

# DOL Fiduciary Advice Rule (Final)



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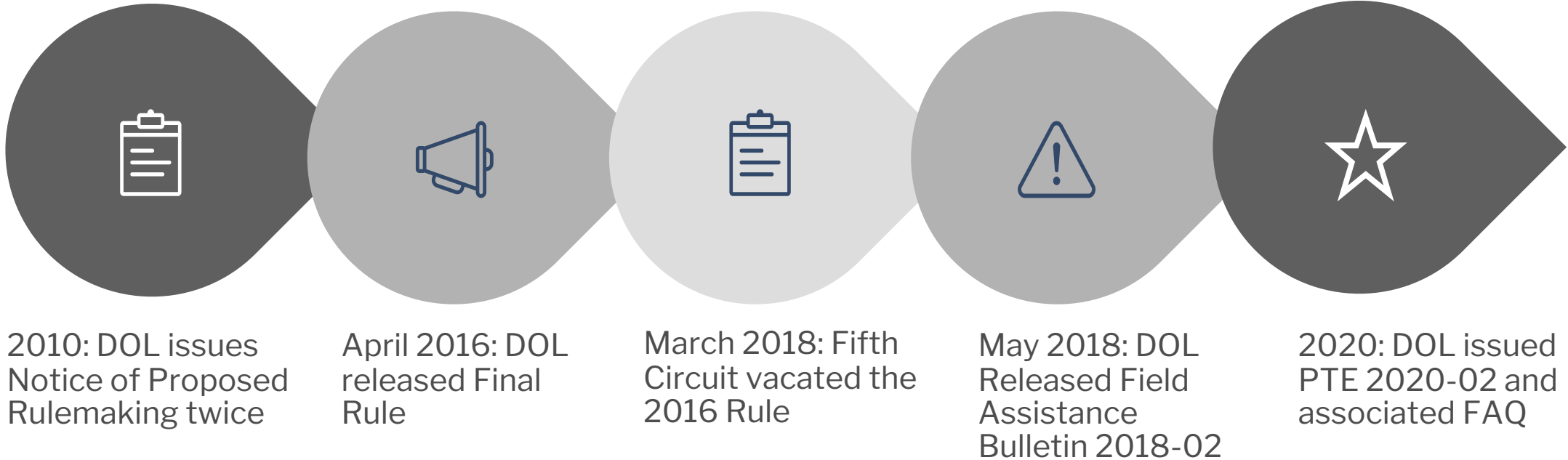
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# Overview of Fiduciary Rule Package

1. Background + Proposed Rule
2. Investment Advice under Final Rule
3. PTE 2020-02
4. PTE 84-24
5. Timeline
6. Action items + Implications



# Background: Getting to Fiduciary Rule v.4



# ERISA Fiduciary Duty: Section 3(21)

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Under ERISA Section 3(21)(A), a person is a fiduciary with respect to a plan to the extent that he/she:

1. Exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets;
2. ***Renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so; or***
3. Exercises any discretionary authority or discretionary responsibility in the administration of such plan.

# ERISA Fiduciary Duty: 1975 Regulation

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Under guidance from 1975, there is a five-part test for determining if a firm or investment professional provides investment advice; all five parts must be met:

1. Render advice to the plan, plan fiduciary, or IRA owner 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 or IRA assets, and that
5. The advice will be individualized based on the particular needs of the plan or IRA.



# Retirement Security Rule (Proposal)

- Replaces the five-part test from 1975 regulation with three ways to become a fiduciary:
  1. Telling someone you are a fiduciary;
  2. Exercising discretionary authority or control over investor's investment property (direct or indirect); or
  3. Making investment recommendations on a regular basis when that is part of your business, and such recommendation is made based on the investor's particular needs.
- Makes updates to several exemptions including PTE 2020-02 and PTE 84-24
- Leaves investment education under Interpretive Bulletin 96-1 alone, but wants your opinion

## **The WHY (Final Rule):**

**The 1975 regulation's five-part test is underinclusive in assigning fiduciary status as it fails to capture many circumstances in which an investor would reasonably expect that they can place their trust and confidence in the advice provider.**

# Power to Regulate, Power to Enforce

## **But wait, can the DOL even regulate in this area?**

*Under the Reorganization Plan No. 4 of 1978, which Congress subsequently ratified in 1984, Congress generally granted the Department authority to interpret the fiduciary definition and issue administrative exemptions from the prohibited transaction provisions in Code section 4975.*

## **So, who enforces these laws? Like, should I even care?**

*Although the Department of Labor has responsibility for issuing regulations and prohibited transaction exemptions under section 4975 of the Code, which applies to IRAs, the IRS maintains general responsibility for enforcing the excise tax applicable to prohibited transactions. The IRS' responsibilities extend to the imposition of excise taxes on fiduciaries who participate in prohibited transactions. As a result, the Department and the IRS share responsibility for addressing self-dealing by investment advice fiduciaries to tax-qualified plans and IRAs.*



# DOL Lays the Foundation for Litigation (again)

DOL is prepared for litigation:

1. Entire section on why they have the authority to regulate
2. Preamble indicates that the provisions are “severable”
3. Includes proactive references to how they are not overreaching, such as:

*The changes made in the final rule should address many of the concerns expressed regarding application of the final rule and the potential for overbreadth. These changes include:*

- *confirmation that whether a “recommendation” has occurred will be interpreted consistent with the SEC’s framework;*
- *elimination of proposed paragraph (c)(1)(i) and changes to the contexts in adopted paragraphs (c)(1)(i) and (ii) that narrowed them and made them more objective;*
- *adoption of a new paragraph (c)(1)(iii) confirming that sales recommendations that are not made in the circumstances set forth in paragraph (c)(1)(i) or (ii) will not result in investment advice fiduciary status and that providing investment information or education, without an investment recommendation, is not advice for purposes of the final rule; and*
- *revision of the definition of a “retirement investor” to exclude plan and IRA fiduciaries that are investment advice fiduciaries.*

# Investment Advice Defined (Final Rule)

Under the final rule, a person is **an investment advice fiduciary** if they provide a recommendation in one of the following contexts:

- *The person either directly or indirectly (e.g., through or together with any affiliate) makes professional investment recommendations to investors on a regular basis as part of their business and the recommendation is made under circumstances that would indicate to a reasonable investor in like circumstances that the recommendation:*
  - *is based on review of the retirement investor's particular needs or individual circumstances,*
  - *reflects the application of professional or expert judgment to the retirement investor's particular needs or individual circumstances, **and***
  - *may be relied upon by the retirement investor as intended to advance the retirement investor's best interest; **or***
    - *The person represents or acknowledges that they are acting as a fiduciary under Title I of ERISA, Title II of ERISA, or both with respect to the recommendation.*
- *The recommendation also must be made “for a fee or other compensation, direct or indirect” as defined in the final rule.*



# Investment Advice Breakdown (Final Rule)

1. Recommendation?
2. To a Retirement Investor?
3. Covered transaction?
4. Fee paid – direct or indirect?
5. On of the following is met:
  - a) Says “I am a fiduciary” OR
  - b) (objective test) A reasonable investor would believe that the individuals holds themselves out as providing advice because the professional routinely does this as part of their business AND the:
    1. recommendation is based on review of the retirement investor’s particular needs or individual circumstances,
    2. reflects the application of professional or expert judgment to the retirement investor’s particular needs or individual circumstances AND
    3. may be relied upon by the retirement investor as intended to advance the retirement investor’s best interest

## Investment Advice Three Components (Final Rule)

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“The revised language includes three component parts that the Department believes identify **objectively** when a person has held themselves out as providing **(1)** an individualized, reliable recommendation **(2)** based on the application of their professional or expert judgment, and **(3)** that is intended to advance the retirement investor's interest.

Thus, the final rule will result in the application of fiduciary status under circumstances in which both parties should reasonably understand that the retirement investor would rely on the recommendation for investment decisions” (emphasis added)

*This is based on facts and circumstances that meet the entire rule.*

# Recommendation (v. Education)

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Recommendation = the line between an investment recommendation and investment education or information will depend on whether there is a **call to action**.

- Uses the SEC's Regulation Best Interest Framework

## **Does NOT rise to recommendation:**

“a general conversation about retirement planning, such as providing a company's retirement plan options” to a retirement investor, would not rise to the level of a recommendation.

“the Department confirms that providing educational information and materials such as those described in **IB 96-1** will not result in the provision of fiduciary investment advice as defined in the final rule absent a recommendation, regardless of the type of retirement investor to whom it is provided”



# Recommendation re: Distributions

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The Department further emphasizes that a recommendation to take a **distribution**, even if it is not accompanied by a recommendation of a specific investment, is a “recommendation of any securities transaction or other investment transaction or any investment strategy involving securities or other investment property,” such that **if all the other parts of the final rule are satisfied**, the person making the recommendation will be an ERISA fiduciary.



# Retirement Investor

Retirement Investor = defined term

“The term “retirement investor” means a plan, plan participant or beneficiary, IRA, IRA owner or beneficiary, plan fiduciary within the meaning of ERISA section (3)(21)(A)(i) or (iii) and Code section 4975(e)(3)(A) or (C) with respect to the plan, or IRA fiduciary within the meaning of Code section 4975(e)(3)(A) or (C) with respect to the IRA”

- Includes HSAs and health and welfare plans
- There is NOT an exclusion for **sophisticated advice recipients** from the definition of retirement investor. The test, instead, is whether a reasonable investor in like circumstances would rely on the recommendation as intended to advance the investor’s best interest.



# Who is NOT covered

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- DOL did revise this provision in the final rule to refer to “professional” investment recommendations.
- Makes clear now the following are NOT covered:
  - the ordinary communications of a human resources employee, who is not an investment professional, in communications with plan participants
  - other employees of the plan sponsor, who are not investment professionals, interacting with plan participants, including in the context of a merger or acquisition.
  - common activities of real estate agents selling homes to prospective residents
  - life coaches
  - probation officers
  - divorce counselors



# Special Considerations

- ✓ “**sales recommendations** that do not satisfy the objective test will not be treated as fiduciary advice”
- ✓ “the mere provision of investment information or **education**, without an investment recommendation, is not advice”
- ✓ “rule is focused on communications with persons with authority over plan investment decisions (including selecting investment options for participant-directed plans), **rather than communications with financial services providers** who do not have such authority”
- ✓ “To the extent firms and financial professionals wish to avoid fiduciary status, they should take care to ensure that their **disclaimers** are consistent with their actions and communications with respect to the retirement investor as well as with State and Federal law.”





# Advice v. Not Advice Examples

The test for advice is objective and is based on what the reasonable investor would believe based on the facts + circumstances!

***Regarding Platform Providers:*** When a firm or financial professional provides individualized recommendations to a plan on the construction of a prudent fund lineup, and otherwise meets the terms of the rule's definition, the investor is entitled to rely on the recommendation as fiduciary advice intended to advance the plan's best interest

## Advice

- ✓ Hire me in the rollover context
- ✓ Hire me in the context of providing the design of the entire plan portfolio

## Not Advice

- ✓ Hire me in the context of an advisor's normal marketing
- ✓ Industry trends
- ✓ Performance history
- ✓ Quality of services description
- ✓ Detailed description of services

\*So long as these are NOT coupled with anything more!

# “Hire me”

## **Hire me does NOT = investment advice:**

Marketing or Sales Conversations. A person who engages in marketing or sales conversations with a Retirement Investor as to the advisability of engaging such person (or an affiliate) to provide investment advice or investment management services shall not be deemed to be a fiduciary within the meaning of section 3(21)(A) of the Act or section 4975(e)(3)(B) of the Code to the extent of such conversations, **provided the person engaging in such conversations does not have discretionary authority** or control with respect to a decision to engage the service provider and does not represent or acknowledge that they are acting as a fiduciary with respect to such decision.

...but to the extent “hire me” communications include covered investment recommendations, those recommendations are **evaluated separately** under the provisions of the final rule.

...the final rule extends ERISA fiduciary status to covered recommendations that are made in accordance with all parts of the final rule, even if the recommendations occur during “hire me” communications.



# PTE 2020-02

## **Covered Transactions:**

- The receipt, directly or indirectly, of reasonable compensation; and
- The purchase or sale of an investment product to or from a Retirement Investor, and the receipt of payment, including a mark-up or mark-down.

## **Exclusions:**

- The Plan is covered by Title I of ERISA and the Investment Professional, Financial Institution, or any Affiliate is:
  - The employer of employees covered by the Plan; or
  - The Plan's named fiduciary or administrator (unless selected to provide investment advice by a fiduciary who is independent of the Financial Institution), or
- The transaction involves the Investment Professional or Financial Institution acting in a fiduciary capacity other than as an investment advice fiduciary.

## **Investment Advice Fiduciary:**

- the provider makes an investment recommendation to a retirement investor;
- the recommendation is provided for a fee or other compensation, such as commissions; and
- the financial services provider holds itself out as a trusted adviser by
  - specifically stating that it is acting as a fiduciary under Title I or II of ERISA; or
  - making the recommendation in a way that would indicate to a reasonable investor that it is acting as a trusted adviser making individualized recommendations based on the investor's best interest.

**No longer does the one-time advice loophole apply.**

# PTE 2020-02

## **Core Standards (also apply to PTE 84-24):**

- Acknowledge fiduciary status, in writing, to the Retirement Investor;
- Disclose services and material conflicts of interest to the Retirement Investor;
- Adhere to Impartial Conduct Standards requiring:
  - investigate and evaluate investments, provide advice, and exercise sound judgment in the same way that knowledgeable and impartial professionals would in similar circumstances (the **Care Obligation**);
  - never place their own interests ahead of the Retirement Investor's interest, or subordinate the Retirement Investor's interests to their own (the **Loyalty Obligation**);
  - charge no more than reasonable compensation and, if applicable, comply with Federal securities laws regarding "best execution"; and
  - avoid making misleading statements about investment transactions and other relevant matters;
- Adopt firm-level policies and procedures;
- Document and disclose the specific reasons for any rollover recommendations; and
- Conduct an annual retrospective compliance review.

**Recordkeeping requirements did not change.**



# PTE 2020-02 Document Delivery (Update)

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“The Department is retaining the requirement in PTE 2020-02 for Financial Institutions to provide a written acknowledgment of fiduciary status to the Retirement Investor...

For purposes of the disclosures required by Section II(b)(1)-(4), the Financial Institution or Investment Professional is deemed to engage in a covered transaction on the later of (A) the date the recommendation is made or (B) **the date the Financial Institution or Investment Professional becomes entitled to compensation (whether now or in the future) by reason of making the recommendation...**”

This update is important because it means that if it is a “Hire Me” conversation pursuant to a rollover, the disclosure can be delivered as late as when there will ultimately be an engagement with the client.



# PTE 2020-02 for 3(38) RFPs

## **But, what if I am responding to an RFP to be a 3(38) Investment Manager?**

“To respond to the concern expressed by the commenters, the Department has determined that parties that are ultimately hired to provide investment management services pursuant to an RFP should be able to rely on this exemption for the provision of investment advice in the hiring process as long as they comply with the Impartial Conduct Standards.

...ERISA 3(38) investment managers have discretion with respect to the investment of plan assets; therefore, they could not rely on PTE 2020-02 for the ongoing provision of investment management services after they are hired. Section II(f) is limited to the prohibited transaction associated with providing fiduciary investment advice in connection with the hiring process...”



# PTE 84-24

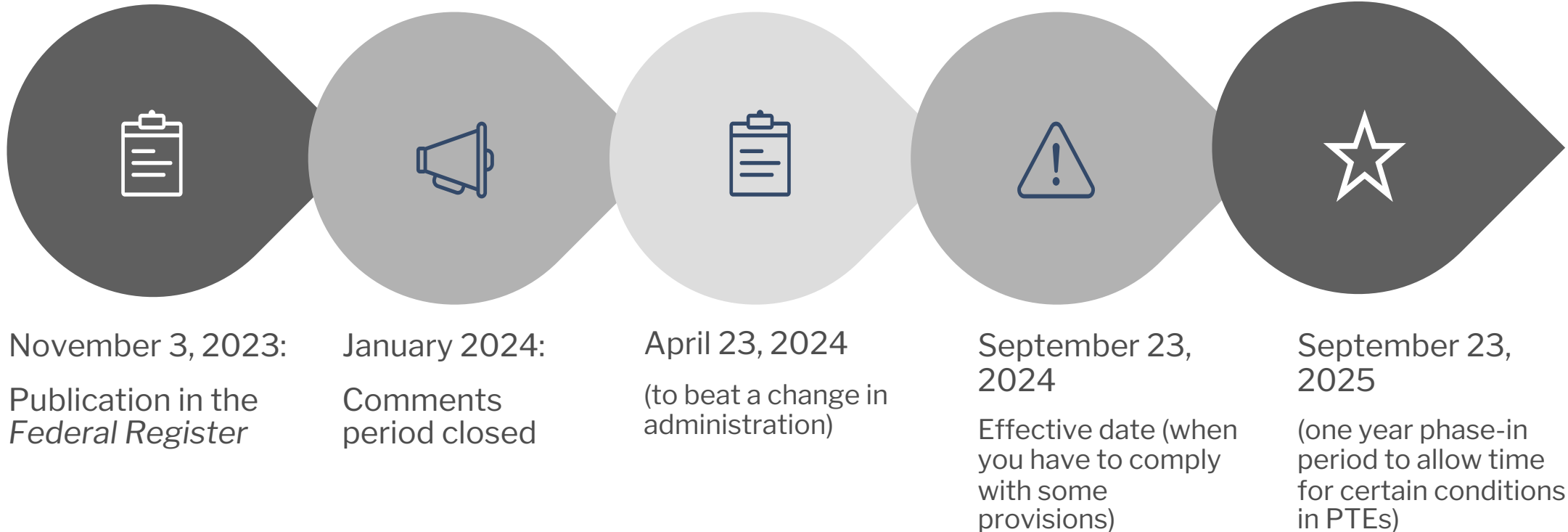
- Tailored for use by independent insurance agents and intended to facilitate their ability to make best interest recommendations under their business model.
- As amended, this PTE provides relief for certain transactions that occur when investment advice fiduciaries and other service providers receive compensation for recommendations that plans or IRAs purchase insurance and fixed rate annuity contracts.
- Unlike PTE 2020-02, the insurance company selling its products through the independent agent is not required to provide a fiduciary acknowledgment and is not treated as a fiduciary merely because it exercised oversight responsibilities over independent agents.
- Instead, the independent insurance agent is required to acknowledge its fiduciary status, and the insurance company is required to exercise supervisory authority over the independent agent with regard to an agent's recommendation of the insurance company's own products.

## **Covered Transactions:**

- The receipt, directly or indirectly, by an Independent Producer of reasonable compensation; and
- the sale of a non-security annuity contract or other insurance product that does not meet the definition of “security” under Federal securities laws.



# Retirement Security Rule: A Potential Timeline



# Action Items for Financial Services Community

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- ✓ Review the final rule (before it becomes effective in September!), understand and ask questions about how it applies to your business
- ✓ Beyond your own business, think about how this rule may impact your clients – both individual wealth management and retirement plan sponsors – and consider if any proactive communication is necessary
- ✓ Assist plan sponsors in preparing for questions from plan participants
- ✓ Assist plan sponsors in determining if any service providers in their ecosystem will be a fiduciary (who were not previously) a fiduciary
- ✓ Develop a strategy for continuing to monitor the coming phases with the rule (e.g., changes in applicability date, FAQs and other interpretive guidance)

# Quick Impacts + Action Items for Investors

- ✓ Understand the advisor's duty of care to you
- ✓ Identify the advisor's fees and ask about internal fees inside of investments or products being sold to you
- ✓ Lookout for written explanation of the recommendations you are receiving
- ✓ Review your advisor's credentials, background and experience



# Contact Us!

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