Fact Sheet

U.S. Department of Labor
Employee Benefits Security Administration
April 23, 2024

Retirement Security Rule and Amendments to Class Prohibited Transaction Exemptions for Investment Advice Fiduciaries

On April 23, 2024, the U.S. Department of Labor released the Retirement Security Rule defining who is an investment advice fiduciary for purposes of the Employee Retirement Income Security Act (ERISA). The Department also released final amendments to class prohibited transaction exemptions (PTEs) available to investment advice fiduciaries, including PTE 2020-02, "Improving Investment Advice for Workers & Retirees." The rule and amendments to the PTEs generally take effect on September 23, 2024, although there is a one-year transition period after the effective date for certain conditions in the PTEs.

America's families spend their working lives paying into their retirement savings so they can retire with dignity. Responsible financial advice providers can help people meet their savings goals, and they should be paid fairly for this important work. Unfortunately, if financial advice providers do not put their clients' interests first, reduced returns and higher costs can chip away at the savings of America's workers and their families.

The rule and amended PTEs will protect retirement investors by requiring trusted advice providers to follow high standards of care and loyalty when they make investment recommendations. Under the final rulemaking, trusted advisers will have to:

- Meet a professional standard of care when making recommendations (give prudent advice);
- Never put their financial interests ahead of the retirement investor's when making recommendations (give loyal advice);
- Avoid misleading statements about conflicts of interest, fees, and investments;
- Charge no more than what is reasonable for their services; and
- Give the retirement investor basic information about the adviser's conflicts of interest.

Retirement investors should expect no less from trusted investment professionals. The rule and exemptions are carefully designed to honor retirement investors' legitimate expectation of advice that is in their best interest.

Background

ERISA is a federal law governing workplace employee benefit plans, such as pension plans and 401(k) plans, along with other types of retirement savings plans, such as individual retirement accounts (IRAs). The law imposes important requirements on "fiduciaries" of these plans, including those who are fiduciaries because they provide investment advice for a fee.

Most retirement investors rely upon the advice of trusted investment professionals, such as brokers, insurance agents, and registered investment advisers, to invest their retirement savings at some point in their lives. These providers often hold themselves out as expert advisers who are making individualized investment recommendations that reflect the retirement investor's best interests.

When retirement investors look to trusted advisers for investment recommendations, the retirement investors' best interests are, and must always be, the most important consideration. Investment advice fiduciaries of workplace benefit plans must give advice that is prudent and loyal to the plans and their participants and beneficiaries. And investment advice fiduciaries must protect retirement investors from potentially dangerous conflicts of interest by complying with conditions in a prohibited transaction exemption under ERISA that is designed to protect retirement investors' interests.

Because of an outdated ERISA investment advice rule, however, trusted investment professionals are too often not subject to ERISA's fiduciary safeguards. This lack of protection needed to be addressed.

<u>The 1975 rule</u>

The Department's prior rule defining when an investment advice provider is an ERISA fiduciary was adopted in 1975, when the most common type of retirement plan was a defined benefit pension plan. These plans were primarily managed by professional money managers and funded by employers, who shouldered the risk of poor investment performance and shortfalls. IRAs were not commonplace and 401(k)-type plans did not even exist.

In the decades since, 401(k)-type plans and IRAs have become the most common way in which workers save for retirement. In these plans, individual retirement investors, rather than professional money managers, are typically responsible for making important investment decisions regarding their retirement savings, and they, rather than their employers or plan officials, shoulder the risk of loss. This is true even though the range and complexity of investment products have only grown in the decades since 1975.

This nearly 50-year-old rule has not kept up with these important changes in the marketplace. For example, under the 1975 rule, a financial services provider was an investment advice fiduciary only if the advice was provided on a "regular basis" with respect to plan assets and there was "a mutual agreement, arrangement, or understanding" that the advice would serve as "a primary basis for investment decisions."

As a result, advice that was provided on a "one-time" basis, like many recommendations to roll retirement savings out of a workplace retirement plan and into an IRA, was typically not treated as fiduciary advice and therefore was not protected by ERISA's fiduciary safeguards. Yet, one-time advice is often the most important advice the retirement investor will ever receive. For example, few recommendations are likely to be more important than advice to pull a lifetime of savings out of a retirement plan to buy an annuity that is supposed to cover benefits for the rest of the investor's life. Yet, the 1975 rule routinely failed to treat such important recommendations as fiduciary advice that should be both prudent and loyal, no matter the investor's reasonable reliance on the recommendation from a trusted professional purporting to act in their best interest.

The new rule and exemptions close the loopholes that defeat legitimate investor expectations by holding trusted advisers to a fiduciary standard. When an individualized recommendation comes from an investment professional holding themselves out as someone who is acting in the investor's best interest, it is only right that the advice meet a fiduciary standard.

Retirement Security Final Rule – Definition of an Investment Advice Fiduciary

The Retirement Security Rule defining an investment advice fiduciary will better protect retirement investors who make decisions about their retirement savings based on advice they receive. It focuses on the nature of the relationship between the advice provider and the investor, and it extends to the types of interactions retirement investors commonly have with trusted advisers in the financial services marketplace.

The Department's final rule provides that a financial services provider will be an investment advice fiduciary under federal pension law if:

- 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.[1]

[1] In the specific words of the rule, the investment professional meets this test with respect to a compensated recommendation if the provider "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[.]"

One-time advice

The regulation closes the loophole for one-time advice. A financial services provider will be a fiduciary with respect to a recommendation to roll over assets from a workplace retirement plan to an IRA if every element of the fiduciary definition is satisfied.

Amounts held in workplace retirement accounts often represent the largest savings an individual has, and financial services providers often have a strong economic incentive to recommend that investors roll money into one of their institution's IRAs or annuities. Applying the ERISA fiduciary standard in these transactions will provide significant protections for retirement investors.

Other regulatory developments

The Department's Retirement Security Rule comes as other regulators have recently updated rules that apply to financial professionals providing investment advice or recommendations. These actions reflect the understanding that:

- broker-dealers and insurance agents, as well as investment advisers, commonly provide advice to their customers for which they are paid as a regular part of their business;
- investors rely upon these recommendations; and
- regulatory protections are important to ensure that the advice is in the investor's best interest.

In light of these market and regulatory developments, the Department believes it is important for it, too, to update its definition of an investment advice fiduciary.

The SEC

In 2019, the Securities and Exchange Commission (SEC) issued a regulation titled "Regulation Best Interest," which established an enhanced best interest standard applicable to broker-dealers when recommending any securities transaction or investment strategy involving securities to retail customers.

The SEC also issued guidance in 2019 reaffirming and clarifying investment advisers' fiduciary duties under the Investment Advisers Act of 1940.

The standards and requirements imposed by the Department on fiduciary recommendations to retirement investors are aligned with those imposed by the SEC under Regulation Best Interest and the Investment Adviser's Act. For that reason, investment professionals and financial institutions that are already complying with the SEC's standards should readily be able to adapt to the requirements of the new rule and exemptions issued by the Department today.

The Department's rulemaking, however, broadly applies to all fiduciary recommendations to retirement investors, even if those recommendations fall outside the scope of the SEC's authority

or Regulation Best Interest's coverage. In this way, the new rule and exemptions ensure that retirement investors get careful and loyal advice from trusted advisers, no matter the type of investment product.

State Insurance Laws

More than 40 states have adopted updated conduct standards for insurance agents and insurance companies recommending annuities based on a model regulation that the National Association of Insurance Commissioners (NAIC) updated in 2020. This reflects a recognition of the need for more protective standards for investment advice in the annuity marketplace.

The Department's rule and exemptions, however, impose broader and more stringent standards of conduct and conflict mitigation than the NAIC model regulation, as applied to retirement investments. These higher standards appropriately reflect ERISA's focus on constraining conflicts of interest, the fundamental importance of tax-preferred retirement savings, and the need for a uniform standard applicable to all retirement investors. Retirement investors should receive advice from trusted advisers that meets appropriate standards of care, loyalty, and conflict-mitigation, regardless of who makes the recommendation.

The State of New York did not adopt the updated NAIC model regulation but rather implements an insurance regulation that aligns more closely with the Department's rule and exemptions. Under New York's law, insurance producers' recommendations "must reflect the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use under the circumstances then prevailing." Additionally, the law provides that "only the interests of the consumer shall be considered in making the recommendation." Thus, insurance producers must act prudently in making a recommendation and must not allow compensation or other incentives to influence their recommendations.

Comparison to the Department of Labor 2016 fiduciary rule

In 2016, the Department finalized an updated investment advice fiduciary definition, granted new prohibited transaction exemptions including the Best Interest Contract Exemption, and amended some pre-existing exemptions. However, in 2018, the Fifth Circuit Court of Appeals struck down the 2016 rulemaking as too broad and as exceeding the Department's authority.

The Retirement Security Rule fiduciary definition is more narrowly tailored than the 2016 fiduciary rule, which applied to virtually all paid recommendations to retirement investors. In addition, unlike the contract and warranty requirements included as part of the 2016 rulemaking, the amended exemptions do not impose any new contract or warranty requirements, as rejected by the Fifth Circuit.

Some important differences between the 2016 rulemaking and this rulemaking include the following:

- This final rulemaking limits fiduciary status to recommendations made by persons who effectively hold themselves out as occupying a position of trust and confidence with respect to the retirement investor, as described above.

- The final rule and exemptions, unlike the 2016 rulemaking, contain no contract or warranty requirements. The sole remedies for non-compliance are precisely those set forth in ERISA and the Code. Thus, in the context of advice to IRAs, the remedies include only the imposition of excise taxes under the Code.

- The broad advice exemption, PTE 2020-02, as finalized, specifically provides an exemption from the prohibited transaction rules for pure robo-advice relationships, unlike the 2016 rulemaking.

- Unlike the 2016 rulemaking, PTE 84-24 has been specially tailored for independent insurance agents and does not require insurance companies to assume fiduciary status with respect to these agents, an important concern of insurers with respect to the 2016 rulemaking.

- Neither PTE 2020-02 nor PTE 84-24, as amended, require financial institutions to disclose all their compensation arrangements with third parties on a publicly available website, as was required by the 2016 rulemaking.

The final rule recognizes the trust and confidence that retirement investors reasonably place in investment professionals making individualized investment recommendations in their interests. It closes loopholes in the 1975 rule that defeated, rather than honored, those legitimate investor expectations, and promotes a marketplace in which trusted advisers compete on a level playing field based on a uniform – and uniformly protective – best interest standard.

Amendments to the prohibited transaction exemptions

The Department has finalized amendments to several existing exemptions to ensure all retirement investors receive the same quality investment advice, regardless of the product or service they receive.

Under the final amendments, there are two administrative exemptions available for the management of conflicts of interest with respect to advice.

- PTE 2020-02 is broadly available for advice with respect to the wide universe of investments recommended to retirement investors.
- PTE 84-24 is tailored for use by independent insurance agents and is intended to facilitate their ability to make best interest recommendations under their business model.

Both exemptions require that investment recommendations adhere to Impartial Conduct Standards. Those standards state:

- Advice must meet obligations of care and loyalty.
    - Under the care obligation, the advice must meet a professional standard of care as specified in the exemptions.
    - Under the loyalty obligation, advice providers may not place their own interests ahead of the interests of the retirement investor.
- The investment professional and firm must charge no more than reasonable compensation and comply with applicable federal securities laws regarding "best execution."
- The advice must be free from misleading statements about investment transactions and other relevant matters.

PTE 2020-02

PTE 2020-02 allows investment advice fiduciaries to receive compensation that would otherwise be prohibited by law, as long as the fiduciaries comply with the exemption's conditions. The exemption conditions, which include the care and loyalty obligations, emphasize mitigating conflicts of interest and ensuring that retirement investors receive prudent and loyal advice.

The Department's amendment to PTE 2020-02 makes clarifying changes that build on the existing exemption conditions to provide more certainty for fiduciary investment advice providers and more protection for retirement investors.

PTE 84-24

PTE 84-24 is tailored to the special challenges of overseeing investment recommendations by independent insurance agents who recommend annuities issued by more than one insurance company.

Under the amendment, a new section is added to PTE 84-24 to provide relief for independent insurance agents receiving compensation that would otherwise be prohibited for investment advice transactions, subject to conditions like those in PTE 2020-02.

However, 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.

The remaining provisions of PTE 84-24 remain available for transactions that don't involve advice, with minor language changes.

Amendments to PTEs 75-1, 77-4, 80-83, 83-1, and 86-128

The Department also finalized amendments to several existing administrative exemptions that provide relief for certain transactions. The amendments remove fiduciary investment advice transactions from the covered transactions in each exemption and make other administrative changes.

As a result of these amendments, all investment advice fiduciaries will be held to the same conduct standards in administrative exemptions, because they will have to rely on PTE 2020-02 or PTE 84-24 to receive compensation that otherwise would be prohibited.