

Employee Benefits Update

May 2024

U.S. DOL Finalizes Major Changes to its Fiduciary Investment Advice Rule

The following groups, among others, *could* be impacted by the Final Rule and related class prohibited transaction exemptions (PTEs or Exemptions) amendments:

- Pension consultants
- Robo-advisors
- Insurance agents and brokers
- Investment company principal underwriters
- Retirement plan fiduciaries
- Insurance companies
- Registered investment advisors
- Banks and credit unions
- Investment professionals
- Financial advisors

The Final Rule and related PTE amendments change many of the rules regarding these groups' interactions with plans, plan participants and beneficiaries, IRA owners, and the like, including subjecting people who were not previously considered investment advice fiduciaries to fiduciary standards under ERISA.

On April 25, 2024, the U.S. Department of Labor (DOL) published its final "Retirement Security Rule" (the Final Rule) (89 FR 32122) that amends the existing rule defining when a person is an investment advice fiduciary under the Employee Retirement Income Security Act of 1974, as amended (ERISA), and the Internal Revenue Code of 1986, as amended (the Code). The DOL simultaneously published amendments to various Exemptions intended to narrow and harmonize the exemptions available to address conflicts of interest with respect to investment advice.

As discussed in this bulletin, the Final Rule and amendments to Exemptions significantly expand who may be considered an investment advice fiduciary under ERISA and the Code

and can impose new and expanded requirements on investment firms and professionals that rely on Exemptions in their work with retirement investors. While the Final Rule was anticipated to be similar to the proposed rule and Exemption amendments issued on October 31, 2023, the DOL made adjustments to the proposed rules based on comments from stakeholders. The focus of this bulletin is the Final Rule; the amended Exemptions will be addressed in a separate bulletin.

Background

ERISA imposes significant fiduciary obligations on individuals responsible for operating and managing a wide range of workplace employee benefit plans, including retirement plans (*e.g.*, 401(k) plans and tax-qualified defined benefit plans). Among other obligations, ERISA fiduciaries must act solely in the interest of plan participants and beneficiaries for the exclusive purpose of providing benefits to them and paying reasonable plan expenses, act in accordance with a prudent person standard, follow the governing plan documents unless contrary to ERISA, and diversify plan assets to minimize the risk of large losses unless it is clearly prudent not to do so. The consequences of breaching those fiduciary duties can be significant, including disgorgement of profits and restoration of plan losses.

ERISA and parallel provisions of the Code (with respect to which DOL has interpretive authority) also prohibit certain conduct by those dealing with many workplace retirement plans and certain retirement and investment accounts (*e.g.*, individual retirement accounts (IRAs) and health savings accounts (HSAs)), including certain conflicts of interest

involving fiduciaries of plans and covered accounts. Violation of these rules can result in “prohibited transactions,” which can lead to significant liability and imposition of excise taxes.

ERISA broadly defines the term “fiduciary” including by reference to a functional test: a person is a fiduciary to the extent he or she engages in certain conduct (or has the authority to do so), including a person who provides investment advice for a fee, direct or indirect, with respect to moneys or property of a plan. In 1975, the DOL adopted a rule defining when a person is a fiduciary as a result of providing investment advice to a plan (the Five-Part Test). Under the Five-Part Test, a person is considered to provide investment advice if that person:

- Renders advice to the plan as to the value of securities or other property or makes 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 plan or plan fiduciary;
- For which the advice will serve as a primary basis for investment decisions with respect to the plan; and
- For which the advice will be individualized based on the particular needs of the plan.

As discussed below, the Final Rule replaces the Five-Part Test with a construct that, in the view of the DOL, “appropriately defines an investment advice fiduciary to comport with reasonable investor expectations of trust and confidence.”

The Final Rule

The Final Rule replaces the Five-Part Test with a less rigid three-part test designed to impose fiduciary status in circumstances when investors “can and should reasonably place trust and confidence in the financial services provider.”

Who is an investment fiduciary?

Under the Final Rule, a person is an investment fiduciary under ERISA and the Code if the person:

1. makes a **recommendation** of any **securities transaction or other investment transaction or any investment strategy** involving securities or other **investment property** to a **retirement investor**;
 2. either:
 - a. directly or indirectly makes **professional investment recommendations to investors on a regular basis as part of their business** and the recommendation is provided under circumstances that would indicate to a **reasonable investor in like circumstances** that the recommendation:
 - i. is based on a review of the retirement investor’s particular needs or individual circumstances,
 - ii. reflects the application of professional or expert judgment to the retirement investor’s particular needs or individual circumstances, and
 - iii. may be relied upon by the retirement investor as intended to advance the retirement investor’s best interest; *or*
 - b. represents or acknowledges that they are acting as a fiduciary under Title I of ERISA (applicable to employer-sponsored plans), Title II of ERISA (applicable to employer-sponsored plans, IRAs and other covered accounts), or both, with respect to the recommendation;
- and
3. receives a **fee or other compensation** in connection with or as a result of the recommendation, **directly or indirectly**.

A discussion of these **bolded** concepts follows.

What is a “recommendation”?

Investment advice must include a “recommendation.” Like the Proposed Rule, the Final Rule does not explicitly define what constitutes a “recommendation.” However, the preamble to the Final Rule (the Preamble) notes that the

determination is based on all the facts and circumstances, including whether the communication can reasonably be viewed as a call to action. Further, the Preamble states that the DOL will interpret and construe the term consistent with the interpretation of the U.S. Securities and Exchange Commission (SEC) under Regulation Best Interest, an SEC rule governing the conduct of broker-dealers. The Preamble also offers that:

- the more individualized a communication, the more likely it will be considered a recommendation;
- a communication to a group can be a recommendation; and
- not all actions of affiliates will be considered in the determination; rather, the determination will consider actions taken “through or together with” the affiliate (or other party).

Although interesting from a transparency perspective as a view into DOL’s thinking, it is worth noting that Preamble statements do not have the same effect as regulatory provisions.

To whom must the recommendation be made?

A recommendation is not investment advice unless it is directed to a “Retirement Investor,” defined under the Final Rule as a plan, plan participant or beneficiary, IRA, IRA owner or beneficiary, plan fiduciary (other than a person who is a plan fiduciary solely as a result of the provision of investment advice), or IRA fiduciary with respect to an IRA. The DOL rejected requests for exceptions or limitations for sophisticated advice recipients, noting that the criteria suggested by various commenters failed to reliably identify whether an advice recipient was, in fact, sophisticated. Informally, individuals at DOL have publicly stated that providing exceptions and limitations could make the rule more susceptible to successful challenges in court. The Final Rule also clarifies that when advice is rendered to a plan or IRA fiduciary, the focus is on the “particular needs or individual circumstances” of the plan or IRA and not the fiduciary. The DOL also rejected blanket exclusions for health and welfare plans and HSAs but noted in the Preamble that many common structures likely would not rise to the level of covered recommendations (*e.g.*, identification of investment alternatives using objective

third-party criteria to assist plan sponsors in their selection and monitoring of investments).

What must be the subject of the recommendation?

A recommendation to a retirement investor is not investment advice unless it relates to:

1. **Investment of securities or investment property.** Recommendations regarding whether to buy, hold, or sell securities or other investment property, or investment strategy, including after a rollover, transfer, or distribution from a plan or IRA. The Final Rule includes coverage of investment strategies to make clear that it covers certain recommendations regardless of whether the recommendations refer to particular securities or investment property. For example, investment strategies will be interpreted broadly to include recommendations for using a bond ladder, day trading or margin strategy, and other strategies.

Note that the term “investment property” is intended to capture investments made by plans and IRAs that are not securities, such as real estate investments, but explicitly does not include health or disability insurance policies, term life policies, or other policies or property that do not contain an investment component.

2. **Investment management.** Recommendations regarding “the management of securities or other investment property,” including recommendations on investment policies, portfolio composition, selection of investment advice or investment management services, account arrangements, and proxy voting. For example, a recommendation to move from a commission-based account to an advisory fee-based account would be a covered recommendation.

The DOL’s focus on the selection of **other** persons to provide advice or management services was intentional: it is intended to exclude communications marketing one’s own advisory or management services (so-called “hire me” communications). The DOL cautioned, however, that marketing communications that rise to the level of a covered recommendation and that satisfy the other requirements of the Final Rule would be investment advice, and, thus, fiduciary in nature. Simply put, the mere fact that a

recommendation may come in the form of or be combined with marketing materials does not shield the recommendation from coverage under the Final Rule.

3. **Rollovers, transfers, or distributions.** As with previous attempts to revise the Five-Part Test, the Final Rule targets rollover and distribution advice to participants and beneficiaries and provides that such recommendations — even without advice on how to invest assets following the rollover or distribution — are considered investment advice. The Preamble provides that “[d]ecisions to take a benefit distribution or engage in a rollover transaction are among the most, if not the most, important financial decisions that plan participants and beneficiaries, and IRA owners and beneficiaries are called upon to make.” The DOL reasons that a recommendation to take a distribution or rollover from a plan or IRA and invest assets generally would require an evaluation of how the option compares to leaving the assets in the plan or IRA. The DOL also noted that the analysis does not turn on whether it is coupled with a change in investments: “The recommendation not to hold an asset in the plan, even if the intention is to hold essentially the same asset outside the plan, is still an investment recommendation.” Finally, the DOL views recommendations on how securities or other investment property should be invested after a rollover, transfer or distribution from a plan or IRA to include an implicit rollover recommendation and would be a covered recommendation.

In what context must the investment advice be provided?

The DOL is clear that a person should be subject to ERISA’s fiduciary duties when the person provides investment advice under circumstances in which a reasonable retirement investor would place their trust and confidence in the advice provider as acting in the retirement investor’s best interest. Under the Final Rule, a person providing a covered recommendation will always be an investment advice fiduciary if they represent — in writing or otherwise — that they are acting as a fiduciary under Title I and/or Title II of ERISA with respect to the recommendation.

However, even absent an acknowledgment of fiduciary status, the Final Rule provides that a person may be an investment advice fiduciary with respect to a recommendation if they satisfy the facts and circumstances test by:

- either directly or indirectly making 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 a 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.

This is intended to be an objective standard, based on the expectations of a reasonable investor in like circumstances. The Final Rule provides that written disclaimers of fiduciary status or the conditions of the facts and circumstances test will not control if they are inconsistent with the advice provider’s oral or written communications, marketing materials, applicable state or federal law (such as the Advisers Act), or other interactions with the retirement investor. In other words, an advice provider cannot engage in activities that create a legitimate expectation that the advice provider is in a position of trust and at the same time disclaim such status. The Preamble also highlights that, in determining whether the standard is met:

- express representation by the advice provider that the components have been satisfied is not required;
- absent unusual circumstances, if the advice provider has investment discretion over the assets that are the subject of a recommendation, the test would be satisfied;
- use of titles (*e.g.*, “financial consultant” or “wealth manager”), credentials or marketing slogans are relevant but generally not determinative; and
- gathering a retirement investor’s personal and financial information is indicative that the advice is individualized.

Notably, the Final Rule eliminates the Five-Part Test's "regular basis prong" and instead focuses on whether the person makes professional investment recommendations to investors on a regular basis as part of their business. As such, the focus shifts from the particular relationship to the advice provider's business and considers the person providing advice, including the person's firm and its employees, agents and representatives. Eliminating the "regular basis prong" also results in the possible coverage of one-time advice, further evidencing the DOL's intent of capturing one-time rollover advice.

To address concerns that marketing communications, investment education, and routine communications from human resources or similar employees could be found to be investment advice subject to fiduciary duties, the Final Rule makes clear that:

- sales pitches and the provision of investment education would not be considered investment advice so long as neither the facts and circumstances test is satisfied nor a fiduciary acknowledgment is provided (*e.g.*, a statement that "you'll love the return on X stock in your retirement plan, let me tell you about it," without more, would not result in fiduciary status), and
- an advice provider must make *professional* investment recommendations. Therefore, routine communications from a non-professional would not be subject to fiduciary duties.

What is considered a direct or indirect fee or other compensation?

According to the Final Rule, a person provides investment advice for a fee or other compensation, direct or indirect if:

the person (or any affiliate) receives any explicit fee or compensation, from any source, for the investment advice or the person (or any affiliate) receives any other fee or other compensation, from any source, in connection with or as a result of the recommended purchase, sale, or holding of a security or other investment property or the provision of investment advice, including, though not limited to, commissions, loads, finder's fees, revenue sharing payments, shareholder servicing fees, marketing or distribution fees, mark-ups or markdowns, underwriting compensation, payments to brokerage firms in return

for shelf space, recruitment compensation paid in connection with transfers of accounts to a registered representative's new broker-dealer firm, expense reimbursements, gifts and gratuities, or other non-cash compensation. A fee or compensation is paid "in connection with or as a result of" such transaction or service if the fee or compensation would not have been paid but for the recommended transaction or the provision of advice, including if eligibility for or the amount of the fee or compensation is based in whole or in part on the recommended transaction or the provision of investment advice.

While this definition is broad, it is not all-encompassing. Specifically, there must be a connection between transaction-based compensation and the recommendation. In other words, compensation is paid in connection with or as a result of a recommendation only if it would not have been paid but for the recommended transaction, or if eligibility for, or the amount of, the fee or compensation is based on the recommended transaction.

Application to Certain Common Circumstances

The Preamble also addresses a variety of common circumstances raised by various commenters, including the application of the Final Rule to platform providers (*i.e.*, entities that offer a platform or selection of investment options to participant-directed individual account plans from which plan fiduciaries select options that will be available to participants), pooled employer plans, investment information and education, call centers, swaps and security-based swaps, and valuation services.

The DOL refrained from providing special exceptions or exemptions to platform providers, pooled employer plans (and more specifically, pooled plan providers), and call center employees and instead reiterated that communications would be evaluated based on the general standards of the Final Rule. However, the DOL noted that platform providers that merely identify investment alternatives using objective third-party criteria without additional screening or recommendation would not be providing covered recommendations. Further, a provider generally does not make a covered recommendation merely by offering a preset list of investments.

With respect to investment information and education, the DOL confirmed that providing investment information and education such as those described in Investment Bulletin 96-1 and the “Investment Education” provision in the 2016 Final Rule (81 FR 20946) without more would not result in the provision of investment advice. The DOL also noted that providing information found in the IRS safe harbor Code Section 402(f) notice would also not result in the provision of investment advice.

Provision of mandated disclosures related to swaps and security-based swaps without more would not result in the provision of investment advice. As in previous attempts to revise the Five-Part Test, the Final Rule excludes valuation services from coverage.

Amendments to Prohibited Transaction Exemptions

Contemporaneous with the issuance of the Final Rule, the DOL also amended several existing Exemptions: PTEs 2020-02, 84-24, 75-1, 77-4, 80-83, 83-1, and 86-128. The amendments make clarifying changes to the exemptions and require investment advice fiduciaries who will receive otherwise prohibited compensation to satisfy, among other requirements, the impartial conduct standards of PTE 2020-02 or PTE 84-24. A subsequent bulletin will discuss the Exemptions in greater detail.

Effective Date

The Final Rule and amended Exemptions are effective September 23, 2024. However, the requirements of amended PTEs 2020-02 and 84-24, other than the impartial conduct standards and acknowledgment of fiduciary status, are delayed until September 23, 2025.

Looking Ahead

The Final Rule marks a significant shift away from the rigid Five-Part Test and instead focuses on the expectations of a hypothetical reasonable investor in like circumstances. Based on the breadth and substance of comments submitted in response to the proposed rule, as well as the legal challenges to past attempts by the DOL to revise the Five-Part Test, future legal challenges are expected. However, given the announced effective date, investment

professionals and financial institutions should review their current offerings and service models to ensure that they either do not result in the provision of investment advice under the Final Rule or that they comply with the fiduciary standards and prohibited transaction provisions of ERISA and the Code, as applicable. Likewise, workplace retirement plan fiduciaries should consider the services provided by plan service providers and assess how the Final Rule may alter the services provided (or how the services are provided).

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