# What Did the DOL Just “Rollover” (and Roll Out)?

## “A Primary Basis” for Understanding the New Proposed ERISA Exemption and Related Guidance

July 17, 2020

# What Did the DOL Just “Rollover” (and Roll Out)? ― “A Primary Basis” for Understanding the New Proposed ERISA Exemption and Related Guidance

**July 2020 | Authored by: Steven W. Rabitz, Andrew Oringer, K. Susan Grafton, Samuel Scarritt-Selman and Andrew H. Braid**

## INTRODUCTION

The U.S. Department of Labor (the “DOL”) on June 29, 2020 issued a release (the “Release”) proposing an important new initiative for retirement accounts (“Plans”) that are subject to the Employee Retirement Income Security Act of 1974 (“ERISA”) or Section 4975 of the Internal Revenue Code of 1986 (the “Code”). The Release continues the decade-long saga that began with the DOL's highly controversial effort to remake its 1975 regulation (the “1975 Rule”) defining what constitutes “investment advice” for purposes of the fiduciary rules under ERISA and Section 4975 of the Code (“Investment Advice”), which many saw as dramatically extending ERISA's reach, even affecting the way financial-services organizations conducted their general (non-ERISA) business. While the DOL's earlier multiple proposals had culminated in 2016 in a final rule (the “2016 Rule”), the 2016 Rule was then vacated in 2018 by the US Court of Appeals for the Fifth Circuit.[1]

Our June 30, 2020 OnPoint, “Rolling” Ahead with New Fiduciary Guidance - Proposed ERISA Exemption Provides Some Early July 4th Fireworks provided an overview of the Release. This OnPoint assumes that the reader has familiarity with the history and demise of the 2016 Rule and with the related underlying ERISA principles, and will address a number of interpretive points and issues. (An index of our other OnPoints on the history, development and demise of the 2016 Rule may be found here.)

This initiative comes on the heels of the June 30, 2020 effective date of Regulation Best Interest (“Reg BI”) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), which was adopted last year by the US Securities and Exchange Commission (the “SEC”). Reg BI is generally intended to apply a best interest standard of conduct for all broker-dealers making recommendations to retail customers (extending both to retirement accounts and to other accounts), and incorporates some (but intentionally not all) of the features of the now-defunct 2016 Rule. We discussed Reg BI in our June 11, 2019 OnPoint, SEC Adopts Enhanced Standard of Conduct for Broker-Dealers and Clarifies Fiduciary Duties of Investment Advisers.[2] SEC Chair Jay Clayton issued a contemporaneous notice of support of the Release in his Statement on the Department of Labor’s Investment Advice Proposal. Previously, there had been discussion among the regulators regarding the benefits of harmonizing Reg BI, ERISA and the Code’s investment advice fiduciary rules, and other standards of conduct, including Rule 2111 (the

1 *Chamber of Commerce v. US Dep’t of Labor*, 885 F.3d 360 (5th Cir. 2018).

2 *See* also Grafton, Oringer, Perlow and Sherman, “Simply the Best (Interest) - SEC Proposes New Broker-Dealer Standard and Additional Related Guidance,” 46 *Tax Management Compensation Planning Journal* (Bloomberg Tax) 127 (Aug. 14, 2018).

"Suitability Rule") of the Financial Industry Regulatory Authority, Inc.[3] However, the precise manner in which the Reg BI framework would integrate with the conditions of the Proposed Exemption will presumably be the subject of significant attention by market participants.

## Introduction

In the Release, the DOL:

- **Reinstated the 1975 Rule**. The DOL implemented steps[4] to complete the reinstatement of the 1975 Rule that defined with a five-part test (the "Five-Part Test") what Investment Advice is, as it existed before being replaced by the now-vacated 2016 Rule.

- **Provided important interpretive guidance regarding the Five-Part Test generally.** While the Release makes no changes to the text of the 1975 Rule, the preamble to the Proposed Exemption (the "Preamble") provides additional important color on the DOL's current thinking about key elements of the Five-Part Test. Among the new interpretations are potentially critical changes in the way that the "regular basis" and "a primary basis" prongs of the Five-Part Test are now being viewed by the DOL.

- **Changed the way that rollover-related advice is viewed by the DOL under the fiduciary rules.** The Preamble provides additional color on the DOL's current thinking about rollovers from Plans to individual retirement accounts ("IRAs") and other Plans, including the express discrediting of certain earlier DOL authority that had concluded that advice regarding rollovers was generally not fiduciary in nature. It is not clear the extent to which the DOL's new approach would be workable for certain institutions that solicit IRA rollovers.

- **Proposed a new exemption for commission-based and variable compensation business models embracing fiduciary status**. The DOL proposed a new exemption[5] (the "Proposed Exemption") from the prohibited transaction rules of ERISA and Section 4975 of the Code that would potentially allow broker-dealers, banks, insurance companies and registered investment advisers to provide Investment Advice to Plans and receive compensation that might otherwise have been inconsistent with the prohibited transaction rules, and to engage in certain otherwise prohibited principal transactions.

- **Confirmed that a key existing temporary enforcement policy remains in place.** After the 2016 Rule was vacated, the DOL issued Field Assistance Bulletin ("FAB") 2018-02, a temporary enforcement policy providing prohibited transaction relief to Investment Advice fiduciaries. In FAB 2018-02, the DOL generally stated it would not pursue prohibited transactions claims against Investment Advice fiduciaries who work to comply with "impartial conduct standards" that had been set forth in now-vacated exemptive relief issued in connection with the 2016 Rule. The Release provides that FAB 2018-02, while still temporary in nature, will remain in place until further notice.

---

[3] FINRA is the primary self-regulatory organization for broker-dealers who conduct a business with public customers.

[4] 85 Fed. Reg. 40,589 (July 7, 2020).

[5] 85 Fed. Reg. 40,834 (July 7, 2020)

- **Reinstated 1996 investment education guidance**. The DOL is reinstating Interpretative Bulletin ("IB") 96-1, relating to what is investment education (as opposed to fiduciary advice). IB 96-1 had been removed in connection with the finalization of the 2016 Rule.

The DOL News Release accompanying the Release states, among other things, that the Proposed Exemption "would allow investment advice fiduciaries to give more choices for retirement using Impartial Conduct Standards. Impartial Conduct Standards are a best interest standard; a reasonable compensation standard; and a requirement to make no materially misleading statements," and would "align with standards of other regulators, including the SEC." The News Release states that the DOL's was taking the "ministerial" action of "amending the Code of Federal Regulations to implement the 5th Circuit's order [vacating the 2016 Rule,]" which order had the effect of reinstating the 1975 Rule defining who is an investment advice fiduciary under ERISA and the Code. The Release expresses the DOL's view that the Proposed Exemption would "give Americans more choices for investment advice arrangements" (although, given some of the expansive approaches taken by the DOL in the Preamble and the Proposed Exemption, it remains to be seen whether the DOL's approach will actually have this effect).

## Who Is Impacted?

The Release will be of interest to many Plans and to financial institutions that provide services to or otherwise transact business with them. The following businesses may find the Release of particular interest:

- **Brokers, Banks, Insurance Companies and Fund Complexes Accepting "Investment Advice" Fiduciary Status While Using a Variable-Compensation or Commission-Based Business Model.** The Proposed Exemption would provide relief to those broker-dealers, banks, fund complexes and insurance companies who receive variable compensation, including brokerage commissions, but under the 2016 Rule, were regarded as fiduciaries, and therefore in some cases changed their business model and practices to conform to the now-vacated "BIC Exemption" (as well as other exemptive relief) that was issued in connection with the 2016 Rule. These practices raise issues under ERISA because they potentially involve the receipt of a wide variety of payments that could otherwise violate the prohibited transaction rules (e.g., commissions in general, 12b-1 fees, mark-ups and mark-downs, sales loads, trailing commissions and revenue-sharing payments). As the Preamble notes, "[i]f broker-dealers that are investment advice fiduciaries with respect to [Plans] provide investment advice that affects the amount of their compensation, they must rely on an exemption." The Proposed Exemption could also be available for those institutions receiving variable compensation that currently operate under the Five-Part Test and do not currently regard themselves as providing Investment Advice, but who decide in the future that as a business matter they wish to embrace a commission-based compensation model while at the same time accepting fiduciary status.

- **Financial Institutions Seeking Rollover Assets**. Rollovers from Plans to IRAs receive significant attention in the Release. The Release will make it more challenging for a number of institutions to take the position that they are not providing Investment Advice in connection with discussions concerning rollovers. If such institutions are or become Investment Advice fiduciaries, the Release indicates that they will need an exemption – such as the Proposed Exemption – from ERISA's (and the Code's) self-dealing prohibited transaction rules.

- **Institutions Generally That Service Retail (and Similar) Retirement Customers**. Many broker-dealers, banks, insurance companies, fund complexes and other financial intermediaries that have chosen to continue to rely on the Five-Part Test, so that they offer their products and services broadly to retail (and similar)

customers and not on the basis of becoming Investment Advice fiduciaries, will want to pay special attention to the color provided in the Release as it relates to the DOL's current thinking about key elements of the Five-Part Test. These institutions may also wish to revisit IB 96-1, which treats certain interactions with customers as "investment education" rather than Investment Advice.

The Proposed Exemption may offer institutions additional planning opportunities. For example, some fiduciary investment managers may conclude that there are aspects of the Proposed Exemption that will be helpful for their business model, and that it may open the possibility of offering additional products and services where ERISA's rules have traditionally proven to be a challenge. By contrast, there are also some institutions whose products and services (including ordinary-course and other debt issuances, participations in initial offerings of securities in which the institution is a member of the syndicate, and other common products) may be limited under the framework of the Proposed Exemption.

# DETAILED DISCUSSION

## I. Background

In 2016, the DOL finalized the now defunct 2016 Rule, which, prior to being vacated by the Fifth Circuit, was essentially a new regulation that replaced the 1975 Rule. It also issued a number of new and amended related prohibited transaction class exemptions ("PTCEs"), notably including the Best Interest Contract Exemption (the "BIC Exemption") and the Principal Transactions Exemption (the "PrTE").

After the U.S. Court of Appeals for the Fifth Circuit vacated the 2016 Rule in 2018, the DOL issued FAB 2018-02, a temporary enforcement policy providing prohibited transaction relief to Investment Advice fiduciaries. In FAB 2018-02, the DOL stated that it would not pursue prohibited transactions claims against Investment Advice fiduciaries who worked diligently and in good faith to comply with "impartial conduct standards" for transactions that would have been exempted by the BIC Exemption or other new PTCEs, or treat the fiduciaries as violating the applicable prohibited transaction rules. As discussed below, impartial conduct standards are a centerpiece of the Proposed Exemption.

Some financial institutions created and implemented compliance structures designed to ensure satisfaction of the then-applicable impartial conduct standards and have been permitted to rely on those structures pending further guidance. The Proposed Exemption would permit financial institutions to continue relying on those compliance structures on a permanent basis, subject to the additional conditions of the Proposed Exemption, rather than requiring them to change course to begin complying with the DOL's other existing exemptions for Investment Advice fiduciaries. In addition, while FAB 2018-02 is limited by its nature to DOL enforcement actions, the effect of satisfying an actual exemption such as the Proposed Exemption would extend to potential claims by Plan participants and beneficiaries, in that satisfaction of the exemption would result in there being no violation of the applicable ERISA (and Code) rules.

## II. New Commentary on the Five-Part Test

### *A. In General*

Under the 1975 Rule, for advice to constitute Investment Advice, the advice must be given by one who is not otherwise an ERISA fiduciary in a situation in which the advisor:

1) renders advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing, or selling securities or other property

2) on a regular basis

3) pursuant to a mutual agreement, arrangement, or understanding with the Plan, Plan fiduciary or IRA owner that

4) the advice will serve as a primary basis for investment decisions with respect to Plan assets, and that

5) the advice will be individualized based on the particular needs of the Plan.

A financial institution or investment professional that meets this five-part test, and receives a fee or other compensation, direct or indirect, is an Investment Advice fiduciary.

While the Release makes no changes to the text of the 1975 Rule, the Preamble provides important color on the DOL's current thinking about key elements of the Five-Part Test.[6] The new DOL interpretations also may have immediate relevance (i.e., even before any finalization of the Proposed Exemption), in that they purport to interpret existing law.

The DOL's interpretations of the Five-Part test in the Preamble, while expansive in scope, are arguably not as expansive as the 2016 Rule. For example, the reach of the 2016 Rule was so potentially broad that the DOL believed it appropriate to state expressly that the 2016 Rule did not generally convert ordinary-course attempts to be hired as a service provider (i.e., so-called "hire me" communications) into fiduciary conduct.[7] In the Release, however, because the language of the 1975 Rule is not proposed to be changed, the DOL did not include any express "hire me" comfort. A number of other features that were incorporated into the 2016 Rule, such as the "sellers' exception" and "institutional investor" exception, also do not reemerge in the Release, because the Release, unlike the 2016 Rule, does not seek to alter the language of the 1975 Rule.

---

[6] Cf. Exec. Order 13891 (Oct. 9, 2019) ("[A]gencies have sometimes used [the authority to issue guidance other than in the form of a regulation (or similar guidance)] inappropriately in attempts to regulate the public without following the rulemaking procedures of the [Administrative Procedure Act]. Even when accompanied by a disclaimer that it is non-binding, a guidance document issued by an agency may carry the implicit threat of enforcement action if the regulated public does not comply. . . . Americans deserve an open and fair regulatory process that imposes new obligations on the public only when consistent with applicable law and after an agency follows appropriate procedures. . . . Agencies may impose legally binding requirements on the public only through regulations and on parties on a case-by-case basis through adjudications, and only after appropriate process, except as authorized by law or as incorporated into a contract.").

[7] See 81 Fed. Reg. 20,968 (Apr. 8, 2016).

### B. Regular Basis

The DOL exhibited new thinking regarding the way in which the regular-basis prong of the Five-Part Test should be viewed. The DOL's thinking was outlined in the context of rollover advice, and is discussed below under Section III. However, the potential implications may be broader than just in the context of rollovers, and the effect of the interpretations offered by the DOL could be extremely wide-ranging and significant.

### C. Mutual Understanding

The Preamble notes that the "determination of whether there is a mutual agreement, arrangement, or understanding that the investment advice will serve as a primary basis for investment decisions is appropriately based on the *reasonable* understanding of each of the parties, if no mutual agreement or arrangement is demonstrated" (emphasis in original). The Preamble states that "written statements disclaiming a mutual understanding or forbidding reliance on the advice as a primary basis for investment decisions are not determinative, although such statements are appropriately considered in determining whether a mutual understanding exists." Thus, under the DOL's approach, it would appear that the use of non-fiduciary legends and other disclaimers may still be an important, but not necessarily determinative, factor in considering whether the mutual-understanding prong of the Five-Part Test is satisfied. The language of the Preamble may indicate that the DOL is looking to the reasonable understanding of the parties in the absence of a demonstrated mutual agreement or understanding, and the Preamble did not directly address the possible relevance of an actual bilateral agreement (as contrasted with a unilateral disclaimer) under which, for example, the customer expressly agrees that no advice will be a primary basis for the customer's decision-making.

Separately, the Preamble highlights that a "one-time sales transaction, such as the one-time sale of an insurance product, does not by itself confer fiduciary status under ERISA or the Code, even if accompanied by a recommendation that the product is well-suited to the investor and would be a valuable purchase." However, the DOL cautions that "insurance agents may have or contemplate an ongoing advice relationship with a customer," citing as an example that "agents who receive trailing commissions on annuity transactions may continue to provide ongoing recommendations or service with respect to the annuity."

In connection with its cost-benefit analysis of the Proposed Exemption, the DOL observed that half of the rollovers it studied were "self-directed" (i.e., effected without the assistance of a financial professional). While the DOL stated that "it is more than reasonable . . . that the advice provider would anticipate that advice about rolling over Plan assets would be a primary basis for . . . investment decisions" (internal quotations omitted), the DOL also noted that, of the rollovers that were handled by financial professionals and thus were not self-directed, there were at least some that "likely involved financial services professionals who were not fiduciaries under the Five-Part Test." The DOL stated that "the actual number of rollovers affected by this Proposed Exemption is likely lower than" the number the DOL assumed for purposes of the cost-benefit analysis.

### D. A Primary Basis

In the Preamble, the DOL specifically reminds the reader that the primary basis prong of the Five-Part Test concerns advice that forms "a" primary basis, not necessarily "the" primary basis, for an investment decision. Importantly, the Preamble states that, "[w]hen financial service professionals make recommendations to a Retirement Investor, particularly pursuant to a best interest standard such as the one in the [Reg BI], or another requirement to provide

advice based on the individualized needs of the Retirement Investor, the parties typically should reasonably understand that the advice will serve as at least a primary basis for the investment decision."[8]

This interpretation may have significance for broker-dealers that are subject to Reg BI, and other institutions that are subject to another "best interest" or similar standard of care.[9] Indeed, the DOL's formulation, which is interpretive and thus may arguably be relevant regardless of whether the Proposed Exemption is finalized, opens up the possibility that proceeding in accordance with Reg BI or "another requirement" could lead to different outcomes for similarly situated institutions: identical advice could be Investment Advice for a provider that is subject to "another (non-ERISA) requirement" for one customer, and not constitute Investment Advice for that provider (or some other provider) where such (non-ERISA) requirement does not apply.[10] Potentially further complicating the analysis that results from the DOL's view, the determination of whether some non-ERISA standard is triggered is itself often facts-and-circumstances dependent. As just one example, there is no bright-line test for purposes of determining whether there is a recommendation for Reg BI purposes.[11]

---

8 Under Reg BI, recommendations to retail customers may no longer just be "suitable" for the client (and the Suitability Rule expressly does not apply if Reg BI applies). Instead, recommendations to retail customers must be in the retail customer's "best interest." Under this standard, broker-dealers cannot put their interests ahead of the interests of the retail customer. 84 Fed. Reg. 33,374 (July 12, 2019). Whether a communication is a "recommendation" such that the Reg BI standard of care is triggered is generally dependent on the applicable facts and circumstances. In the case of Reg BI, it may not always be the case that advice governed by Reg BI is individualized. Although the SEC, and FINRA with respect to the Suitability Rule, has not defined the term "recommendation," they have offered guidance for determining whether particular communications by broker-dealers and their associated persons are recommendations. For example, in its Notice to Members 01-23, FINRA stated that a communication will be deemed to be a recommendation if "given its content, context, and manner of presentation - a particular communication from a broker/dealer to a customer reasonably would be viewed as a 'call to action,' or suggestion that the customer engage in a securities transaction. . . . [T]he more individually tailored the communication to a specific customer or a targeted group of customers about a security or group of securities, the greater likelihood that the communication may be viewed as a 'recommendation.' [footnote incorporated into text]" Notice to Members 01-23 further states that there is a recommendation when "[a] member sends its customers an e-mail stating that customers should be invested in stocks from a particular sector (such as technology) and urges customers to purchase one or more stocks from a list with 'buy' recommendations." FINRA has also noted that an explicit recommendation to hold a particular security is tantamount to a "call to action" in the sense of a suggestion that the customer stay the course with the investment, and that a communication with customers to generally use a bond ladder would similarly be treated as a recommendation for these purposes. FINRA further noted that "recommendations to customers to invest in more specific types of securities, such as high dividend companies or the 'Dogs of the Dow'" would also be regarded as a recommendation that triggered suitability. FINRA Rule 2111 (Suitability) FAQ, available at https://www.finra.org/rules-guidance/key-topics/suitability/faq. Thus, it may well be the case that a communication can be a recommendation that is based on the particular retail customer's investment profile, as required by the Care Obligation of Reg BI, but the recommendation itself may be of general applicability to a number of customers of the broker-dealer.

9 For example, FINRA's Rule 2111 imposes a suitability obligation on recommendations that are not otherwise subject to Reg BI.

10 The Release notes 950 Mass. Code Regs. 12.204 & 12.207 as amended effective March 6, 2020, New York State Department of Financial Services Insurance Regulation 187, 11 NYCRR 224, First Amendment, effective August 1, 2019, and NAIC Takes Action to Protect Annuity Consumers; available at https://content.naic.org/article/news_release_naic_takes_action_protect_annuity_consumers.html.

11 The financial-services industry, with guidance from FINRA, has adopted interpretations and policies for determining when communications are recommendations. Would these practices be relevant to whether or not the "a primary basis" prong of the Five-Part Test has been met? If a broker-dealer is overly inclusive in determining whether communications are "recommendations" for purposes of Reg BI, should that determine whether the "a primary basis" prong of the Five-Part Test has been met?

In this regard, it may be worth recalling that the SEC cited reduced investor choice following the imposition of a fiduciary standard under the 2016 Rule as a reason for deciding not to adopt a fiduciary standard for broker-dealers. The SEC stated: "Our concerns about the ramifications for investor access, choice, and cost from adopting either of these approaches are not theoretical. With the adoption of the now vacated [2016 Rule] there was a significant reduction in retail investor access to brokerage services, and we believe that the available alternative services were higher priced in many circumstances."[12]

Nevertheless, the DOL seems to be of the view that merely complying with Reg BI or another similar standard could make a broker-dealer (or other regulated entity under a similar applicable standard) more likely to be characterized as an ERISA fiduciary.[13] This view, without more, may itself be extremely significant.[14] Putting aside the question of whether the DOL's interpretation would be upheld or is otherwise correct, institutions that are at risk for being considered to be Investment Advice fiduciaries may wish to consider the extent to which they are otherwise subject to any "best interest" or similar fiduciary-type requirements and, if so, the possible relevance thereof under the "a primary basis" prong of the Five-Part Test in light of the DOL's new interpretation.

---

[12] When adopting Reg BI, the SEC expressly "declined to subject broker-dealers to a wholesale and complete application of the existing fiduciary standard under the [Investment Advisers] Act [of 1940] because it is not appropriately tailored to the structure and characteristics of the broker-dealer business model (i.e., transaction-specific recommendations and compensation), and would not properly take into account, and build upon, existing obligations that apply to broker-dealers, including under FINRA rules." The SEC also noted that it "believes (and our experience indicates), that [the adoption of a fiduciary standard] would significantly reduce retail investor access to differing types of investment services and products, reduce retail investor choice in how to pay for those products and services, and increase costs for retail investors of obtaining investment recommendations." The SEC specifically "declined to craft a new uniform standard that would apply equally and without differentiation to both broker-dealers and investment advisers" noting that "we do not believe that applying the existing fiduciary standard under the Investment Advisers Act of 1940 to broker-dealers or adopting a new uniform fiduciary standard of conduct applicable to both broker-dealers and investment advisers would provide any greater investor protection (or, in any case, that any benefits would justify the costs imposed on retail investors in terms of reduced access to services, products, and payment options, and increased costs for such services and products)."

[13] Broker-dealers that provide certain investment advice that is "solely incidental" to their business as broker-dealers and who not receive special compensation for such advice are excluded from the definition of "investment adviser" in Section 202(a)(11) of the Investment Advisers Act of 1940. In *Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion From the Definition of Investment Adviser*, 84 Fed. Reg. 33,681 (July 12, 2019), the SEC made clear that investment discretion (rather than price and time discretion when executing a customer's order) and account monitoring pursuant to an agreement (rather than a broker's voluntary review of a customer's account and holdings) constitutes investment advice that is not "solely incidental" to the business of a broker-dealer. Nevertheless, not all account monitoring constitutes the provision of investment advice by a broker-dealer. "[A] broker-dealer that agrees to monitor a retail customer's account on a periodic basis for purposes of buy, sell or hold recommendations may still be considered to provide advice in connection with and reasonably related to effecting securities transactions [and thus, qualify for the "solely incidental" exception]."

The SEC declined to "delineate every circumstance where agreed-upon monitoring is and is not solely incidental to a broker-dealer's brokerage business." The SEC further noted that policies and procedures may be adopted to demarcate when certain activities may be within and outside the exception: "For example, broker-dealers may provide in their policies and procedures that a registered representative may agree to monitor a customer's account at specific time frames (e.g., quarterly) for the purposes of determining whether to provide a buy, sell or hold recommendation to the customer" but the policies and procedures "should not permit a broker-dealer to agree to monitor a customer account in a manner that in effect results in the provision of advisory services that are not in connection with or reasonably related to broker-dealer's primary business of effecting securities transactions, such as providing continuous monitoring…."

[14] Reg BI requires that broker-dealers, when making recommendations about securities, put the interests of retail customers ahead of their own, and requires broker-dealers to disclose, mitigate, and in some cases eliminate, financial conflicts of interest. Disclosure of a financial conflict alone is not always considered adequate under Reg BI.

## III. Rollovers

### *A. In General*

The Release focuses substantial attention on rollovers involving Plans and IRAs because "[a]mounts accrued in an ERISA-covered Plan can represent a lifetime of savings, and often comprise the largest sum of money a worker has at retirement" and a rollover is therefore "potentially a very consequential financial decision" for retirement investors. The Preamble expresses concerns about incurring "transaction costs associated with moving the assets into new investments and accounts," and, "the loss of economies of scale [with the result that] the cost of investing through an IRA may be higher than through a Plan." In addition, the Preamble indicates that IRA investors may "lose important ERISA protections, including the benefit of a Plan fiduciary representing their interests in selecting a menu of investment options or structuring investment advice relationships, and the statutory causes of action to protect their interests." The Preamble also points to the fact that there have been large numbers of rollovers reported in the past years, and that there are embedded incentives for financial institutions to accrete IRA assets because they "can generally expect to earn transaction-based compensation such as commissions, or an ongoing advisory fee, from the IRA, but may or may not earn compensation if the assets remain in the Plan." The Preamble therefore refers to rollovers as a "primary" concern of the whole proposal.

### *B. The Five-Part Test*

In the context of rollovers, as noted above, the DOL stated that "it is more than reasonable . . . that the advice provider would anticipate that advice about rolling over Plan assets would be a primary basis for . . . investment decisions" (internal quotation marks omitted). The DOL then went on to state that "[n]umerous sources acknowledge that a common purpose of advice to roll over Plan assets is to establish an ongoing relationship in which advice is provided on a regular basis outside of the Plan, in return for a fee or other compensation" and cited to FINRA Regulatory Notice 13-45, which stated that "a financial adviser has an economic incentive to encourage an investor to roll Plan assets into an IRA that he will represent as either a broker-dealer or an investment adviser representative." The DOL also cites a study by the General Accounting Office for the proposition that "cross-selling IRA rollovers to participants, in particular, is an important source of income for service providers." It is not clear, however, that the pronouncements cited by the DOL necessarily lead to the conclusion that incentives to sell products and services and to obtain relationship assets, standing alone, are indicative of a mutual agreement to provide personalized advice on a regular basis.

The Preamble goes on to analyze the application of the regular-basis prong of the Five-Part Test specifically in the context of rollovers. Although the DOL acknowledged that "advice to take a distribution from a Plan and roll over the assets may be an isolated and independent transaction that would fail to meet the 'regular basis' prong" of the Five-Part Test, it "believes that whether advice to roll over Plan assets to an IRA satisfies the regular-basis prong of the five-part test depends on the surrounding facts and circumstances." The Preamble states that "advice to roll over Plan assets can occur as part of an ongoing relationship or an anticipated ongoing relationship that an individual enjoys with his or her advice provider." In the context of a preexisting relationship with a financial institution, "the advice to roll assets out of a Plan is part of an ongoing advice relationship that satisfies the 'regular basis' requirement."

The Preamble also states that "advice to roll assets out of the Plan into an IRA where the advice provider will be regularly giving financial advice regarding the IRA in the course of a more lengthy financial relationship would be the start of an advice relationship that satisfies the 'regular basis' requirement. In these scenarios, there is advice to the Plan - meaning the Plan participant or beneficiary - on a regular basis." Under this view, it may be the case that,

even though the 1975 Rule requires that advice be provided on a regular basis, the regular-basis prong of the Five-Part Test can be considered to have been satisfied even before the relationship has developed into one where advice is being regularly provided.[15] It is unclear whether a court would adopt this type of expectations-based approach under the regular-basis prong of the Five-Part Test (particularly, for example, in situations in which the expectations never materialize).

In this regard, it may be important to consider the interaction of the DOL's interpretation of the regular-basis prong with the mutual-agreement prong. If, for example, advice is provided with respect to a rollover, but the parties mutually agree (and the actions of the parties are consistent with such agreement) at the time of the rollover that future services following the rollover will not be individually tailored and will not serve as a primary basis for investment decisions, it may be possible to conclude that the post-rollover interactions would not constitute Investment Advice. In that event, it seems possible that the advice in connection with the rollover could itself be "an isolated and independent transaction" and therefore not in the nature of Investment Advice.[16]

In light of this newly-articulated analysis, the DOL now believes that DOL Advisory Opinion[17] 2005-23A (Dec. 7, 2005) (the "Deseret Letter") is "incorrect." The Deseret Letter had indicated that advice to roll assets out of a Plan did not generally constitute Investment Advice. However, the DOL stated in the Preamble that "advice to take a distribution of assets from an ERISA-covered Plan is actually advice to sell, withdraw, or transfer investment assets currently held in the Plan," and that "a recommendation to roll assets out of a Plan is necessarily a recommendation to liquidate or transfer the Plan's property interest in the affected assets, the participant's associated property interest in the Plan investments, and the fiduciary oversight structure that applies to the assets." In addition, the "distribution recommendation commonly involves either advice to change specific investments in the Plan or to change fees and services directly affecting the return on those investments." The DOL ultimately determined that "the better view is that a recommendation to roll assets out of a Plan is advice with respect to moneys or other property of the Plan."

While the DOL has previously expressed reservations about the Deseret Letter in connection with the process surrounding the adoption of the 2016 Rule,[18] the Preamble's detailed analysis of the regular-basis prong of the Five-Part Test in the context of rollovers is both new and expansive. Ultimately, if rollover solicitations may now commonly be deemed to meet all of the prongs of the Five-Part Test and the provider is thereby deemed to be an ERISA fiduciary, the provider may generally be prohibited from receiving fees resulting from its Investment Advice, unless an exemption (such as the Proposed Exemption) applies. Furthermore, in the case of a rollover from an ERISA plan, the full panoply of ERISA's general fiduciary requirements, including for example the prudence requirement, might be directly applicable. In contrast, where a provider solicits rollovers from an IRA, or advises on the investment of an

---

[15] The DOL stated that it "is aware that some Financial Institutions pay unrelated parties to solicit clients for them. See Rule 206(4)-3 under the Investment Advisers Act of 1940; see also Investment Advisers Advertisements; Compensation for Solicitations, Proposed Rule, 84 FR 67518 (December 10, 2019). The Department notes that advice by a paid solicitor to take a distribution from a Plan and to roll over assets to an IRA could be part of ongoing advice to a Retirement Investor, if the Financial Institution that pays the solicitor provides ongoing fiduciary advice to the IRA owner."

[16] Note that the SEC stated that broker-dealers' recommendations regarding rollovers are specifically covered by Reg BI, but the SEC did not take that the view that broker-dealers who provide advice about rollovers are acting as investment advisers.

[17] "Only the parties described in the request for [an advisory] opinion may rely on the opinion . . . ." ERISA Proc. 76-1. § 10.

[18] See 81 Fed. Reg. 20,964 (Apr. 8, 2016).

IRA, there would be no private right of action or DOL enforcement as to Section 4975 of the Code,[19] and the only possible plaintiff, at least as to Section 4975 itself, would seem to be the Internal Revenue Service.

Notwithstanding the DOL's approach to the regular-basis prong of the Five-Part Test and the Deseret Letter, there may be a fundamental open question regarding whether the regular-basis prong can be met in the rollover context generally. While any advice regarding the rollover would appear to be provided with respect to the transferor Plan (indeed, the transferee IRA (or other Plan) might not even yet exist),[20] any subsequent advice would seem clearly to be advice to the transferee IRA (or other Plan).[21] Thus, query whether later advice regarding a transferee IRA (or other Plan) can ever cause otherwise isolated and independent advice regarding the rollover from the transferor Plan to be considered to be provided on a "regular basis" for these purposes.[22]

It is also noted that, while the DOL's discussion of the "a primary basis" prong is generally in the context of rollover solicitations, a question may emerge as to whether the DOL's reasoning would be applied by the DOL in other contexts involving solicitations or otherwise involving sales and marketing. That type of expansive effect on the

---

[19] Reorganization Plan No. 4 of 1978 allocates to the DOL interpretive authority, but not enforcement authority, over Section 4975 of the Code. See Reorg. Plan No. 4 of 1978, §§ 102, 105; see also Pub. L. No. 98-532, 98 Stat. 2705 (statutorily ratifying and reaffirming prior reorganization plans).

[20] Cf. 81 Fed. Reg. 20,946, 20,964 (preamble to the final version of the 2016 Rule) ("Even if the assets will not be covered by ERISA or the Code when they are moved outside the plan or IRA, the recommendation to change the plan or IRA investments is investment advice under ERISA and the Code. Thus, recommendations on distributions (including rollovers or transfers into another plan or IRA) or recommendations to entrust plan or IRA assets to a particular IRA provider would fall within the scope of investment advice in this regulation, and would be covered by Title I of ERISA, including the enforcement provisions of section 502(a).").

[21] The Preamble in discussing the Deseret Letter seems to focus on the transferor Plan and not on the transferee IRA: "A recommendation to roll assets out of a Plan is necessarily a recommendation to liquidate or transfer the Plan's property interest in the affected assets, the participant's associated property interest in the Plan investments, and the fiduciary oversight structure that applies to the assets."

[22] Unlike the Release, the 2016 Rule specifically added categories of investment advice that would render one an investment advice fiduciary, including "[a] recommendation as to the advisability of acquiring, holding, disposing of, or exchanging, securities or other investment property or a recommendation as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred, or distributed from the plan or IRA." 81 Fed. Reg. 20,948 (Apr. 8, 2016). The preamble to the 2016 Rule indicates that "paragraph (a)(1)(i) cover[ed] recommendations regarding the investment of plan or IRA assets, including recommendations regarding the investment of assets that are being rolled over or otherwise distributed from plans to IRAs." Indeed, the preamble to the 2015 proposal arguably acknowledges that the regular-basis prong of the Five-Part Test would not be met with respect to rollovers, and thus supported a change to the actual regulatory language, stating:

> "One example of the five-part test's shortcomings is the requirement that advice be furnished on a 'regular basis' . . . [T]he 'regular basis' requirement also deprives individual participants and IRA owners of statutory protection when they seek specialized advice on a one-time basis, even if the advice concerns the investment of all or substantially all of the assets held in their account (e.g., as in the case of an annuity purchase or a roll-over from a plan to an IRA or from one IRA to another). . . The proposed regulation, if finalized, would supersede Advisory Opinion 2005-23A. Thus, recommendations to take distributions (and thereby withdraw assets from existing plan or IRA investments or roll over into a plan or IRA) or to entrust plan or IRA assets to particular money managers, advisers, or investments would fall within the scope of covered advice."

It seems, then, that the DOL in 2015 did not reach a different conclusion than the Deseret Letter regarding the proper application of the Five-Part Test, but instead felt it necessary to change the regulatory text (and in particular a change to the regular-basis prong of the Five-Part Test) in order to effect a change to the result in the Deseret Letter.

application of ERISA and Section 4975 of the Code resulting from the 2016 Rule was among the more controversial and contentious aspects of the 2016 Rule, and it remains to be seen whether the interpretive guidance in the Releases will, even without a change to the language of the 1975 Rule, raise the same specter.

## IV The Proposed Exemption

### *A. Background*

The 2016 Rule substantially broadened the types of ordinary course interactions that would be regarded as resulting in Investment Advice fiduciary status. The manner in which financial institutions responded to the 2016 Rule was not uniform across market participants.[23] Some sought to preserve their traditional commission-based platform by using, among other avenues, the now-vacated BIC Exemption and PrTE.

With the demise of the 2016 Rule, the BIC Exemption and the PrTE no longer applied. Financial institutions that migrated to an exemption or set of exemptions designed to work under the 2016 Rule sometimes accepted or even embraced fiduciary status. However, with the vacating of the 2016 Rule and the resulting elimination of the related exemptions, the receipt of the types of fees and compensation arrangements mentioned above, and various principal transactions, could involve non-exempt self-dealing or related-party prohibited transactions.

FAB 2018-02 was issued after the demise of the 2016 Rule as “a temporary enforcement policy providing prohibited transaction relief to investment advice fiduciaries.” In it, the DOL announced that “it would not pursue prohibited transactions claims against investment advice fiduciaries who worked diligently and in good faith to comply with certain impartial conduct standards for transactions that would have been exempted in the new exemptions, or treat the fiduciaries as violating the applicable prohibited transaction rules.” These impartial conduct standards contain three components: a best interest standard; a reasonable compensation standard; and a requirement to make no misleading statements about investment transactions and other relevant matters.

The DOL notes that it is issuing the Proposed Exemption so that “financial institutions could continue relying on those compliance structures on a permanent basis, subject to the additional conditions of the exemption, rather than changing course to begin complying with the DOL’s other existing exemptions for investment advice fiduciaries.” In addition, the Proposed Exemption “would provide a defense to private litigation as well as enforcement action by the DOL, while the FAB is limited to the latter.” The Proposed Exemption would apply to those Financial Institutions (as defined below) that seek to make use of this relief.

### *B. FAB 2018-02, Reg BI and an Overview of the Proposed Exemption*

The Proposed Exemption utilizes many of the concepts and features in FAB 2018-02, and in some important contexts, the now-vacated BIC Exemption and PrTE. While the Proposed Exemption may seem facially easier to satisfy than the BIC Exemption and the PrTE, it is not clear the extent to which that actually will be the case for all affected institutions. Significantly, the Proposed Exemption’s Impartial Conduct Standards (the “Impartial Conduct Standards”) tends to incorporate many Reg BI concepts that were absent from the 2016 Rule, thereby continuing an effort by various regulators to harmonize standards of conduct. For example, the SEC expressly rejected using (and the Proposed Exemption does not use) the BIC Exemption’s old “without regard to” test, which many found

---

[23] For statistics showing how market participants responded to the 2016 Rule, see 84 Fed. Reg. 33,322, 33,421 & nn. 33-34, 1005-1007 (July 12, 2019).

cumbersome at best.[24] However, there are some instances where the requirements of the Proposed Exemption extend beyond Reg BI.

In general, and as discussed in greater detail below, the Proposed Exemption is available for SEC-registered investment advisers, broker-dealers, banks, and insurance companies ("Financial Institutions") and their individual employees, agents, and representatives ("Investment Professionals") that provide fiduciary Investment Advice to Plan participants and beneficiaries, IRA owners, and Plan and IRA fiduciaries (also referred to as "Retirement Investors"). The Proposed Exemption applies only to Investment Advice fiduciary relationships, and not to discretionary or investment management relationships.[25]

### *C. Coverage- in General*

The Proposed Exemption applies to a variety of services. However, it applies only to a limited number of principal and riskless principal transactions. In addition, there are some specific cautionary notes on municipal securities and "complex" investments.

The Proposed Exemption would require that the Financial Institution:

- provide (and the Investment Professional would also have to provide) advice in accordance with the Impartial Conduct Standards, which include -
  - a duty to comply with Section 404(a) of ERISA's prudence standards;
  - a duty not to place the interests of the Financial Institution, Investment Professional, affiliates, related entities or other parties ahead of the interests of the Plan, or to subordinate the interests of the Plan to their own;
  - a duty of "best execution"; and
  - a requirement that the Plan pay no more than "reasonable compensation";
- acknowledge in writing its and its Investment Professionals' fiduciary status under ERISA and Section 4975 of the Code, as applicable, when providing Investment Advice to Plan participants and beneficiaries, IRA owners, and Plan and IRA fiduciaries;
- describe in writing the services to be provided and the Financial Institutions' and Investment Professionals' material conflicts of interest;

---

[24] The BIC Exemption required that recommendations be made "without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party." Many expressed concern that this standard was too broad and set an institution up for a failure of the exemption any time a plaintiff could prove that the Financial Institution did not recommend the investment that paid it the least. The preamble to Reg BI noted that the SEC decided to reject this standard because the "language could alter the way in which conflicts are viewed and cause a substantial portion of conduct that is currently permitted, and reasonably accepted and desired by retail customers, to be limited or eliminated."

[25] The BIC Exemption prior to finalization applied only to Investment Advice fiduciaries. Arguably, the Proposed Exemption raises similar issues.

- adopt policies and procedures prudently designed to ensure compliance with the Impartial Conduct Standards—with special considerations for rollovers, commission-based compensation arrangements, and limited or proprietary platforms;
- conduct an annual retrospective review of compliance—with certain certifications by the chief executive officer (the "CEO"); and
- not have been convicted of certain crimes.

The Proposed Exemption would be available to Financial Institutions and their Investment Professionals that provide fiduciary Investment Advice to Retirement Investors. The DOL notes that the "proposed definition is based on the entities identified in the statutory exemption for investment advice under ERISA section 408(b)(14) and Code section 4975(d)(17), which are subject to well-established regulatory conditions and oversight." While independent marketing organizations, field marketing organizations and brokerage general agencies are not covered Financial Institutions for purposes of the Proposed Exemption, the Preamble notes that their activities may be covered if appropriately supervised by an insurance company that is itself a Financial Institution. The DOL also notes that it may be possible for such organizations to obtain the benefit of the Proposed Exemption by applying for individual prohibited transaction exemption relief. In addition, the Financial Institution and Investment Professional (as applicable) must not have been disqualified or barred from making investment recommendations by any insurance, banking, or securities law or regulatory authority (including any SRO).

### *D. Exclusions*

#### 1. Independence

The Proposed Exemption would not be available for Investment Advice fiduciary relationships offered to Plans of the Financial Institution or its affiliates. The Proposed Exemption would also be unavailable for a named fiduciary or Plan administrator, or an affiliate thereof, who was selected to provide advice to the Plan by a fiduciary who is not "independent of the Financial Institution, Investment Professional, and their affiliates." For purposes of the independence requirement, the DOL stated that it "would [not] view a party as independent of the Financial Institution and Investment Professional if . . . the person has a relationship to or an interest in the Financial Institution, Investment Professional or any affiliate that might affect the exercise of the person's best judgment in connection with transactions covered by the [Proposed Exemption], or . . . the party [receives] or is projected [to receive] within the current federal income tax year, compensation or other consideration for his or her own account from the Financial Institution, Investment Professional or an affiliate, in excess of 2% of the person's annual revenues based upon its prior income tax year."

The DOL's reason for the exclusion is in some ways fairly straightforward: "to protect employees from abuse, employers generally should not be in a position to use their employees' retirement benefits as potential revenue or profit sources, without additional safeguards. Employers can always render advice and recover their direct expenses in transactions involving their employees without need of an exemption."

#### 2. Multiple Fiduciary Roles

The Proposed Exemption would also exclude transactions "that involve the Investment Professional acting in a fiduciary capacity other than as an investment advice fiduciary." Interpretive questions may arise here as to, for example, whether an IRA of an Investment Professional employee of a Financial Institutions would be precluded from

relying on the Proposed Exemption because the Investment Professional also serves as the grantor of his or her own IRA, and whether the Investment Professional's employing Financial Institution would be precluded from using the Proposed Exemption for another IRA of the Investment Professional if the Financial Institution provides advice to the Investment Professional concerning any IRA. So-called "outside chief investment officers" and sponsors of certain pooled investment vehicles may be among those that also find this exclusion to be of interest.

#### 3. Certain Robo-Advisors.

The Proposed Exemption would not apply to so-called "robo" advice arrangements that do not involve interaction with an Investment Professional. The DOL noted that such arrangements may be eligible for relief under reasoning of DOL Advisory Opinion[26] 2001-09A (Dec. 14, 2001) or Sections 408(b)(14) and 408(g) of ERISA (and the corresponding provisions of the Code). The DOL stated that, while "hybrid" robo-advice arrangements (i.e., arrangements that involve both computer software-based models and personal Investment Advice from an Investment Professional) "would be permitted under the [Proposed Exemption], arrangements in which the only investment advice provided is generated by a computer model would not be eligible for relief under the [Proposed Exemption]."

### *E. Specific Covered Transactions, Products and Services*

#### 1. Rollovers and Recommendations to Move Accounts

As indicated above, one of the "primary" focuses of the Release is rollovers. The Proposed Exemption would specifically cover compensation received as a result of Investment Advice to roll over assets from a Plan to an IRA. The Proposed Exemption would also cover migrations of Plan assets from one account type to another (i.e., from a fee-based or commission based), including "from an IRA account at another Financial Institution, or even between different account types."

Nevertheless, echoing a concern under the 2016 Rule, the DOL has indicated that it "cautions that certain practices such as 'reverse churning' (i.e. recommending a fee-based account to an investor with low trading activity and no need for ongoing monitoring or advice) or recommending holding an asset solely to generate more fees may be prohibited transactions that would not satisfy the Impartial Conduct Standards." Should a Financial Institution embrace (or accede to) a fiduciary model, there may be challenges similar to those involved with migrating accounts to comply with the BIC Exemption or other approaches.[27]

#### 2. Certain Services

Echoing the now-defunct BIC Exemption, the Proposed Exemption would cover "all forms of reasonable compensation as a result of their investment advice to Retirement Investors." Thus, sales commissions, 12b-1 fees, trailing commissions, sales loads and other compensation associated with the provision of services or the sale of products would be eligible for relief, to the extent they constitute reasonable compensation.

---

[26] As indicated above, Advisory Opinions cannot generally be relied upon other than by those to whom they are issued.

[27] As the SEC noted in its Reg BI release, "fee-based compensation could result in so- called "reverse churning" and a disincentive to reduce assets under management, even if that would be in the investor's best interest, while flat-fee models can lead to shirking and overbilling." 84 Fed. Reg. 33,426 (July 12, 2019).

As under the BIC Exemption, the fact that compensation may vary from product to product or service to service would not be a per se bar to using the Proposed Exemption. A provider would be able to receive different trailing payments or commissions, for example, depending on the specifics of the product and would not otherwise be regarded as violating the self-dealing prohibited transaction rule in which fiduciaries are not permitted to give advice that affects the amount of their compensation. The Proposed Exemption would allow for variable compensation if the other applicable conditions are satisfied.

However, the DOL expressly cautioned that "investments that possess unusual complexity and risk," for example, may require ongoing monitoring to protect the investor's interests. An Investment Professional may be unable to prudently recommend to an "individual Retirement Investor" certain investments in the first place "without ongoing monitoring of the investment." (Similarly, the preamble to the BIC Exemption contained language that warned institutions about investing in "complex" products). In addition, the DOL noted that such opportunities "may be unable to satisfy the exemption's best interest standard with respect to such investments without a mechanism in place for monitoring." The Preamble also indicates that in considering such "complex" products, "the cost of monitoring . . . should also be considered." The DOL suggested, that some "complex products or recommendations" should not be made if they "might, on their face, appear inconsistent" with the best interest of the Plan.

### 3. Specified Principal and Riskless Principal Transactions

In connection with the issuance of the 2016 Rule, the DOL issued the PrTE for principal transaction and riskless principal transactions. Principal transactions inherently involve adversity in that the Financial Institution is "opposite" on a given transaction rather than simply a service provider.

Principal transactions often involve mark-ups, mark-downs, or other payments. And, although they are the predominant way in which certain instruments, such as fixed income securities trade, they may also include equity securities where the Financial Institution acts as underwriter in a fixed commitment offering or has a particular security in its inventory. The DOL defines a riskless principal transaction as 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.

Like the PrTE, the Proposed Exemption differentiates between sales from a Plan and sales to a Plan. The Proposed Exemption would apply to any principal (or riskless principal) transaction involving a Plan's sale or disposition of any security or other property.

While the Proposed Exemption is broad when it comes to a Plan's disposal of assets in a principal or riskless principal transaction, the universe of transactions covered with respect to Plan purchases would be much narrower. While the universe of permitted purchase transactions is broader than those permitted under the PrTE in that municipal bonds are now included on the approved list, there may still be gaps in the application of the Proposed Exemption to many ordinary course purchase transactions that many Plans and Financial Institutions would need to carefully consider.

For example, the Proposed Exemption is only available for certain specified purchase transactions that are effected on a principal basis. These are limited to transactions involving: corporate debt securities offered pursuant to a registration statement under the Securities Act of 1933; US Treasury securities; debt securities issued or guaranteed by a U.S. federal government agency other than the US Department of the Treasury; debt securities issued or

guaranteed by a government-sponsored enterprise; municipal bonds; certificates of deposit and interests in unit investment trusts.

There are many common principal transactions that are not on the Proposed Exemption's list of permitted purchase transactions. These include foreign-currency transactions. Many ordinary course interest, dividends, and proceeds on the sale of foreign denominated assets need to be repatriated to US dollars. The Proposed Exemption would not apply to purchases of debt of foreign issuers and debt of foreign sovereigns. Similarly, purchases of equity securities that are effected on a principal or riskless principal basis would be ineligible for relief (notwithstanding that, in many cases, it may well be possible that a broker-dealer or bank is able to obtain a better price for the customer through its own inventory than by trading "away.")[28] The Proposed Exemption would not cover purchases of securities in initial offerings where the institution (or an affiliate) participates in the placement or underwriting, and may not cover initial offerings of registered closed end funds, to the extent effected on a principal or riskless principal basis. Other examples of transactions and other items that would not be covered by the Proposed Exemption include short sales and other margin transactions, overdraft protection, receipt of float, error corrections, settlement accommodations and prepayment of fees. In sum, those who found certain of the restrictions under the PrTE to be constraining may have similar concerns with the Proposed Exemption.

### *F. Credit Risk, Liquidity and Municipal Bonds*

Financial institutions would need to adopt policies and procedures "reasonably designed to ensure that the debt security, at the time of the recommendation, has no greater than moderate credit risk and has sufficient liquidity that it could be sold at or near its carrying value within a reasonably short period of time." The PrTE had a similar constraint. The Preamble notes that the "moderate credit risk" standard "is intended to identify investment grade securities, and is included to prevent the exemption from being available to Financial Institutions that recommend speculative debt securities from their own accounts." As under the PrTE, many Financial Institutions may find these constraints limiting, especially in light of recent market conditions. It is difficult to have foreseen the recent pandemic and its ensuing market reactions in 2020 and the implication of this standard may be far from certain where the Financial Institution would need to determine that the position "could be sold at or near its carrying value within a reasonably short period of time."

While the approved list of transaction under the Proposed Exemption includes municipal bonds, the DOL in the Preamble "cautions, however, that Financial Institutions and Investment Professionals should pay special care to the reasons for advising Retirement Investors to invest in municipal bonds. Tax-exempt municipal bonds are often a poor choice for investors in ERISA plans and IRAs because the plans and IRAs are already tax advantaged and, therefore, do not benefit from paying for the bond's tax-favored status."

### *G. Impartial Conduct Standards*

#### 1. Overview

The Impartial Conduct Standards are a centerpiece of the Proposed Exemption, as the predecessor impartial conduct standards were with the BIC Exemption. The standard has three components: a best interest standard; a reasonable

[28] There is also the possibility that the price of a share of stock may be too great for one client, but a broker dealer could provide it as a fractional share in a principal transaction. Consider that several widely popular stocks have seen trading prices over $1,500, and, in at least one case, over $273,900 in the past months.

compensation standard; and a requirement to make no misleading statements about investment transactions and other relevant matters.

As a prefatory matter, it is important to consider that Reg BI followed the adoption of, and revocation of, the 2016 Rule and the BIC Exemption. The DOL has responded to these new regulatory developments as assets in their rule making here. In this regard, the DOL notes that the Impartial Conduct Standards "are, in the Department's view, aligned with those of the [Reg BI]" among other recent initiatives at the State and other authority."

Indeed, there are provisions of the Proposed Exemption that are substantially identical to portions of Reg BI; however, there are also some significant departures from Reg BI. In some cases, the Proposed Exemption seems to run beyond those requirements for specified purposes tailored to ERISA.

### 2. Best Interest

The Proposed Exemption, like the BIC Exemption, contains a "Best Interest Standard" that itself is comprised of several elements. Consistent with the standards of prudence found in Section 404(a) of ERISA, a Financial Institution relying on the Proposed Exemption must offer advice that "reflects 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 use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, and does not place the financial or other interest of the Investment Professional, Financial Institution or any affiliate, related entity or other party ahead of the interests of the Retirement Investor, or subordinate the Retirement Investor's interests to their own." This second part of the standard in the Proposed Exemption is substantially identical to Reg BI's formulation that a broker-dealer (and its associated persons) not place "the financial or other interest of the broker-dealer [or its associated persons] ahead of the interests of the retail customer." Moving away from the BIC Exemption's "without regard to" test, and harkening back to the efforts generally to harmonize standards of conduct under ERISA and the federal securities laws and rules, the DOL makes clear that "[t]he standard [in the Proposed Exemption] is to be interpreted and applied consistent with the standard set forth [in Reg BI]."

While these standards may largely correspond and both regimes call for restitutions and disgorgement of profits in certain instances, it is important to recognize that the penalties for violating ERISA and Section 4975 of the Code can also involve punitive excise taxes. As noted by the SEC in the Reg BI adopting release, there are key "differences in the approach to the treatment of conflicts under ERISA and under the federal securities laws." The SEC continued by saying that "ERISA starts by prohibiting conflicts and then through exemptions permits certain conflicts, whereas the federal securities laws generally start with disclosure and become more restrictive." The Proposed Exemption thus (like the BIC Exemption before it) would effectively adopt an ERISA-type prudence standard of care not only to regulate behavior, but also as an express condition to relief under a prohibited transaction exemption.[29]

### 3. Reasonable Compensation

The Impartial Conduct Standards would require that fees and other compensation paid with respect to transactions covered under the Proposed Exemption not exceed reasonable compensation within the meaning of Section

[29] Query whether the application of prudence standards to non-ERISA IRAs raises the kinds of overreach concerns that the Fifth Circuit had with the 2016 Rule and the BIC Exemption in the *Chamber of Commerce* case (cited above), even here. Arguably, however, the reach of the Proposed Exemption is not as extensive as the reach that the BIC Exemption had in light of the 2016 Rule.

408(b)(2) of ERISA (and the corresponding provisions of the Code). The DOL requires that "compensation not be excessive, as measured by the market value of the particular services, rights, and benefits" provided. Helpfully, the DOL notes that "the Financial Institution and Investment Professional would not have to recommend the transaction that is the lowest cost or that generates the lowest fees without regard to other relevant factors. Recommendations of the "lowest cost" security or investment strategy, "without consideration of other factors, could in fact violate the exemption." With particular focus on annuities and other products, the DOL also suggested that the reasonable compensation test would also apply in the aggregate to "investment products that bundle together services and investment guarantees or other benefits, such as annuities." The DOL also noted that, "[i]n assessing the reasonableness of compensation in connection with these products, it is appropriate to consider the value of the guarantees and benefits as well as the value of the services."

### 4. Misleading Statements—Caution on Exculpatory Clauses

The Impartial Conduct Standards would require that the Financial Institution and its Investment Professionals not provide misleading statements about the recommended transaction or other relevant matters at the time they are made. These "other relevant matters" include "fees and compensation, material conflicts of interest, and any other fact that could reasonably be expected to affect the Retirement Investor's investment decisions." The DOL noted that it "would consider it materially misleading for the Financial Institution or Investment Professional to include any exculpatory clauses or indemnification provisions in an arrangement with a Retirement Investor that are prohibited by applicable law." Aside from the implications of such color as it pertains to ERISA and Section 4975 of the Code, this reasoning would appear to extend to other (non-ERISA/non-Code) legal provisions. Given the variety of different standard forms of documentation used in different circumstances, this particular gloss may present significant practical challenges for many Financial Institutions.

### 5. Fiduciary Acknowledgment

Financial Institutions would have to acknowledge in writing that the Financial Institution and its Investment Professionals are fiduciaries under ERISA and Section 4975 of the Code, as applicable, with respect to any fiduciary Investment Advice provided by the Financial Institution or Investment Professional to the Retirement Investor. The Financial Institution would have to provide a written description of the services to be provided and material conflicts of interest arising out of the services and any recommended investment transaction. The description must be accurate in all material respects. As was the case under the BIC Exemption,[30] the acknowledgment requirement could raise issues for Financial Institutions that may not always be sure whether any given relationship is or may be at risk of resulting in tailored Investment Advice.

As indicated above, this requirement may be of particular importance for those Financial Institutions accepting rollovers. For example, issues may be raised regarding whether and how to make this acknowledgment in situations in which the Financial Institutions wishes to preserve the position that it is indeed not acting as an Investment Advice fiduciary in the rollover context, but simultaneously wishes to have the protective cover of an exemption like the Proposed Exemption.[31]

---

[30] The issue could also arise under ERISA's Section 408(b)(2) rules.

[31] By contrast, for example, PTCE 84-24, an exemption utilized by or insurance companies and brokers, is expressly available to inadvertent fiduciaries.

### 6. Disclosures

Industry participants had expressed the view that the disclosure requirements of the BIC Exemption and the PrTE were potentially onerous. Although the Proposed Exemption's disclosure requirements are still significant, they may be somewhat more streamlined than those of the BIC Exemption and the PrTE.

The DOL offers a number of insights here. The DOL notes that disclosures "should be in plain English, taking into consideration Retirement Investors' level of financial experience." In addition, required disclosures need not be in any one place. Rather, the "requirement can be satisfied through any disclosure, or combination of disclosures" and includes those disclosures that may be "required to be provided by other regulators" if, of course, they satisfy the Proposed Exemption's disclosure obligations. Importantly, the DOL also notes that the disclosures are not intended to "create a private right of action as between a Financial Institution or Investment Professional" and that the DOL "does not believe the exemption would do so."[32] In addition, the DOL remarks that the Release "does not require specific disclosures to be tailored for each Retirement Investor or each transaction as long as a compliant disclosure is provided before engaging in the particular transaction for which the exemption is sought."

### 7. Policies and Procedures

The Release establishes "an overarching requirement" that Financial Institutions "establish, maintain and enforce written policies and procedures prudently designed to ensure that the Financial Institution and its Investment Professionals comply with the Impartial Conduct Standards." The Proposed Exemption would require "ongoing vigilance as to the impact of conflicts in the provision of fiduciary advice to Retirement Investors." Elsewhere, the DOL comments that it regards these policies and procedures as central to establishing a "culture of compliance." In some respects, the policies and procedures may seem to echo obligations of broker-dealers under Reg BI. However, there may be some examples of substantial departures.

The policies and procedures generally "would be required to mitigate conflicts of interest to the extent that the policies and procedures, and the Financial Institution's incentive practices, when viewed as a whole, are *prudently* designed to avoid misalignment of the interests of the Financial Institution and Investment Professionals and the interests of Retirement Investors" (emphasis added). In particular, the Preamble notes that these policies and procedures "would be required to be prudently designed to protect Retirement Investors from recommendations to make excessive trades or to buy investment products, annuities or riders that are not in the Retirement Investor's best interest or that allocate excessive amounts to illiquid or risky investments."[33] The DOL's use of the term "prudently" departs from the language of Reg BI's Compliance and Conflict of Interest Obligations as well as FINRA's Rule 3110, which sets forth the requirement that broker-dealers a supervisory system "that is reasonably designed to achieve compliance with applicable securities laws and regulations." The SEC expressly stated its view that the omission of an express prudence requirement does not affect Reg BI's "care obligation" (which requires that the Financial Institution "have a reasonable basis to believe that a recommendation, or series of recommendations, does not place the financial or other interest of the broker-dealer or its associated persons ahead of the interest of the particular" investor). Rather,

[32] The Preamble notes that the Chamber of Commerce case (cited above) concluded that "the [DOL] did not have the authority to include certain contractual requirements in the new exemptions granted as part of the 2016 fiduciary rulemaking. The [DOL] is mindful of this holding and has not included any contract requirement [in the Proposed Exemption]."

[33] The Preamble does not further define "excessive trades," "investment products or annuities or riders that are not in the best interest of the Retirement Investor," or "excessive amounts" (as they relate to allocations) or "illiquid or risky investments."

the SEC said that it avoided the use of the term "prudence" to "address commenter concerns that it might create legal confusion and uncertainty."[34]

### 8. Best Execution

The Impartial Conduct Standards would require that Financial Institutions and Investment Professionals seek to obtain the "best execution" of the investment transaction reasonably available under the circumstances. Many Financial Institutions are already subject to a duty of best execution under common law, the Exchange Act, the Investment Advisers Act of 1940 or the rules of FINRA or the Municipal Securities Rulemaking Board. Plainly stated by the DOL in the Preamble, a duty of best execution means that a Financial Institution must "execute customers' trades at the most favorable terms reasonably available under the circumstances."

The Proposed Exemption would effectively import the best-execution requirement as a condition for relief under the Proposed Exemption. Thus, unclear facts and circumstances regarding whether best execution is obtained could cause uncertainty about the overall availability of the Proposed Exemption.[35]

## *H. Conflicts of Interest*

Under the Proposed Exemption, Financial Institutions must describe in writing the services to be provided and the Financial Institutions' and Investment Professionals' material conflicts of interest. For these purposes, a conflict of interest is "an interest that might incline a Financial Institution or Investment Professional - consciously or unconsciously - to make a recommendation that is not in the 'Best Interest' of the Retirement Investor."[36] Reg BI utilizes similar language in its conflict of interest provisions. It defines a conflict of interest as "an interest that might incline a broker-dealer, or a natural person who is an associated person of the broker-dealer—consciously or unconsciously—to make a recommendation that is not disinterested."

The DOL also notes that examples of "misalignment" are the making of excessive trade, buying investment products, annuities, or riders that are not in the investor's best interest or that allocate excessive amounts to illiquid or risky investments." Is it possible that the Financial Institution or Investment Professional can still be acting in the best interest of the Retirement Investor and allocating, per the Retirement Investor's investment objectives, a substantial

---

[34] 84 Fed. Reg. 33,445 (July 12, 2019).

[35] These issues may be particularly troublesome in that best execution is a principles-based obligation, with no bright-lined tests as to what is "best" execution. For example, the factors (e.g., price, speed, fees/rebates, chance of fills) that Financial Institutions must consider when making routing and execution decisions can differ based on the facts and circumstances. Financial Institutions would need to better understand any impact on their duty of best execution in the specific context of the Proposed Exemption. The Preamble does not specifically state why the DOL believed it needed to make the satisfaction of a provision already applicable to SEC-regulated advisers and broker-dealers as a condition to relief under the Proposed Exemption. As noted in Section IV(N), the Proposed Exemption incorporates certain other otherwise applicable legal rules as conditions for relief under the Proposed Exemption. Cf. Exec. Order 12866 (Sept. 30, 1993) ("Each agency shall avoid regulations that are inconsistent, incompatible, or duplicative with its other regulations or those of other Federal agencies.").

[36] The DOL has in the past indicated that the possibility of an effect on judgment could be sufficient to give rise to prohibited self-dealing. See, e.g., 29 C.F.R. § 2550.408b-2 ("[The provisions of Section 406(b) of ERISA] are imposed upon fiduciaries to deter them from exercising the authority, control, or responsibility which makes such persons fiduciaries when they have interests which may conflict with the interests of the plans for which they act. . . . Thus, a fiduciary may not use the authority, control, or responsibility which makes such person a fiduciary to cause a plan to pay an additional fee to such fiduciary (or to a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary) to provide a service.").

portion of the account to "illiquid" or "risky" investments? Financial Institutions operating under the Proposed Exemption will have to grapple with how this standard is to be judged, as again, a behavioral duty of prudence is converted into a foot-fault that results in potential excise tax exposure.

### *I. Change of Account Types and Requirements for Rollovers*

The Preamble indicates that recommendations "to change from one type of account to another (e.g., from a commission-based account to a fee-based account)" would be "required to document the specific reason or reasons why the recommendation was considered to be in the best interest of the Retirement Investor."[37] The DOL stated its belief that documentation "will serve an important role in protecting Retirement Investors during this significant decision" and that "[t]he requirement is designed to ensure that Investment Professionals take the time to form a prudent recommendation, and that a record is available for later review."

The DOL also states that a prudent recommendation to roll over from an ERISA-covered Plan to an IRA "would necessarily include consideration and documentation of the following: the Retirement Investor's alternatives to a rollover, including leaving the money in his or her current employer's Plan, if permitted, and selecting different investment options; the fees and expenses associated with both the Plan and the IRA; whether the employer pays for some or all of the Plan's administrative expenses; and the different levels of services and investments available under the Plan and the IRA." By contrast, when the DOL discusses rollovers from another IRA or changes from a commission-based account to a fee-based arrangement, there is a much less detailed procedural requirement to the effect that "a prudent recommendation would include consideration and documentation of the services that would be provided under the new arrangement."

The Preamble also states that, to be in compliance, Financial Institutions would "identify and carefully focus on the particular aspects of their business model that may create incentives that are misaligned with the interests of Retirement Investors." The Preamble notes that, if a "Financial Institution anticipates that conflicts of interest in its business model will center on advice to roll over Plan assets, and after the rollover, the Financial Institution and Investment Professional will be compensated on a level-fee basis, the Financial Institution's policies and procedures should focus on the rollover or distribution recommendation."[38] Separately, as noted above, the DOL also cautions against so-called "reverse churning" transactions ("i.e. recommending a fee-based account to an investor with low trading activity and no need for ongoing monitoring or advice") or recommending holding an asset solely to generate more fees." The DOL indicates that such practices may result in prohibited transactions.

---

[37] This requirement would seem to extend beyond Reg BI's requirements for documenting recommendations with respect to rollovers. Rather than imposing a general requirement that broker-dealers document customer-specific recommendations on rollovers, it focused more on the process for making such recommendations. Indeed, the "care obligation" of Reg BI expressly "does not require broker-dealers to document the basis for a recommendation," and in fact the SEC chose documentation of the basis for risks associated with a recommendation to be contained in disclosures to the customer. 84 Fed. Reg. 33,378 (July 12, 2019); see also *id.* at 33,380.

[38] Beyond satisfying a best interest standard, it is unclear what the DOL is suggesting, since a Financial Institution and Investment Professional would have an incentive to accrete more assets.

The specific documentation-related requirements of the Proposed Exemption would go beyond what is expressly required under Section 404(a) of ERISA, which generally governs a fiduciary's prudence obligations,[39] and goes beyond what Reg BI requires. In this regard, the Preamble acknowledges that "[t]he SEC already encourages firms to record the basis for significant investment decisions such as rollovers, although doing so is not required under Reg BI [even though it does not require such documentation]." Thus, the Proposed Exemption would seem to envisage documentation that neither general prudence principles of ERISA nor Reg BI require.

Separately, the Preamble states, "[t]he Investment Professional and Financial Institution should make diligent and prudent efforts to obtain information about the existing Plan and the participant's interests in it." The Preamble then goes on: "If the Retirement Investor is unwilling to provide the information, even after a full explanation of its significance, and the information is not otherwise readily available, the Investment Professional should make a reasonable estimation of expenses, asset values, risk, and returns based on publicly available information and explain the assumptions used and their limitations to the Retirement Investor." This affirmative action was not required under the BIC Exemption and suggests that the Financial Institution (and Investment Professional) must actively engage in meaningful and proactive research to satisfy its substantive prudence requirements. It also suggests the possible need for some significant quantitative analysis and assumptions that may not be empirically precise. The DOL in its cost-benefit analysis surmises "that it would take, on average, 10 minutes per rollover to document [rollover-related] justifications."

It is possible that a consequence of requirements like these would be to contract, rather than expand, the availability of investment advice in connection with rollovers. The DOL has specifically asked for comments on these documentation requirements "that would promote prudent rollover advice without overlapping existing regulatory requirements."

### *J. Transaction-Based Compensation*

The Preamble states that, "if a Financial Institution intends to receive transaction-based third party compensation, and compensate Investment Professionals based on transactions that occur in a Retirement Investor's accounts, such as through commissions, the Financial Institution's policies and procedures would also address the incentives created by these compensation arrangements" and "would need to consider how to minimize the impact of these compensation incentives on fiduciary investment advice to Retirement Investors, so that the Financial Institution would be able to meet the exemption's standard of conflict mitigation." The Preamble makes it clear that Financial Institutions "would be encouraged to focus on both financial incentives to Investment Professionals and supervisory oversight of investment advice."

The Preamble continues: "These two aspects of the Financial Institution's policies and procedures would complement each other, and Financial Institutions would retain the flexibility, based on the characteristics of their businesses, to adjust the stringency of each component provided that the exemption's overall standards would be satisfied. . . . Financial Institutions that significantly mitigate commission-based compensation incentives would have less need to rigorously oversee Investment Professionals." The DOL cautions, however, that "Financial Institutions that have

---

[39] See 29 C.F.R. § 2550.404a-1(b)(1). ("A fiduciary satisfies the prudence requirements of that section if it "has given appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the plan's investment portfolio with respect to which the fiduciary has investment duties.")

significant variation in compensation across different investment products would need to implement more stringent supervisory oversight."

Helpfully, the DOL notes that Financial Institutions "could implement conflict mitigation strategies identified by the Financial Institutions' other regulators." For a non-exhaustive list, the DOL singles out the SEC's guidelines utilized in Reg BI: "(i) avoiding compensation thresholds that disproportionately increase compensation through incremental increases in sales; (ii) minimizing compensation incentives for employees to favor one type of account over another; or to favor one type of product over another, proprietary or preferred provider products, or comparable products sold on a principal basis, for example, by establishing differential compensation based on neutral factors; (iii) eliminating compensation incentives within comparable product lines by, for example, capping the credit that an associated person may receive across mutual funds or other comparable products across providers; (iv) implementing supervisory procedures to monitor recommendations that are: near compensation thresholds; near thresholds for firm recognition; involve higher compensating products, proprietary products or transactions in a principal capacity; or, involve the rollover or transfer of assets from one type of account to another (such as recommendations to roll over or transfer assets in an ERISA account to an IRA) or from one product class to another; (v) adjusting compensation for associated persons who fail to adequately manage conflicts of interest; and (vi) limiting the types of retail customer to whom a product, transaction or strategy may be recommended."

The Preamble suggests that those seeking to comply with the Proposed Exemption identify and mitigate "conflicts of interest associated with the product and [decline] to recommend a product if the Financial Institution cannot effectively mitigate associated conflicts of interest." The Preamble also notes that "Financial Institutions also should consider minimizing incentives at the Financial Institution level." The BIC Exemption strongly encouraged policies and procedures that focused on the compensation practices on Investment Professionals, but also focused attention on potential incentives at the institutional level.

### *K. Insurance Company Transaction-Based Compensation*

There is also some special color for insurance companies in terms of supervision of their agents, with the Preamble stating that "[t]o comply with the exemption, the insurer could adopt and implement supervisory and review mechanisms and avoid improper incentives that preferentially [independent insurance agents] to push the products, riders, and annuity features that might incentivize Investment Professionals to provide investment advice to Retirement Investors that does not meet the Impartial Conduct Standards."

The DOL approvingly cross-references a pronouncement of the National Association of Insurance Commissioners as a methodology of compliance.[40] The Preamble also addresses a concern raised among many in the insurance industry under the BIC Exemption concerning independent agents when they offer products and services of a different carrier: the insurance company would be responsible for supervision "only for an Investment Professional's recommendation and sale of products offered to Retirement Investors by the insurance company in conjunction with fiduciary investment advice, and not unrelated and unaffiliated insurers." The Preamble suggests that insurance companies can promote oversight by "contracting with an IMO to implement policies and procedures designed to ensure that all of the agents associated with the intermediary adhere to the conditions of this exemption" and by "monitoring market prices and benchmarks for their products and services, and remaining attentive to any financial

[40] National Association of Insurance Commissioners, *Suitability in Annuity Transactions Model Regulation*, § 6(C)(2)(d) (Spring 2020).

inducements they offer to independent agents that could result in a misalignment of the interests of the agent and his or her Retirement Investor customer."

It is potentially important for insurance carriers that they can rely on contractual obligations, rather than on-premises oversight that many carriers found impossible to implement under the BIC Exemption, in combination with a "review of documentation prepared by insurance agents to comply with the exemption . . . or the use of third-party industry comparisons available in the marketplace to help independent insurance agents recommend products that are prudent for the Retirement Investors they advise." The Preamble indicates that an insurance company may want to negotiate terms with the agent where "the intermediary . . . eliminate[s] compensation incentives across all the insurance companies that work with the intermediary." The intermediary may therefore actually "[assist] each of the insurance companies with their independent obligations under the exemption." It is not immediately clear how easy it would be for the insurance industry to implement the steps suggested by the DOL.

### *L. Proprietary Products and Limited Investment Menus of Products*

One central concern some had about the BIC Exemption was how Financial Institutions were to deal with the many standards of care, disclosure and conflict mitigation provisions when the Financial Institution offered both proprietary and affiliated, and third party products. The Preamble notes that Financial Institutions can "provide investment advice on proprietary products or on a limited menu, including limitations to proprietary products and products that generate third party payments" but again calls out the fact that "limited menus, particularly if they focus on proprietary products and products that generate third party payments, can result in heightened conflicts of interest." It is helpful that the DOL indicates that many of these conflicts can be resolved through a disclosure based approach, where the Financial Institution gives "complete and accurate disclosure of their material conflicts of interest in connection with such products or limitations and adopt policies and procedures that are prudently designed to prevent any conflicts of interest from causing a misalignment of the interests of the Financial Institution and Investment Professional with the interests of the Retirement Investor." The Preamble even notes that "[p]roduct limitations can serve a beneficial purpose by allowing broker-dealers and associated persons to develop increased familiarity with the products they recommend."

The policies would be satisfied where the institution decides to recommend third party products when it "prudently determines that its proprietary products or limited menu do not offer Retirement Investors an investment option in their best interest when compared with other investment alternatives available in the marketplace." In addition, the focus is on a "reasonable conclusion" about "whether the menu of investment options would permit Investment Professionals to provide fiduciary investment advice to Retirement Investors in accordance with the Impartial Conduct Standards." This approach seems more flexible than that of the BIC Exemption (particularly that of the BIC Exemption's "without regard to" provision) so long as the Financial Institution and Investment Professional do not in fact place the financial or other interest of the Investment Professional, Financial Institution or any affiliate, related entity or other party ahead of the interests of the Retirement Investor, or subordinate the Retirement Investor's interests to their own.[41] Once again, however, the policies and procedures prong of the Proposed Exemption expressly incorporates a "prudence" requirement.

---

[41] Certain institutions may have been concerned about maintaining offerings that included both affiliated and third-party products, except under very narrow circumstances. Financial Institutions considering an "open architecture" or "complementary" Investment Advice business model would still need carefully to consider the challenges that may be inherent at the institutional level in offering affiliated and third party products and services as well as at the Investment Professional level, although, as indicated in text, the Impartial Conduct Standards might be more flexible than the corresponding standards of the BIC Exemption.

### M. Annual Retrospective Review and CEO Certification

The Proposed Exemption offers a review-and-certification condition that was not present in the BIC Exemption or the PrTE. The DOL additionally believes that "Financial Institutions must also monitor Investment Professionals' conduct to detect advice that does not adhere to the Impartial Conduct Standards or the Financial Institution's policies and procedures." The Proposed Exemption thus would require an annual review "reasonably designed to assist the Financial Institution in detecting and preventing violations of, and achieving compliance with, the Impartial Conduct Standards and the policies and procedures governing compliance with the exemption."

The annual review would be required to be completed no later than six months following the end of the period covered by the review. The DOL "envisions that the review would involve testing a sample of transactions to determine compliance" and that the "methodology and results of the retrospective review" would be "reduced" to a report. The report would then be delivered to the institution's CEO (or equivalent officer) who would then be required to certify annually that:

- The CEO has reviewed the report of the retrospective review;
- The Financial Institution has in place policies and procedures prudently designed to achieve compliance with the conditions of this exemption; and
- 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 is reasonably designed to ensure continuing compliance with the conditions of this exemption.

As the DOL acknowledges, FINRA already has certification and compliance protocols under its Rule 3130, which requires a broker-dealer's CEO (or equivalent) to certify annually, among other things, that the firm has in place processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable FINRA rules, MSRB rules and federal securities laws and regulation. The DOL believes, however, that the additional requirement in the Proposed Exemption would allow institutions to "find more effective ways to ensure that Investment Professionals are providing investment advice in accordance with the Impartial Conduct Standards, and to correct any deficiencies in existing policies and procedures."

The DOL also believes that this requirement produces a "means of creating accountability for the review," and expressed the intent to "serve the purpose of ensuring that more than one person determines whether the Financial Institution is complying with the conditions of the exemption and avoiding non-exempt prohibited transactions." The Preamble notes that the CEO may "not have the experience or expertise to determine whether to make the certification," in which case "he or she would be expected to consult with a knowledgeable compliance professional to be able to do so."

It is unclear the extent to which Financial Institutions will find these requirements cumbersome or worse,[42] particularly at the CEO level.[43] In addition, it is not immediately clear what the precise effect would be under the terms of the Proposed Exemption if the annual review identifies deficiencies.[44]

### *N. Disqualification*

The Proposed Exemption contains a disqualification provision in which "the grounds for ineligibility would involve certain criminal convictions or certain egregious conduct with respect to compliance with the exemption." In addition, the Proposed Exemption would be unavailable where the institution receives a "written ineligibility notice from the Director of the Office of Exemption Determinations that they (i) engaged in a systematic pattern or practice of violating the conditions of the exemption; (ii) intentionally violated the conditions of this exemption; or (iii) provided materially misleading information to the Department in connection with the Investment Professional's or Financial Institution's conduct under the exemption." The disqualification triggers would apply not only if the Financial Institution was responsible for the purported violations, but also if any of their "control group" affiliates was guilty, applying certain 80% affiliation tests for this purpose. Importantly, the criminal disqualification event would only apply with respect to a criminal conviction arising out of an entity's provision of investment advice to Retirement Investors. The disqualification would last for 10 years and thus is likely to be regarded as substantial by those Financial Institutions considering utilizing the Proposed Exemption.

There could be a concern under the disqualification provisions that, with the stakes so high, the standards are vague. Further, Section 411 of ERISA already prohibits Financial Institutions from acting as fiduciaries under ERISA if they are convicted of a broad array of criminal and related activity, and that there are other commonly used PTCEs that deal with conflicts of interest that do not have these types of disqualification provisions.[45]

The Proposed Exemption would still be available for a "one-year winding down period" for Financial Institutions in the case of a conviction, but would apparently be lost immediately upon notice from the DOL concerning other "ineligibility." There is also a set of "petition" provisions concerning a criminal conviction that may strike some as

[42] We note our experience that the certification requirements of the statutory "cross trading" exemption are perceived by a range of institutions as unacceptably burdensome.

[43] The Preamble does not explain why the DOL felt that this requirement was necessary at the CEO level.

[44] PTCE 84-14 also requires an annual report by qualified professional asset managers ("QPAMs") in certain circumstances. Part V of PTCE 84-14 calls for an annual review of certain provisions of the exemption by an "auditor" where the manager manages assets of a Plan that is sponsored or maintained by the manager or certain affiliates. The DOL noted in connection with the amendment of PTCE 84-14 that "an adverse finding in the auditor's report would not, in itself, render the exemption unavailable for any transaction engaged in by the QPAM on behalf of the Plan. The Department cautions that the failure of the QPAM to take appropriate steps to address any adverse findings in an unsatisfactory audit would raise issues under ERISA's fiduciary responsibility provisions."

[45] See, e.g., PTCE 77-4 (investments in open-end registered mutual funds); Prohibited Transaction 84-24 (transactions involving insurance agents, brokers, pension consultants, insurance and investment companies, and investment company principal underwriters); PTCE 86-128 (agency transactions in securities with a broker-dealer affiliated with a fiduciary asset manager). In connection with relief from the prohibited transaction rules of Section 406(a) of ERISA, Part I(g) of PTCE 84-14 does set forth additional anti-criminal requirements applicable to QPAMs.

perplexing, especially since the petition is required to be conducted by the DOL, and not with an administrative law judge.[46]

## V. Continued Availability of FAB 2018-02

FAB 2018-02 set forth a temporary enforcement policy under which the DOL would not pursue prohibited transactions claims against Investment Advice fiduciaries who worked diligently and in good faith to comply with previously applicable impartial conduct standards for transactions that would have been exempted by the BIC Exemption or certain other PTCEs, or treat the fiduciaries as violating the applicable prohibited transaction rules. FAB 2018-02 is limited by its nature to DOL enforcement actions, and did not would extend to potential claims by Plan participants and beneficiaries, in that satisfaction of the exemption would result in there being no violation of the applicable underlying ERISA (and Code) rules.

FAB 2018-02 was issued in response to the revocation of the 2016 Rule and potentially allowed institutions that had migrated to an operational structure that was compliant with the 2016 Rule and in many cases the BIC Exemption to continue to proceed on that basis. FAB 2018-02 was issued as "temporary" relief but continues to remain in force. As the Preamble notes, "its designation as 'temporary' communicated its nature as a transitional measure following the vacatur of the Department's 2016 rulemaking." The Preamble confirms that FAB 2018-02 remains in force. However, the Preamble confirms that "the Department does not envision that the FAB represents a permanent compliance approach." The stated reason for this appears to be a concern that FAB 2018-02 was designed "to avoid enforcement action by the Department but it does not (and cannot) provide relief from private litigation."

## VI. Certain Prior Authority

### *A. Restoration of Certain PTCEs*

The Release reinstates several important prohibited transaction class exemptions in the form that they were in immediately prior to their 2016 Rule form. These include widely used exemptions such as PTCE 75-1, PTCE 77-4, PTCE 84-24 and PTCE 86-128, along with PTCE 80-83, and PTCE 83-1.

### *B. Reinstatement of IB 96-1*

IB 96-1 set out the DOL's view of what constituted investment education as opposed to Investment Advice. IB 96-1 was substantially modified under the 2016 Rule, and the Release proposes officially to reinstate it as it was. The fact that IB 96-1 permits models to include a given individual's entire (i.e., not just Plan) financial picture has been helpful not only for individual Plan participants, but also for Financial Institutions in developing materials that allow Plan participants and fiduciaries to choose among a suite of possible investment options, and other products and services.

IB 96-1 provides guidance on Plan related information, that informs "a participant or beneficiary about the benefits of Plan participation, the benefits of increasing Plan contributions, the impact of preretirement withdrawals on retirement income, the terms of the plan, or the operation of the Plan" and "investment alternatives under the plan (e.g., descriptions of investment objectives and philosophies, risk and return characteristics, historical return information, or related prospectuses." IB 96-1 characterizes as investment education, among other things, the use of certain asset

[46] It is noted that the DOL has actively pursued disqualification-type initiatives in connection with the administration of the anti-crime provision of Section I(g) of PTCE 84-14.

allocation models and the use of certain "questionnaires, worksheets, software, and similar materials which provide a participant or beneficiary the means to estimate future retirement income needs and assess the impact of different asset allocations on retirement income."

## VII. Comment Period and Next Steps

The Release indicates a fast track comment period: 30 days from the publication of the Proposed Exemption in the Federal Register, which was on July 7, 2020, resulting in a deadline for comments of August 6, 2020.

## CONCLUSION

While the return to the 1975 Rule has now been confirmed, the Release, including the Preamble and the Proposed Exemption, signal an important new chapter in the decade-long effort by the DOL to revamp the definition of Investment Advice, particularly with respect to defined contribution plans and IRAs. Although the principles of the 1975 Rule are reaffirmed, some of the interpretive guidance in the Preamble, as well as a number of the specifics in the Proposed Exemption, may come as a surprise to market participants and ERISA practitioners alike. The reaction to the Release has already been and will presumably continue to be varied.

.

* * *

Comments to the Proposed Exemption are due by August 6, 2020, and we stand ready to assist in this regard. More generally, if you would like to discuss the Release, or any other aspect of ERISA's fiduciary rules, please contact any of the Dechert lawyers listed below or any Dechert lawyer with whom you regularly work.

This update was authored by:

**Steven W. Rabitz**
Partner, New York
+1 212 649 8785
steven.rabitz@dechert.com

**Andrew Oringer**
Partner, New York
+1 212 698 3571
andrew.oringer@dechert.com

**K. Susan Grafton**
Partner, New York
+1 212 698 3611
susan.grafton@dechert.com

**Samuel Scarritt-Selman**
Associate, New York
+1 215 698 3842
sam.scarritt-selman@dechert.com

Dechert LLP

**Andrew H. Braid**
Associate, Philadelphia
+1 215 994 2613
andrew.braid@dechert.com

© 2020 Dechert LLP. All rights reserved. This publication should not be considered as legal opinions on specific facts or as a substitute for legal counsel. It is provided by Dechert LLP as a general informational service and may be considered attorney advertising in some jurisdictions. Prior results do not guarantee a similar outcome. We can be reached at the following postal addresses: in the US: 1095 Avenue of the Americas, New York, NY 10036-6797 (+1 212 698 3500); in Hong Kong: 27/F Henley Building, 5 Queen's Road Central, Hong Kong (+852 3518 4700); and in the UK: 160 Queen Victoria Street, London EC4V 4QQ (+44 20 7184 7000). Dechert internationally is a combination of separate limited liability partnerships and other entities registered in different jurisdictions. Dechert has more than 900 qualified lawyers and 700 staff members in its offices in Belgium, China, France, Germany, Georgia, Hong Kong, Ireland, Kazakhstan, Luxembourg, Russia, Singapore, the United Arab Emirates, the UK and the US. Further details of these partnerships and entities can be found at dechert.com on our Legal Notices page.