposed Exemption (to the extent the firm was acting as an investment advice fiduciary and relying on the exemption for exemptive relief) also were not satisfied, and thus expose the firm to ERISA remedies for a non-exempt prohibited transaction?*
- *Will DOL make an independent determination on the question, under either Regulation BI or the terms of the Proposed Exemption directly? How will the SEC handle the reverse situation?*
- *Will the dynamics and incentives around settling an enforcement matter with either DOL or the SEC change as a result of the Proposed Exemption? For purposes of the firm's continued eligibility to rely on the Proposed Exemption, will DOL treat an SEC settlement with respect to Regulation BI as evidence of intentional or systematic violation of the conditions of the Proposed Exemption?*
- *Should firms reconsider any judgment calls they made in developing their Regulation BI compliance programs, if those programs now have ERISA consequences as well as securities law consequences?*

We mean to suggest not that the approach taken by DOL in the Proposed Exemption is unsound, but only that its enforcement consequences deserve attention if and when Proposal 3.0 is implemented.

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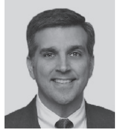

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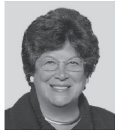

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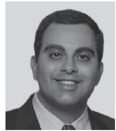

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2020
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Eversheds Sutherland handles matters in all 50 states

Our litigation clients include 12 of the Top 20 largest life insurance companies ranked by total assets

Eversheds Sutherland represents 10 of the Top 12 independent US Broker-Dealers in litigation and regulatory matters

Law360 Global 20

Top
10

"This is an exceptional team with strong legal experience and deep industry knowledge. They are extremely effective and achieve most results in minimal time."
– Chambers USA 2020

"Their advice was consistently timely, well thought out and practical. Their collective professionalism, industry knowledge and collaboration are their greatest strengths."
– Chambers USA 2020

"Eversheds Sutherland has demonstrated an ability to understand and successfully navigate through areas where multiple types of subject matter intersect; this is an unusual and valuable element."
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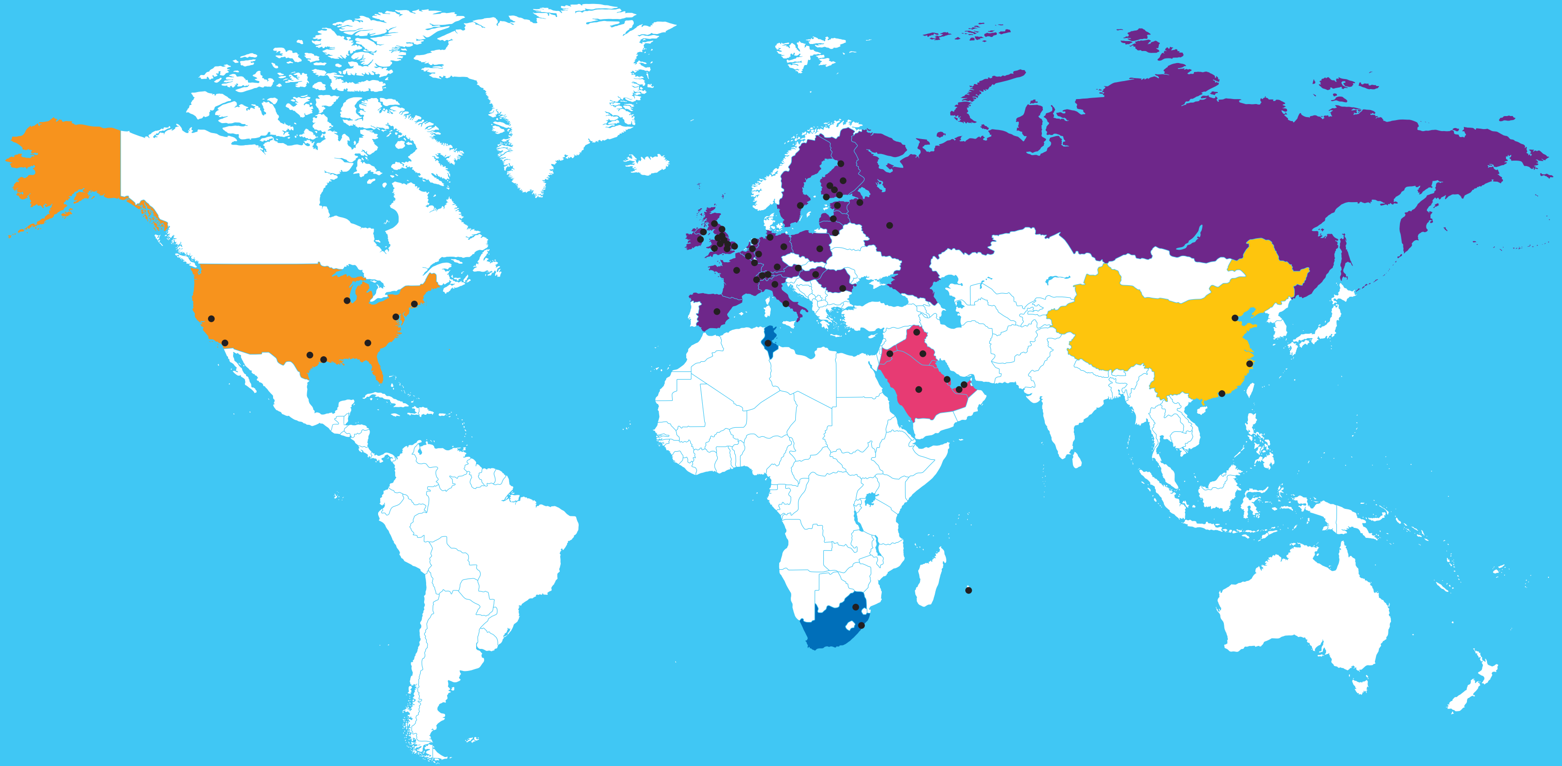
Global reach

We have **68 offices** across **32 countries** worldwide



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