

# Morgan Lewis

**MORGAN LEWIS RETAIL ADVICE GROUP**  
**DOL INVESTMENT**  
**ADVICE STANDARDS 4.0**

**Proposed Definition of Investment Advice Fiduciary  
and Amended Prohibited Transaction Exemptions**

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## Key Issues—Proposal has the same results as 2016 Fiduciary Rule (but uses different words)

- **Regulation** creates board **presumption** that all investment interactions by firms (and their reps.) relating to ERISA/IRA assets trigger fiduciary status, requiring reliance on a DOL exemption.
- **Exemptions** are revised to apply equally across securities, banking, insurance and other assets (e.g., commodities and real estate). Generally, sets the conditions for the receipt of (direct and indirect) compensation, and requires consent to DOL jurisdiction over IRAs and other non-ERISA, tax qualified accounts.

## Rollovers (including IRA to IRA transfers)

- Challenges education-only approach to roll outs: states that a roll in recommendation includes an implicit roll out recommendation.
- **Question:** Can this presumption be rebutted through disclosure, client direction/sign-off, or differentiated service levels (e.g., charging a fee for roll out advice)?

## Advised brokerage/insurance

- Changes calculus of “episodic” brokerage and insurance advice as nonfiduciary.
- Removes other available exemptions like PTEs 86-128 and 75-1, forcing firms into PTEs 2020-2 and 84-24 compliance, generally.

## Institutional relationships—No express carve-out

- **Model Managers/Providers** may be viewed as fiduciaries to end acct.
- **Daisy-chain issue** for wholesalers and manufacturers providing sales support and tools
- **Private fund sales and RFPs** to plan/IRA fiduciaries and consultants may be fiduciary
- **Platform decisions/offerings** could be subject to fiduciary standards

## Non-discretionary advisory and tools

- PTE 2020-02 would be **available for pure-robo advice** (consider possible use for account/asset acquisition and account-type recommendations).

## Execution-only brokerage platforms and services—

depending on structure and scope of offering, could fall into limited/select list and be viewed as fiduciary recommendation of entire in platform.

## Recruiting compensation, trips and other incentives—

appears to be aligned with Massachusetts fiduciary rule and NASAA model BI rule proposal in restricting incentives that create significant conflicts for reps.

## Business Drivers

**Product availability.** Presumption of fiduciary status significantly limits the types of assets that can be sold on a principal basis (riskless is broad under PTE 2020-02) and extensions of credit. Need to evaluate:

- **Principal traded assets:** IPOs, preferreds, other equity securities, underwritings and syndicates, closed-end funds, structured products, F/X, debt securities with less than moderate credit risk or illiquidity, UITs, etc.
- **Credit:** Margin, affiliate-issued structured products (affiliated bank deposits ok).
- **Insurance Products:** Particularly securities insurance products by independent producers & indirect compensations

## Business models and industry trends

- Continue acceleration to fee-based advisory, away from brokerage and rationalization of investment product offerings/shelf to address pressures on differential compensation.
- On-going debate over rollovers—education vs. recommendation on roll-out decision.

## Enforcement and litigation risks

- Exposes firms’ retirement business to DOL oversight and enforcement—amendments to PTE 2020-02 would strengthen DOL ability to be involved, including through ineligibility provisions and annual report (with inclusion of IRS excise tax filings and payments for corrections outside of PTE 2020-02/84-24).
- Potential that SEC, FINRA and states could coordinate more closely with DOL and IRS.
- Will IRS step up to enforce IRA market? SEC/FINRA/states have already become more aggressive in this space.
- Even though DOL stated it doesn’t intend a private right of action to be created by the exemption disclosure requirements, its difficult to see how such a right based on disclosure won’t be asserted in litigation. Potential provision for retirement investor access to books and records likely strengthens plaintiffs’ ability to pursue claims.

## Regulatory convergence and regulation through enforcement.

Cannot view standards in isolation.

- Compliance with DOL will need to be viewed in tandem with Reg. BI and vice versa, as well as state standards, which may be getting stricter and broader—See SEC Reg. BI Staff Bulletins, Predictive Data Analytics proposal and NASA Model Rule.
- Principles based standards are flexible, but frequently change based on informal guidance and enforcement outcomes.

## Uncertainty continues...

- If finalized as proposed, a lawsuit against the DOL is almost inevitable as there are strong arguments DOL exceeded its statutory authority. As with any agency litigation, however, outcome is uncertain and injunction unlikely.
- We anticipate a short implementation period given the political pressure to get this done.
- Will Biden administration go forward with this proposal in an election year?



## DIAGRAM OF PROPOSED FIDUCIARY INVESTMENT ADVICE DEFINITION

**Covers recommendations to** “retirement investors,” including plans and IRAs (including HSAs and Keoghs), **plan & IRA fiduciaries**, plan participants and beneficiaries, and IRA owners and beneficiaries.

### Triggered if:

1. person making recommendation directly or indirectly (**including through an affiliate**) has investment **discretion** to purchase or sell investments for the **retirement investor** (*think affiliated mutual fund or CIT*);
2. (A) person making recommendation directly or indirectly (**including through an affiliate**) **makes investment recommendations** to “investors” on a regular basis as part of their business, (B) recommendation is based on **particular needs or individual circumstances** of the retirement investor and (C) may be relied on as “**a basis**” for investment decisions that are in the retirement investor’s best interest; **or**
3. Person making recommendation represents or acknowledges fiduciary status when making recommendations.

**Written disclaimers** do not control if inconsistent with oral communications, marketing materials, applicable state or federal law, or other interactions with the retirement investor.

**Investment education generally.** The DOL noted that its historic guidance on participant education (IB 96-1) is currently effective and acknowledged that “hire me” conversations are not fiduciary investment advice, unless accompanied by an investment recommendation. DOL also emphasizes that fiduciary status is determined on a transactional basis and a person is a fiduciary only “to the extent” they are acting as such—*But once you (or your affiliate) is a fiduciary, your communications are presumed to be fiduciary?*

### Challenges educational approach to roll out interactions.

DOL indicates that any recommendation as to how rolled over assets should be invested implies a recommendation to roll assets out of the plan – (*this seems an overreach*).

**Institutional relationships are in scope.** Unlike 2016 fiduciary rule, DOL did not propose any explicit exceptions from the fiduciary definition and indicated that fiduciary status would depend on the facts and circumstances. DOL staff has informally stated that they are thinking about institutional investors and other carve-outs the same way they did in 2016, even though they are not spelled out in the proposal, but proposed rule text would technically cause many relationships with institutional investors to trigger fiduciary status.



## OBSERVATIONS / ISSUES

### Observations:

- New definition removes “mutual understanding,” “regular basis to the plan,” and “a primary basis” elements of five-part test, and brings into scope activities of entire enterprise in determining fiduciary status of an entity’s recommendation.
- This definition is so broad that it seems to **create a presumption of fiduciary status** for any interaction between a financial institution/professional and a retirement investor, whether retail or institutional.
  - The main open question is **whether (and how) the presumption can be rebutted.**

### Issues

- What would the proposal mean for **continued ability to rely on education or client direction regarding the decision to roll assets out of the plan** and limit fiduciary status to any roll in recommendations?
- Is there any way to rebut the presumption of fiduciary status in **full service brokerage or insurance sales**, or a part thereof (e.g., principal trades)?
- How can **model manager programs** allocate fiduciary obligations between model and overlay managers?
- Can a **private fund manager** talk to a pension trustee consultant (or IRA owner) without triggering fiduciary status?
- Can **mutual fund wholesalers** market and provide sales tools to broker-dealer/investment advisers in a non-fiduciary capacity?
- If a retirement investor brings a **distribution check** to a broker-dealer, can the broker-dealer discuss how to invest the funds without becoming a fiduciary to the 401(k) plan?
- If an affiliate refers taxable investors to a third-party for investment management services, is the 2nd prong of the test triggered?
- Would express carve-outs be helpful or is the facts and circumstances analysis preferred?



## PROPOSED AMENDMENTS TO PROHIBITED TRANSACTION EXEMPTIONS

### PTE 2020-02 Amendments

**Broader applicability**—Available to digital advice/tools without human interaction & pooled plan providers.

**More definitive fiduciary acknowledgement**—Must acknowledge financial institution & professional are providing fiduciary investment advice and are ERISA/Code fiduciaries when making an investment recommendation.

**State Best Interest standard**—previously included in model language.

**Enhanced conflicts disclosure requirements**—(most BDs and IAs probably already satisfy amended requirements)

- Describe how retirement investor will pay for services (directly or indirectly, through third-party payments, through commissions or transaction-based payments).
- Must be in plain English taking into consideration level of financial experience.
- Retirement investor can request specific information regarding costs, fees, and compensation in dollar amounts, percentages, or formulas free of charge (consider whether phonebook disclosure satisfies requirement).
- Comments requested on website disclosure.

**Explicit prohibition** of quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation, or other similar actions or incentives that are intended or likely to result in non-Best Interest recommendations—**DOL specifically calls out rewards trips and educational conferences in preamble.**

#### Rollover analysis—

- Applies “before engaging in a rollover” or “making a recommendation to a Plan participant as to the post-rollover investment of assets currently held in a Plan”.
- Must consider and document reasons rollover is in retirement investor’s Best Interest and provide documentation to Retirement Investor.
- Specific factors to consider include:
  - Alternatives to rollover, including leaving money in Plan or account
  - Fees and expenses of Plan vs. recommended investment or account
  - Whether employer pays Plan’s administrative expenses
  - Different levels of services and investments available under Plan and recommended investment or account

#### Retrospective review pulls in Form 5330 filings.

Senior executive officer must certify timely filing and payment of excise taxes and correction of any non-exempt prohibited transactions in connection with fiduciary investment advice.

**Ineligibility provisions expanded** to include a broader array of crimes and systematic practice of failing to correct and pay excise taxes with respect to non-exempt prohibited transactions (DOL informally indicates it will apply prospectively only).



## OBSERVATIONS/ISSUES

### Observations:

- DOL appears to be trying to prevent firm’s from providing a conditional fiduciary acknowledgement and criticizes “artful” language.
- Would apply rollover documentation and disclosure requirements to circumstances where the firm relies on investment education or investor direction for roll out decision and only provides **advice on how to invest rolled-in assets.** DOL otherwise does not appear to have materially changed the requirements for rollovers.
- Pressure on platform limitations—must ensure that best interest recommendations can still be made—This could materially effect limitations
- Consider impact of potential plaintiff litigation on compliance approach for:
  - Plan rollovers/transfers and recruiting transitions
  - ERISA plan participant investment recommendations
  - Recommendations to plan fiduciaries (but may be able to more effectively disclaim fiduciary status for these relationships where appropriate).
- Changes to annual report and ineligibility appear to **strengthen DOL’s ability to enforce** exemption and be involved in retirement investment advice business generally.
  - DOL’s ability to revoke exemption is a significant risk for firms seeking to rely on it.
  - Regulatory reach by DOL to extend authority to overseeing IRAs.

### Issues:

- Consider how to clarify circumstances under which firm is **not acting as a retirement account fiduciary** in light of amendments to acknowledgment
- Consider whether firms can continue to support **rollover education and client directions** in rollover interactions.
- **Review current client disclosures** to determine whether changes would need to be made to meet amended requirements.
- May need to **develop a more formal process** to meet reporting requirements with respect to excise tax filings and for determining whether firm or affiliates or financial professionals are ineligible to rely on exemption due to disqualifying crimes.
- May need to consider changes to **comp. plans and incentive compensation arrangements.** Changes made for Mass probably need to be considered for DOL.
- Note comments requested on **website disclosure and broader access to books and records** (including by retirement investors).



## PROPOSED AMENDMENTS TO PROHIBITED TRANSACTION EXEMPTIONS

### PTE 84-24 Amendments

#### Narrowed scope—

- 406(b)/self-dealing relief only available for “**Independent Producers**” selling non-securities annuities or other insurance products.
- Covers only receipt of an “**insurance sales commission**”—a commission paid by the insurance company or an affiliate of Independent fiduciary for recommending or effecting the purchase or sale of an insurance or annuity contract, including renewal and trailing fees.
- Would not cover revenue sharing, administrative fees, marketing payments, payments from parties other than the insurance company or its affiliates, or any other similar fees.

#### Adds PTE 2020-02 conditions—

- Impartial conduct standards
- Fiduciary acknowledgment/best interest standard (insurance producer only)
- Disclosure of amount of commission paid in dollars and percentage of premium payments or account value)
- Rollover disclosures
- Policies and procedures—Insurance company has supervisory obligations
- Retrospective review, self-correction and ineligibility provisions.

**Enhanced recordkeeping requirements** would apply to all transactions under the exemption.

### PTE 86-128, 77-4, 75-1, 80-83, and 83-1 Amendments

**Limit relief to discretionary fiduciaries.** Non-discretionary/investment advice fiduciaries must rely on PTE 2020-02, 84-24, or another available exemption.

Unlike 2016 fiduciary rule, **would not add impartial conduct standards** as conditions of relief or specifically limit the types of compensation for which relief may be available.

#### Other changes—

- **PTE 86-128** would be amended to apply disclosures (including portfolio turnover) and acknowledgment to IRAs and Keogh plans
- **PTE 75-1, Part II** would be amended to delete relief for mutual fund trades.
- **PTE 75-1, Part V** would be amended to cover reasonable compensation received by a fiduciary for extending credit to avoid a failed trade if certain conditions are met.
- Would also make certain changes to PTE 75-1 **recordkeeping requirements**.



## OBSERVATIONS/ISSUES

#### Observations/Issues:

- The amendments significantly limit the scope of PTE 84-24 coverage
- Will likely result in **most fiduciary insurance sales being forced into PTE 2020-02 (where available)**, which covers broader forms of compensation and annuities that are also securities.
- Unless insurance companies are willing to take on PTE 2020-02 obligations for independent producers, **independent producers will be limited to providing recommendations on non-securities insurance products** (e.g., fixed annuities) for commission only.
- Will the insurance industry challenge this rulemaking.

#### Observations/Issues:

- The amendments are generally intended to **force investment advice fiduciaries into PTE 2020-02/84-24**.
- The changes to PTE 86-128 to require disclosures for IRAs/Keoghs may prove **challenging to implement** for these types of accounts.



# Morgan Lewis

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