DOL Proposes Restoring Original Investment Advice Regulation and New Prohibited Transaction Class Exemption for Investment-Advice Fiduciaries

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On June 29, 2020, the Department of Labor (DOL) proposed a series of regulatory actions regarding the definition of "investment advice" under ERISA section 3(21). The proposed actions result from the Fifth Circuit's decision to vacate a 2016 DOL regulation that eliminated the five-part test and set forth a new standard for determining whether an individual was furnishing "investment advice." In addition to restoring the original investment advice regulation and its five-part test, the actions propose a new associated prohibited transaction class exemption and a series of changes to existing prohibited transaction exemptions. The recent proposed actions, if finalized, will:

1. Restore the original "investment advice" regulation and its five-part test for defining an investment-advice fiduciary as well as DOL Interpretive Bulletin 96-1 regarding participant investment education;
2. Create a new prohibited transaction class exemption ("proposed class exemption") that would be available for investment-advice fiduciaries in lieu of the Best Interest Contract Exemption and the Principal Transaction Exemption that the DOL issued in 2016; and
3. Restore Prohibited Transaction Exemptions 75-1, 77-4, 80-83, 83-1, 84-24, and 86-128 that were amended in 2016 to their pre-amendment form.

Impartial Conduct Standards

In order for investment advice fiduciaries to rely on the proposed class exemption, they must satisfy the "impartial conduct standards" set forth in the exemption, which include three components: (1) a best interest standard; (2) a reasonable compensation standard; and (3) a requirement to make no materially misleading statements about recommended investment transactions and other relevant matters.

According to the proposed class exemption, satisfying the "best interest standard" requires prudence and loyalty. The prudence definition is taken verbatim from ERISA. The loyalty prong reflects ERISA's "exclusive benefit rule" that a fiduciary must act solely in the interest of a plan, its participants, and beneficiaries. The DOL states that the best interest standard under the proposed class exemption is aligned with the conduct standards in the SEC's Regulation Best Interest (Reg BI) and the fiduciary duty of registered investment advisers. However, the proposed class exemption's definition of "best interest" expressly refers to "prudence" whereas Reg BI does not.

The proposed class exemption also contains conditions requiring certain disclosures to retirement investors, conflict mitigation procedures, and retrospective compliance review. The disclosure condition requires financial institutions to disclose to retirement investors their status as investment-advice fiduciaries and provide an accurate written description of their services and material conflicts of interest. With regard to conflict mitigation, the proposed class exemption would "require financial institutions to establish, maintain, and enforce policies and procedures prudently designed to ensure that they and their investment professionals comply with the impartial conduct standards in connection with covered fiduciary investment advice." The retrospective compliance review requires financial institutions to conduct annual reviews that are reasonably designed to detect and prevent violations of, and achieve compliance with, the impartial conduct standards.

DOL Views on Rollovers

The preamble to the proposed class exemption also provides the DOL's views regarding rollovers from ERISA-covered plans to IRAs, including when advice regarding a rollover may be covered by the five-part test under the investment advice regulation. In this regard, the DOL states that it does not intend to apply the contrary analysis set forth in DOL Advisory Opinion 2005-23A. In the prior analysis, the DOL stated that merely advising a plan participant to take an otherwise permissible plan distribution, even when that advice is combined with a recommendation as to how the distribution should be invested, does not constitute "investment advice" within the meaning of the five-part test. The preamble also clarifies that the "mutual agreement, arrangement, or understanding" prong of the five-part test is based on the *reasonable* understanding of each of the parties if no mutual agreement, arrangement, or understanding is demonstrated.

Initial Reactions

We are in the process of reviewing the proposals to assess the impact on the industry. It is encouraging that the DOL proposed a somewhat simplified proposed class exemption that the DOL touts as being broader and more flexible. While the best interest standard of the proposed class exemption is not exactly aligned with Reg BI, the DOL was constrained given the language in ERISA.

Written comments and requests for a public hearing on the proposed class exemption must be submitted to the DOL within 30 days of publication in the Federal Register.

For additional information, please contact the author of this article.