

Employee Benefits Update

February 2021

DOL Prohibited Transaction Exemption for Participant Investment Advice Passes Review

The Department of Labor (DOL) announced that the “Improving Investment Advice for Workers and Retirees” prohibited transaction class exemption (Exemption) has passed the new administration’s review and has been allowed to go into effect on February 16. The Exemption provides financial institutions and their investment professionals with broad prohibited transaction relief, allowing them to receive otherwise impermissible “self-dealing” types of compensation in connection with the provision of fiduciary investment advice to plan participants. The announcement also advises that related guidance will be forthcoming.

Background

The Employee Retirement Income Security Act of 1974, as amended (ERISA), imposes requirements on plan fiduciaries, including a prohibition on using their authority as fiduciaries to cause themselves or their affiliates or related parties to receive, directly or indirectly, additional compensation from a plan. In 2016 the DOL issued a final rule that would have expanded the scope of who is considered a fiduciary by reason of providing investment advice. In conjunction with the rule, it also adopted a broad, principles-based prohibited transaction exemption known as the Best Interest Contract Exemption (BICE) to address self-dealing types of compensation. However, the final fiduciary rule and the BICE were vacated by the U.S. Court of Appeals for the Fifth Circuit in June 2018.

FAB 2018-02

Recognizing that many financial institutions had already devoted significant resources to comply with the BICE, the

DOL issued Field Assistance Bulletin (FAB) 2018-02, which provided enforcement relief to those who attempted in good faith to satisfy the BICE’s Impartial Conduct Standards, which consisted of meeting the best interest standard, receiving no more than reasonable compensation for their services, and refraining from making materially misleading statements to their investor clients. The FAB relief will continue to be available until December 18, 2021.

New Guidance

On July 7, 2020, the DOL formally reinstated the historical five-part test for determining when an investment advice provider is a fiduciary under ERISA, but proposed a [dramatic, expanded reinterpretation of the five-part test](#). In conjunction with the proposed expanded interpretation, the DOL proposed a new class exemption to address the receipt of impermissible self-dealing types of compensation by plan investment advice providers who are ERISA fiduciaries. Following hearings and review of comments submitted, the DOL published the Exemption.

The Exemption

The Exemption largely follows the structure of the proposed exemption with some notable modifications. It generally will apply to registered investment advisers, broker-dealers, banks, insurance companies (collectively, “Financial Institutions”) and their employees, agents, independent contractors and representatives who are investment advice fiduciaries (“Investment Professionals”) and will allow them to receive otherwise prohibited self-dealing types of compensation for providing investment advice to ERISA plan participants, including advice regarding rollovers. The

Exemption also applies to investment advice with respect to Individual Retirement Accounts (IRAs). The Exemption is not available to robo-advice that does not involve interaction with an investment professional or to investment professionals who act in a fiduciary capacity other than as an investment advice fiduciary, such as when an investment professional is engaged as an investment manager.

To rely on the Exemption, a Financial Institution must provide advice in accordance with the Impartial Conduct Standards, make certain disclosures to retirement investors, adopt policies and procedures (e.g., to mitigate material conflicts), engage in an annual, retrospective compliance review and certification process, and maintain records thereof for a period of six years. Investment Professionals must also meet the Impartial Conduct Standards.

The Impartial Conduct Standards

The Exemption requires investment advice to be provided in accordance with the Impartial Conduct Standards which have three components: the Best Interest of the Retirement Investor Standard (“Best Interest Standard”), the receipt of reasonable compensation and best execution standard, and a requirement to make no materially misleading statements about investment transactions or other relevant matters.

The Best Interest Standard requires that investment advice be, at the time provided, in the best interest of the retirement investor. Investment advice meets the Best Interest Standard if it reflects the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances and needs of the retirement investor. The Best Interest Standard also requires that the financial or other interests of the Financial Institution, investment professional, an affiliate or related entity not be placed ahead of the interests of the retirement investor.

The reasonable compensation standard adopts the reasonable compensation standard under Section 408(b)(2) of ERISA and Section 4975(d)(2) of the Internal Revenue Code of 1986, as amended. The reasonable compensation

standard requires that compensation not be excessive, as measured by the market value of the services, rights and benefits an investment professional delivers to the investor. The reasonableness of fees generally will depend on the facts and circumstances present at the time of the recommendation and includes analysis of the market price of the services, the amount of the underlying assets, the scope of the monitoring and the complexity of the product. The best execution standard requires the investment advice fiduciary to seek to obtain the best execution of the investment transaction reasonably available under the circumstances.

The final provision of the Impartial Conduct Standards requires that investment professionals not make any materially misleading statements, measured at the time such statements are made. Relevant matters include statements regarding fees and compensation, material conflicts of interest and any other factor that could be reasonably expected to affect an investment decision.

Investor Disclosures

In addition to meeting the Impartial Conduct Standards, the Exemption also requires an investment fiduciary to disclose to the retirement investor its status as an investment advice fiduciary under Title I of ERISA and the Code, as applicable, and the DOL offered model language in the preamble for this purpose. Investment fiduciaries must also provide an accurate description of their services and material conflicts of interest. Additionally, when rollover advice is given, the Financial Institution must provide documentation of the specific reasons for the rollover recommendation and why the recommendation meets the Best Interest Standard.

The DOL noted in the preamble to the Exemption that it does not intend for the Exemption to create a new private right of action for the retirement investor, nor does it require Financial Institutions to make enforceable contractual commitments. Note, however, that Section 502(a) of ERISA provides a cause of action for fiduciary breaches relating to ERISA plans.

Policies and Procedures

Financial Institutions must establish, maintain and enforce policies and procedures prudently designed to ensure that they and their Investment Professionals comply with the Impartial Conduct Standards. The policies and procedures must mitigate conflicts of interest to the extent that a reasonable person reviewing the policies and procedures and incentive practices, as a whole, would conclude that they do not create an incentive for a Financial Institution or Investment Professional to place their interests ahead of the interests of retirement investors. The policies and procedures must also provide for the documentation of the specific reasons for any rollover recommendation.

The preamble to the Exemption notes that the prudence of certain policies and procedures will depend in large part on the circumstances and business model of the Financial Institution and the Investment Professional. For example, the DOL notes that Financial Institutions that continue to offer transaction-based compensation would need to focus on both financial incentives to its Investment Professionals and supervisory oversight of investment advice to meet the applicable standards.

Retrospective Compliance Review

Financial Institutions must conduct an annual review that is reasonably designed to assist them in detecting and preventing violations of, and achieving compliance with, the Impartial Conduct Standards and policies and procedures governing compliance with the class exemption. The methodology and results of the review must be reduced to writing and certified by a senior executive officer (i.e., the chief compliance officer, chief executive officer, president, chief financial officer or one of the three most senior officers of the Financial Institution). This is a departure from the proposed Exemption, which required certification by the chief executive officer.

The review, report and certification must be completed no more than six months after the end of the annual period to which they relate and must be retained for a period of six years. The Financial Institution generally must provide the report, certification and supporting data available to the DOL within 10 days of request.

Self-Correction

The Exemption also provides for self-correction of certain violations that would otherwise result in a loss of reliance on the Exemption. A violation will not result in a loss of reliance on the Exemption if:

- either the violation did not result in investment losses to the retirement investor or the Financial Institution made the retirement investor whole for any resulting losses,
- the Financial Institution corrects the violation and notifies the DOL via e-mail within 30 days of correction,
- the correction occurs no later than 90 days after the Financial Institution learned of the violation or reasonably should have learned of the violation, and
- the Financial Institution notifies the person responsible for conducting the retrospective review during the applicable review cycle and the violation and correction are specifically set forth in the written report of the retrospective compliance review.

Loss of Eligibility

Financial Institutions and Investment Professionals may lose access to the Exemption for a period of 10 years for certain criminal convictions in connection with the provision of investment advice or for systemic or intentional violation of the Exemption's conditions, including providing materially misleading information in relation to conduct under the Exemption. Disqualified organizations and individuals could still rely on other existing exemptions or seek an individual exemption from the DOL. Disqualified Financial Institutions will have a winding-down period to allow for orderly transition away from reliance on the Exemption.

Principal Transactions

The Exemption also provides relief for certain principal transactions, i.e., transactions in which a Financial Institution sells or purchases certain securities and other investments from their own inventories to or from ERISA plans or IRAs.

Effective Date and Discussion

Although the Exemption is now effective, it is unlikely that Financial Institutions and their Investment Professionals will rely on it until the relief under FAB 2018-02 – which is less onerous – sunsets on December 18, 2021.

Based on the DOL's revised interpretation of the five-part test for identifying investment advice fiduciaries, it is more likely that plan service providers who provide rollover recommendations will need to rely on the Exemption in the future. Financial Institutions, Investment Professionals and ERISA plan fiduciaries should reexamine if and how they or their service providers interact with plan participants in connection with rollovers and determine what, if any, changes may be necessary to comply with the DOL's interpretation and whether relief, under the Exemption or otherwise, may be necessary going forward.

FOR MORE INFORMATION

For more information, please contact:

Edward C. Redder

614.469.3258

Edward.Redder@ThompsonHine.com

Brian L. Gaj

216.566.5931

Brian.Gaj@ThompsonHine.com

or any member of our [Employee Benefits & Executive Compensation](#) group.

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