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Moving on

The array of ERISA compliance solutions for rollover advice

The US Department of Labor's (DOL) new interpretation that rollover advice may be fiduciary "investment advice" for purposes of the Employee Retirement Income Security Act of 1974, as amended (ERISA), will compel companies across the financial services industries to reconsider whether and how they provide this essential service to retirement investors. If DOL persists with and asserts this interpretation in future enforcement cases, it seems inevitable that its position will eventually be tested in court, which absolutely is not the way such a consequential policy decision should be made. In the meantime, financial services providers will need to come to terms with DOL's position and consider their alternatives for continuing to be of service to retirement investors while operating on an ERISA-compliant basis.

By way of background, ERISA reserves its most stringent standards of conduct for fiduciaries to ERISA plans as defined in section 3(21), including persons who provide investment advice for a fee. Fiduciaries are subject to a series of standards, including:

- Statutory care (prudent expert) and loyalty (sole interest and exclusive purpose) standards in section 404(a);
- Prohibited transaction rules in section 406(a) that, absent a prohibited transaction exemption (PTE), bar a fiduciary from dealing on behalf of the plan with specified "parties in interest" that might be in a position to abuse the plan; and
- A second set of prohibited transaction rules in section 406(b) that, absent a PTE, prohibit fiduciaries from self-dealing, acting with a conflicted interest or receiving third-party payments.

The Internal Revenue Code, in an excise tax provision, largely replicates the prohibited transaction rules (but not the statutory care and loyalty standards) and makes them applicable to a range of retirement arrangements including Individual Retirement Accounts (IRA). For purposes of the discussion below, references to ERISA plans should be understood to include IRAs, and references to plan fiduciaries or participants to include IRA owners.

When presented with a potential fiduciary conflict of interest implicating the ERISA prohibited transaction rules – which DOL's rollover interpretation creates – the standard compliance playbook has three steps:

Fiduciary Status	Is it possible and appropriate to provide this service or arrangement without taking on ERISA fiduciary status?
Conflict of Interest	If not, is it possible and appropriate to neutralize any conflict of interest, generally by structuring the service or arrangement so the rollover advice provider and its affiliates are economically indifferent to the investment choices arising from that advice?
Exemption	If not, is there an ERISA prohibited transaction exemption applicable to the service or arrangement that provides conflict of interest relief and is acceptable from a business/legal perspective?

In the discussion below, we leave aside the prospects of whether DOL will be able to prevail in its interpretation, and focus on possible compliance alternatives under each of the foregoing steps assuming DOL's interpretation stands.

ESsentials: By the terms of the guidance issued to date (i.e., the preamble to PTE 2020-02), DOL has reserved the right to assert its new interpretation for rollover advice provided after February 16, 2021. That is, DOL functionally left no time for financial services providers to ascertain the applicability of DOL's new rollover interpretation to their business model, design a compliance solution, operationalize that compliance solution and train its workforce in that solution. Even if a provider had built rollover compliance systems under vacated Rule 2.0 and has been observing the terms of DOL's temporary enforcement policy (discussed below) in other aspects of its business, this is optimistically a 12-month process for most providers. However it chooses to proceed substantively, DOL has exposed financial services providers to unwarranted legal risk for which it must provide a workable fix.

Fiduciary Status	Is it possible and appropriate to provide this service or arrangement without taking on ERISA fiduciary status?

DOL's position is that rollover advice is fiduciary investment advice – specifically, because that advice entails disposition of the investments in the retirement investor's current retirement arrangement and acquisition of investments in the new arrangement – if it satisfies the 5-part test of fiduciary status from DOL's 1975 ERISA regulation. To paraphrase that test, a person is an ERISA fiduciary if that person, for a direct or indirect fee:

1. makes recommendations to a plan, plan fiduciary, plan participant or IRA owner as to the advisability of investing in, purchasing, or selling securities or other property of the plan or IRA
2. on a regular basis
3. pursuant to a mutual agreement, arrangement or understanding, written or otherwise, that
4. the advice will serve as a primary basis for investment decisions with respect to plan or IRA assets, and that
5. the advice will be individualized based on the particular needs of the plan, participant or IRA owner.

That is, under DOL's new interpretation, rollover advice is not inherently ERISA fiduciary advice; it becomes fiduciary advice only if it meets each element of this test.

ESsentials: Note that this definition is not limited to investments that are regulated as securities, but to any asset or property of the plan or IRA.

As is evident from the guidance announcing this position, DOL accepts that there will be cases where rollover interactions do not rise to the level of fiduciary advice. These cases include the following:

- **Execution only.** Merely executing a rollover at the request and instruction of the retirement investor does not result in fiduciary status. If no recommendation is provided, by definition, there cannot be fiduciary investment advice.
- **Investment education only.** As a variation, if the financial services provider only offers investment education in connection with the rollover – e.g., the pros and cons of remaining in the existing arrangement versus moving retirement savings to available alternative structures – and does not recommend any specific action, there cannot be fiduciary advice. DOL's long-standing investment education regulation was reinstated following the vacatur of Rule 2.0 without the helpful refinements related to rollovers that were adopted in 2016, but those refinements were not controversial and were consistent with the prior common understanding of the regulation.
- **Business model.** In its guidance, DOL admitted the possibility that there are financial services business models that generally do not confer fiduciary status, specifically referencing insurance sales transactions. To take a paradigm example, if an insurance salesperson who has no prior or subsequent interaction with the retirement investor proposes a rollover from an ERISA plan to an IRA single premium immediate annuity, the preamble suggests that the salesperson is not acting as a fiduciary.
- **Sales interactions.** There are cases where the rollover interaction is an arm's-length sales transaction in which the retirement investor is seeking a business proposal rather than continuing and trusted advice. It should still be possible to structure, document and conduct these interactions so one or more elements of the 5-part test is not met.
- **Sporadic interactions.** DOL's guidance specifically contemplates, without drawing any clear lines, that isolated or sporadic interactions are insufficient to create a "regular basis" fiduciary relationship.
- **Delegation of advice to an unconflicted financial expert.** If the customer-facing but conflicted fiduciary relies on an unconflicted outside expert to generate any rollover recommendation, which the conflicted fiduciary passes through to the retirement investor, DOL authority suggests that the delegation of the recommendation, if properly structured, means the conflicted fiduciary is not providing the advice and has not committed a prohibited transaction.

There are, of course, complexities in executing these compliance strategies, including the risk that the facts on the ground may prove to be different than those intended under the strategy. Also, DOL states in its guidance that the facts and intentions of the parties at the time the rollover advice is provided will be determinative, but it seems inevitable that subsequent facts will be (inappropriately) introduced as evidence of the parties' intentions at such time.

Conflict of Interest	If not, is it possible and appropriate to neutralize any conflict of interest, generally by structuring the service or arrangement so the rollover advice provider and its affiliates are economically indifferent to the investment choices arising from that advice?

In the most common formulation, an ERISA fiduciary is said to violate the prohibited transaction rules against self-dealing or acting with a conflicted interest if the revenue received by it or an affiliate varies based on the investment advice provided by the fiduciary. Accordingly, if it is possible to structure the arrangement so that such revenue does not vary and the fiduciary is economically agnostic among the range of choices it might recommend to the retirement investor, that approach can be an effective compliance solution.

There are ERISA conflict of interest problems that are conducive to this solution, but the rollover setting generally is not one of them. While there are conceivable situations where this solution might be structurally available (e.g., the existing retirement plan provider is offering the rollover advice and its revenue would remain constant under the recommended rollover vehicle), most often, the rollover advice provider is receiving no revenue under the existing arrangement, or at most different revenue than the rollover alternative would provide. To put it in stark terms, when the possible outcomes for the rollover advice provider are not getting paid (the current arrangement) or getting paid (the rollover arrangement), it may not be possible to neutralize the ERISA conflict in this manner.

Exemption	If not, is there an ERISA prohibited transaction exemption applicable to the service or arrangement that provides conflict of interest relief and is acceptable from a business/legal perspective?

If the rollover interaction does (or might) constitute ERISA fiduciary advice, and it is not possible to structure the interaction to neutralize any self-dealing or conflict of interest presented, the third option in the compliance playbook is to rely on an applicable PTE provided by statute or granted by DOL.

Universal Solutions

There are only two prohibited transaction exemptions (or equivalent guidance) available across financial service business models – as distinguished from exemptions tied to specified transactions – that appear available and helpful for rollover advice.

Exemption	Relief provided	Key conditions
Temporary enforcement policy	DOL will not assert a violation for transactions in scope of the vacated Best Interest Contract Exemption, which generally includes rollover advice	– Diligent and good-faith effort to comply with impartial conduct standards – Scheduled to expire December 20, 2021
PTE 2020-02 (granted simultaneously with the new rollover interpretation)	Reasonable compensation received as a result of conflicted investment advice, and certain principal transactions	– Admission of fiduciary status – Advance disclosures – Impartial conduct standards – Policies and procedures in support of those standards – Documentation of rollover advice – Annual retroactive compliance review

Note that two other universal exemptions seem unhelpful to address conflicted rollover advice.

- The ERISA §408(b)(2) exemption for reasonable services does not include relief from the section 406(b) prohibitions against self-dealing or acting with a conflicted interest.
- In principle, it seems that the ERISA §408(b)(14) exemption for participant investment advice provided by computer model might also be available, but its focus on investments available under the plan may cause it to be inapt in most situations.

Transaction-Specific Solutions

The great majority of available prohibited transaction exemptions are limited to a specific type of transaction, e.g., in a mutual fund or insurance product. To the extent a rollover results in such a transaction, these exemptions should be available to provide relief. We list a selection of potentially pertinent exemptions below that provide relief for fiduciary conflicts.

ESsentials: In evaluating this compliance strategy, our premise is that exemptive relief to, for example, purchase, hold or sell a particular investment or insurance product necessarily subsumes the investment advice – including rollover advice – leading to that transaction. Our premise must be correct for the exemptions to accomplish their intended purpose, that is, relief for the economic event that completes and gives rise to the prohibited transaction is ineffective unless it includes (as needed) relief for the steps leading to that event such as conflicted investment advice and liquidation of existing investments. DOL's guidance refers specifically to at least one such exemption as a potential source of relief in the rollover setting, so we infer that DOL agrees with that premise, but it would be helpful for DOL to explicitly address that point. Note also that new PTE 2020-02, which intentionally provides a compliance solution for rollover transactions, by its terms exempts only the receipt of reasonable compensation as a result of investment advice provided (the economic event that completes and gives rise to the prohibited transaction), and does not explicitly state that it provides relief for either the conflicted investment advice itself or the disposition of existing investments (the steps leading up to that event).

Exemption	Relief provided	Key conditions
PTE 75-1, Part II(2)	Purchase or sale of non-proprietary mutual fund shares between a plan and an SEC-registered broker-dealer	– Broker-dealer conducts principal transactions in the ordinary course of business – Arms-length transaction standard
PTE 77-4	Purchase or sale of proprietary mutual fund shares, where the fund adviser is providing nondiscretionary or discretionary advice to the plan or IRA	– No sales commission or (unless paid to the fund) surrender charge – No duplication of investment advisory fees – Disclosure and independent fiduciary approval

Exemption	Relief provided	Key conditions
PTE 83-1, Part I(b)	Sale, exchange or transfer of mortgage pool certificates between the plan and the mortgage pool sponsor	– Independent fiduciary approval – Arms-length transaction standard – No advisory fee paid to pool sponsor with regard to the transaction – Transaction size limits – Conditions for mortgage pool
PTE 84-24	Receipt of sales commission in connection with purchase of an insurance or annuity contract or shares of a proprietary mutual fund; effecting of such purchase	– Transaction is effected in the ordinary course of business – Arms-length transaction standard – Reasonable compensation standard – Advance disclosures, including of commissions – Independent fiduciary approval
PTE 86-128, Part II(a)	Plan fiduciary using its authority to cause a plan to pay a fee for effecting securities transactions	– Transactions are not excessive in amount or frequency – Advance disclosures – Independent fiduciary authorization – Confirmations or other reports of transactions – Annual summary
PTE 2004-07, Part I(b)	Purchase or sale of qualifying REIT shares at the direction of a plan participant or independent fiduciary	– Control requirements for participant or independent fiduciary – Advance disclosures – Confidentiality safeguards – Limited to cash transactions on primary exchange at market value – Arms-length transaction standard
ERISA §408(b)(4)	Investment of plan assets in bank interest-bearing deposits	– Approval in plan documents or by independent fiduciary
ERISA §408(b)(6)	Provision of bank ancillary services	– Reasonable compensation standard – Adequate internal banking safeguards – Compliance with certain other bank guidelines, if any
ERISA §408(b)(8)	Purchase or sale of an interest in a bank collective investment fund or insurance company pooled separate account	– Reasonable compensation standard – Approval in plan documents or by independent fiduciary

These transaction-specific exemptions have material differences from the two universal solutions noted above.

– The transaction-specific exemptions all predated DOL's introduction of impartial conduct standards as PTE conditions, and the 2016 amendment of existing PTE's as part of Rule 2.0 to include such conditions was vacated by the Fifth Circuit Court of Appeals in March 2018. That is not to say, however, that those standards are wholly irrelevant in a rollover compliance program. To the extent the rollover advice is treated as advice in respect of an ERISA plan, the statutory impartial conduct standards of ERISA – the fiduciary standards of care and loyalty in ERISA §404(a) – will be applicable independent of any exemption.

– As distinguished from PTE 2020-02, none of these other exemptions require written acknowledgment of ERISA fiduciary status. Given the inevitable uncertainty about how DOL's rollover interpretation will work out in practice, this may have some appeal.

ESsentials: Contrary to DOL's suggestions in its preamble discussion of the fiduciary acknowledgment condition of PTE 2020-02, any such compliance strategy does not mean that the financial institution is shirking a commitment to do right by the retirement investor. It means DOL has introduced a significant legal uncertainty as to when rollover interactions constitute fiduciary advice; that the financial institution will comply with applicable PTE conditions required by DOL in the event and as if it is a fiduciary; but that the financial institution prefers not to create the legal status of ERISA fiduciary, through a fiduciary acknowledgment required by a PTE, where it does not otherwise exist on the facts and circumstances.

In considering the scope of these transaction-specific exemptions, it is readily apparent that, uniquely among the financial services industries, there is no such PTE specific to registered investment advisers (RIA). Historically, the RIA interaction with retirement investors as to the selection of an advisory account and agreement to pay an advisory fee, in the rollover setting or otherwise, was regarded for ERISA purposes as pre-fiduciary selling activity, regulated by the Investment Advisors Act of 1940 but not by ERISA. Rule 2.0 changed that regulatory paradigm, prior to its vacatur, and DOL's rollover interpretation in Rule 3.0 extends that change, resulting in a disparity in the ERISA compliance solutions RIA's can consider as compared to other financial services providers. We suspect that, with further review, similar disparities will be identified in other circumstances involving other financial services industries. And to the extent DOL withdraws or delays PTE 2020-02, RIA's (and others similarly situated) will be without a PTE solution for rollover advice once the temporary enforcement policy expires, which is an untenable outcome DOL will be obliged to address.

For More Information

For resources and commentary regarding the DOL fiduciary initiative, visit Eversheds Sutherland's dolfiduciaryrule.com.

- Text of and supporting materials for Rules 1.0, 2.0 and 3.0
- Pleadings and decisions in the litigations that challenged Rule 2.0
- Articles, presentations and client alerts
- Videocasts about Rule 2.0

For commentary regarding the emerging landscape related to the standards of conduct for investment professionals, visit Eversheds Sutherland's fiduciaryregulatory.com.