

Employee Benefits Update

February 2021

What's Old Is New Again: DOL Reinterprets Five-Part Investment Advice Test

The Department of Labor (DOL) dramatically shifted its interpretation of when an investment advice provider is a fiduciary under the Employee Retirement Income Security Act of 1974, as amended, (ERISA) in the December 18, 2020 preamble to the “Improving Investment Advice for Workers and Retirees” prohibited transaction class exemption (Exemption). Specifically, the DOL **disavowed** its previous interpretation and took the new position that advice regarding the rollover of ERISA plan assets to an individual retirement account (IRA) would be fiduciary investment advice under ERISA if the remaining requirements of the existing five-part test are satisfied.

Note that the Exemption, when effective, will make available broad prohibited transaction relief to allow ERISA and IRA fiduciary investment advice providers to receive otherwise impermissible forms of compensation if certain protective requirements are met.

Background

The Five-Part Test

An individual is an investment advice fiduciary under ERISA to the extent he or she renders investment advice for a fee or other compensation, whether direct or indirect, with respect to assets of an ERISA plan. Under the DOL’s five-part test (originally issued in 1975), for advice to constitute ERISA fiduciary “investment advice,” an individual who is not otherwise a fiduciary under an ERISA plan must:

- render advice to the ERISA plan 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;

- on a regular basis;
- pursuant to a mutual agreement, arrangement, or understanding with the ERISA plan or ERISA plan fiduciary;
- for which the advice will serve as a primary basis for investment decisions with respect to the ERISA plan; and
- for which the advice will be individualized based on the particular needs of the ERISA plan.

Whether all these requirements have been met is based on all the surrounding facts and circumstances.

The DOL issued a final rule to supersede the five-part test in 2016, but the Fifth Circuit Court of Appeals vacated the final rule, effectively reinstating the five-part test. In July 2020, the DOL adopted a technical amendment to the regulation that formally reinstated the five-part test, and in the notice of the proposed Exemption, the DOL describes its proposed interpretation of the five-part test. The preamble to the final Exemption further addresses the DOL’s interpretation of the five-part test.

Preamble to the Final Exemption

Rollover Advice for an ERISA Plan Is ERISA Fiduciary Investment Advice

The preamble to the Exemption disavows the previous interpretation of ERISA as expressed in DOL Advisory Opinion 2005-23A (Deseret Letter) that a recommendation to roll assets out of an ERISA plan is not fiduciary investment advice with respect to the ERISA plan. As a result, an investment adviser making a rollover recommendation that otherwise satisfies the requirements of the five-part test would be a

fiduciary under ERISA and must comply with ERISA's fiduciary duties and avoid prohibited transactions under ERISA and the Code, as applicable.

The DOL's new interpretation also differs from that taken under the vacated final fiduciary rule, which generally would have treated all rollover recommendations as investment advice. Instead, the DOL acknowledges that some rollover recommendations may not constitute investment advice, such as when:

- parties enter into a one-time sales transaction in which there is no ongoing investment advice relationship or expectation of an ongoing investment advice relationship, or
- an insurance agent recommends the purchase of an annuity without the provision of subsequent ongoing advice.

The Regular Basis Prong

Under the five-part test, for advice to be considered fiduciary investment advice under ERISA, it must be provided on a regular basis. The DOL notes that one-time advice or sporadic advice generally would not satisfy the regular basis requirement. However, advice to roll over ERISA plan assets often occurs as part of an ongoing relationship or with an expectation of an ongoing relationship. In those circumstances, according to the DOL's new interpretation, the regular basis prong would be satisfied.

Whether the regular basis prong is satisfied is determined at the time of the recommendation. If, at the time of the recommendation, there is an expectation of an ongoing advisory relationship, the entirety of the relationship – including the first instance of advice – is investment advice. In contrast, a prior, isolated instance of advice would not be considered investment advice if the facts and circumstances show that the interaction did not mark the beginning of an ongoing advice relationship.

Mutual Understanding that Advice Will Serve as a Primary Basis for Investment Decisions

In determining whether a mutual understanding between the parties exists under the five-part test, the DOL will consider the facts and circumstances. Statements that

advice is provided pursuant to a best interest or other standard will typically involve a reasonable understanding of the parties of a mutual agreement or arrangement. While written statements disclaiming a mutual understanding or precluding reliance will be considered in determining whether a mutual understanding exists, such statements are not determinative (especially if the adviser's marketing materials hold themselves out as providing best interest advice). If an adviser wishes to avoid ERISA fiduciary status, it may contractually disclaim any of the five parts and act accordingly, including clearly disclosing the nature of its relationship to the investor.

The DOL rejected comments suggesting that the primary basis prong can only be satisfied by a showing that the advice was the "single most important determinative factor" in the decision. In the DOL's view, this interpretation is inconsistent with the regulation's requirement that the advice be "a" primary basis rather than "the" primary basis. Instead, if the parties reasonably understand that the advice is important to the investor and could determine the outcome of the investor's decision, the primary basis prong is satisfied.

"Hire Me" Communications

Addressing commenters' concerns regarding marketing efforts, the DOL noted that absent an accompanying investment recommendation, introductory hire-me communications and marketing generally will not be investment advice because they would not satisfy the five-part test.

Non-Enforcement Policy

In response to commenters' concerns that the DOL's changed interpretation could subject advisers to liability for past rollover recommendations that would not have been considered investment advice under the Deseret Letter, the DOL announced that it will not pursue claims for breach of fiduciary duty or prohibited transactions against any party for the period between 2005 and February 16, 2021 (the Exemption's effective date) based on a rollover recommendation that would not have been considered fiduciary in nature under the Deseret Letter. Further, the DOL indicated that FAB 2018-02, which provided transition

relief for those who worked in good faith to comply with the final fiduciary rule's Impartial Conduct Standards, would remain available through December 20, 2021.

Effective Date and Discussion

The DOL's interpretation of the five-part test was effective upon publication, while the Exemption is effective on February 16, 2021. With the change in administrations, there remains a distinct possibility that the Exemption may be delayed or modified. This does not, however, alter the DOL's current interpretation. As a result, plan fiduciaries and service providers should reexamine their practices in connection with rollover recommendations to determine whether they result in the provision of ERISA fiduciary investment advice. If so, reliance on the new Exemption may be required.

FOR MORE INFORMATION

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