Fact Sheet

U.S. Department of Labor
Employee Benefits Security Administration
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Retirement Security Proposed Rule and Proposed Amendments to Class Prohibited Transaction Exemptions for Investment Advice Fiduciaries

On October 31, 2023, the U.S. Department of Labor released a proposed rule defining who is an investment advice fiduciary for purposes of the Employee Retirement Income Security Act (ERISA). The Department also released proposed amendments to class prohibited transaction exemptions (PTEs) available to investment advice fiduciaries, including PTE 2020-02, "Improving Investment Advice for Workers & Retirees."

America's families spend their working lives paying into their retirement savings so they can rely on them to retire with dignity. Responsible advice providers can help people meet their savings goals and retire with dignity and they should be paid fairly for this important work. Unfortunately, if financial advice providers do not put their clients' interests first, the reduced returns or higher costs that can result are hidden junk fees chipping away at the savings of many Americans. The rule would protect retirement investors by requiring trusted advice providers to adhere to high standards of care and loyalty when they make investment recommendations, and to avoid recommendations that favor their own financial interests at the expense of retirement savers.

In line with EBSA's mission of ensuring the security of the workplace-related benefits of America's workers and their families, these critically important proposals protect retirement investors by requiring firms and people who provide retirement investment advice for a fee or other compensation to adhere to high standards of care and loyalty, and generally avoid engaging in transactions where they have unchecked conflicts of interest that could lead them to favor their own interests at the retirement investor's expense.

That means that if a retirement investor receives investment advice from a firm or someone and compensates that person for providing that advice, the retirement investor has the right to expect that the person providing the advice is going to act in the investor's interest, and not in the advice provider's own interest.

In addition, investment professionals deserve to be paid for their advice and should be able to compete for business on a level playing field, not an unfair and unbalanced field where advice providers are held to different standards depending on what products they recommend.

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.

Investment advice fiduciaries must avoid conflicts of interest in their interactions with the plans unless they comply with conditions in a prohibited transaction exemption. In addition, investment advice fiduciaries of workplace plans must give advice that is prudent and loyal to the plans and their participants and beneficiaries.

The Department's current rule with respect to investment advice has not kept up with important changes in the marketplace. In 1975, when the rule was adopted, the most common type of retirement plan was a defined benefit pension plan, which was primarily managed by professional money managers and funded by employers, who shouldered the risk of poor investment performance.

In the decades following publication of the current rule, 401(k)-type plans with individual accounts and IRAs have become the predominant way in which workers save for retirement. In 401(k) plans and IRAs, individual retirement investors are typically responsible for making important investment decisions, and they, rather than their employers or plan officials, shoulder the risk of poor investment performance or inadequate savings. Because most retirement investors are not investment experts, they rely upon the advice of investment professionals, such as brokers, insurance agents, and registered investment advisers on how to manage their retirement savings at some point in their lives. Too often, however, these investment professionals are not subject to ERISA's fiduciary protections, including ERISA's key obligations requiring fiduciaries to give advice that meets an expert standard of care (the duty of prudence), puts the customer first (the duty of loyalty), and avoids dangerous conflicts of interest (the prohibited transaction rules).

This is true, even though in today's marketplace, these financial service providers commonly portray themselves as expert advisers who are making individualized recommendations that reflect the best interests of the retirement investor. The best interests of the individual retirement investor are, and must always be, paramount. Despite holding themselves out this way, however, the advice providers often are not treated as ERISA fiduciaries under the technical requirements of the 1975 rule, and may not be subject to the same duties to a person investing for retirement, even when the advice provider is giving such important advice as whether to liquidate a lifetime of retirement savings held in an ERISA-protected plan and transfer those savings to an annuity or other retirement investment and whether and where to roll over their retirement savings.

Moreover, often these advice providers have significant conflicts of interest with respect to the advice, which has the potential to bias their recommendations. Yet, under the 1975 rule, they can readily evade fiduciary status and the obligation to act as ERISA fiduciaries who must render advice that is prudent, loyal, and undistorted by dangerous conflicts of interest.

The Department is proposing the new definition of an investment advice fiduciary to better protect retirement investors who make decisions about their retirement savings based on advice they receive. The Department is also proposing amendments to prohibited transaction exemptions available to investment advice fiduciaries so that fiduciaries who use them must follow consistent and protective compliance requirements, including an obligation to act in retirement investors' best interest.

Retirement Security Proposed Rule – Definition of a Fiduciary

The Department is proposing that a financial services provider would be an investment advice fiduciary under federal pension law if:

- the provider provides investment advice or makes an investment recommendation to a retirement investor,
- the advice or recommendation is provided for a fee or other compensation, and
- the financial services provider makes the recommendation in the context of a professional relationship in which an investor would reasonably expect to receive sound investment recommendations that are in their best interest:
    - the provider has discretion over investment decisions for the retirement investor;
    - The provider makes investment recommendations to investors on a regular basis as part of their business, and the recommendation is provided under circumstances indicating that the recommendation is based on the particular needs or individual circumstances of the retirement investor and may be relied upon by the retirement investor as a basis for investment decisions that are in the retirement investor's best interest; or
    - the provider states that they are acting as a fiduciary when making investment recommendations.

The Department believes that in each of these contexts, the retirement investor can and should reasonably place trust and confidence in the financial services provider, and it is appropriate for the provider to be held to a fiduciary standard.

This proposed fiduciary definition would apply to recommendations to roll over assets from a workplace retirement plan to an IRA if every element of the proposed 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 institutions' IRAs or annuities. Applying the ERISA fiduciary standard in these transactions will provide significant protections for retirement investors.

Improvements over the 1975 rule

The Department has found that the 1975 rule defining a fiduciary doesn't meet today's retirement investors' expectations. Under the nearly 50-year-old rule, a financial services provider is an investment advice fiduciary only if, among other things, the advice is provided on a "regular basis" and there is a "a mutual agreement, arrangement, or understanding" that the advice will serve as "a primary basis for investment decisions."

As a result, for example, advice that is provided on a one-time basis, such as many rollover recommendations, is typically not treated as fiduciary advice. Yet, one-time advice is often the most important advice the retirement investor will ever receive. For example, such advice includes a recommendation to liquidate a lifetime of savings in an ERISA-covered plan and purchase an annuity, or advice to a terminating defined benefit pension plan on the purchase of a group annuity contract to cover all the benefits promised to all the plan's participants for the rest of their lives, or advice on an illiquid real estate investment involving hundreds of millions of plan assets or most of a worker's savings. In each of these cases, the advice provider would likely not be treated as a fiduciary under the 1975 rule, even when they hold themselves out as providing expert and individualized advice based on the retirement investor's best interest and even if the investor was wholly dependent on their expertise in making the most important investment decision they would ever make.

In such cases, the technical requirements of the 1975 rule work to defeat, rather than honor, legitimate expectations that the investor can place trust and confidence in the advice provider and their recommendations. Similarly, some investment advice providers include boilerplate disclaimers in their marketing materials to avoid a conclusion that there is a mutual agreement that the advice will serve as a primary basis for investment decisions. These disclaimers may conflict with the other communications and interactions between the advice providers and the retirement investor, all of which are aimed at reassuring the investor that they can rely upon the investment recommendation as individualized professional advice based on the investor's best interest.

The new proposed fiduciary definition does not include these limitations, which can defeat reasonable investor expectations, but rather focuses directly on the nature of the relationship between the advice provider and the investor. It is intended to extend to the type of interactions retirement investors commonly have in the financial services marketplace with trusted advisers. The proposed definition is intended to match what retirement investors reasonably can and should expect from trusted advice providers.

Other regulatory developments

The Department's proposal 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; that investors rely upon these recommendations; and that 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 that it is important for it, too, to update its definition of an investment advice fiduciary.

<u>The SEC</u>

In 2019, the Securities and Exchange Commission issued a regulation titled "Regulation Best Interest," which established a 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 the fiduciary duties of investment advisers under the Investment Advisers Act.

National Association of Insurance Commissioners

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 updated in 2020.

Comparison to the Department of Labor 2016 fiduciary rule

In 2016, the Department finalized an updated investment advice fiduciary definition, granted new PTEs including the Best Interest Contract Exemption, and amended some pre-existing PTEs. However, in 2018, a court struck down this rulemaking as too broad, and as exceeding the Department's authority by requiring advice providers to execute enforceable contracts and make specified warranties to investors, especially in the IRA market.

The new proposed investment advice fiduciary definition is more narrowly tailored than the 2016 fiduciary rule, which applied to virtually all paid recommendations to retirement investors. In addition, the proposed amendments to the Department's exemptions do not impose any new contract or warranty requirements.

As noted above, the focus of the regulatory package is on honoring legitimate investor expectations about the nature of their relationship, and ensuring in those cases, that the advice adheres to stringent fiduciary standards. The proposal states that investment advice providers are fiduciaries only if recommendations are made in certain specified contexts, each of which describes circumstances in which the retirement investor can reasonably place their trust and confidence in the advice provider.

Proposed Amendments to the Prohibited Transaction Exemptions

The Department is proposing 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 proposal, the Department would make two exemptions available for the management of conflicts of interest with respect to advice. One exemption (PTE 2020-02) would be broadly available for advice with respect to the wide universe of investments recommended to retirement investors. A second exemption (PTE 84-24) would be tailored for use by independent insurance agents and is intended to facilitate their ability to make best interest recommendations under their business model.

Fundamental to both exemptions is the requirement that investment recommendations adhere to Impartial Conduct Standards, which require:

- Advice that is in the "best interest" of the retirement investor. This best interest standard has two chief components: prudence and loyalty:

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

<u>PTE 2020-02</u>

PTE 2020-02 allows investment advice fiduciaries to receive compensation for advice that would otherwise be prohibited by law, as long as the fiduciaries comply with the exemption's conditions, including providing advice in investors' best interest. The exemption conditions emphasize mitigating conflicts of interest and ensuring that retirement investors receive advice that is prudent and loyal.

The Department is proposing to maintain the core conditions in PTE 2020-02 that provide fundamental investor protections. The proposed amendment would make clarifying changes that build on the existing exemption conditions to provide more certainty for fiduciary investment advice providers and more protection for retirement investors.

<u>PTE 84-24</u>

Currently, PTE 84-24 allows fiduciaries to receive compensation that would otherwise be prohibited when plans and IRAs enter into certain insurance and mutual fund transactions, as well as certain related transactions. The proposed amendment would limit coverage for advice to independent insurance agents and make minor language changes. The exemption is tailored to the special challenges posed for overseeing investment recommendations by independent insurance agents who recommend annuities issued by more than one insurance company.

Under the proposed amendment, a new section would be 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 similar to those in PTE 2020-02.

However, unlike PTE 2020-02, the insurance company selling its products through the independent agent would not be required to provide a fiduciary acknowledgment and would not be treated as a fiduciary merely because it exercised oversight responsibilities over independent agents. Instead, the independent insurance agent would be required to acknowledge its fiduciary status, and the insurance company would be required to exercise supervisory authority over the independent agent with regard to an agent's recommendation of the insurance company's own products.

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

The Department is proposing amendments to several existing PTEs that currently provide relief for certain transactions, including in connection with investment advice. The proposed amendments would remove fiduciary investment advice transactions from the covered transactions in each exemption and make certain other administrative changes.

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