

July 5, 2017

DOL's 2016 Fiduciary Rule on Investment Advice

Under the Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406), a person who provides *investment advice* has a fiduciary obligation to provide the advice in the sole interest of plan participants. Thus, redefining the term investment advice could affect who is subject to this fiduciary standard. More detailed information about the rule is available in CRS Report R44884, *Department of Labor's 2016 Fiduciary Rule: Background and Issues*.

On April 8, 2016, DOL issued a final rule that redefined the term *investment advice* within pension and retirement plans. On April 7, 2017, DOL delayed the applicability date by 60 days to June 9, 2017, of (1) the expanded definition of investment advice and (2) the Impartial Conduct Standard of the Best Interest Contract (BIC) exemption. While these two aspects of the rule are currently in effect, other aspects of the exemptions become applicable on January 1, 2018.

Prior Regulation From 1975

Regulations issued in 1975 defined investment advice using a five-part test. To be held to ERISA's fiduciary standard with respect to his or her advice, an individual must have (1) made recommendations on investing in, purchasing, or selling securities or other property, or give advice as to the value (2) on a regular basis (3) pursuant to a mutual understanding that the advice (4) would serve as a primary basis for investment decisions, and (5) would be individualized to the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.

2016 Investment Advice Regulation

DOL's 2016 rule broadened the term's definition to capture activities that occurred within pension and retirement plans, but did not meet the prior definition of investment advice. The rule replaces the five-part test with a more inclusive definition. The following recommendations constitute investment advice under the rule, if they are done for a fee or other compensation:

- the advisability of buying, selling, holding, or exchanging investments;
- how investments should be invested after being rolled over, transferred, or distributed from an IRA;
- the management of investments; or
- IRAs, including whether, in what form, in what amount, and to what destination rollovers, distributions from IRAs and transfers from IRAs should be made.

In addition, the person who makes a recommendation as listed above must (1) represent or acknowledge that the person is acting as a fiduciary, (2) provide a written or verbal understanding that the advice is based on the particular needs of the advice recipient; or (3) direct the advice to a specific recipient.

The 2016 rule specifies that certain activities do *not* constitute investment advice. These activities include marketing by platform providers who market without regard to the needs of individual plans or participants; making available general communications, such as general circulation newsletters; providing investment advice; providing advice to independent fiduciaries with financial expertise (as defined in the regulations); and executing securities transactions. In addition, individuals who are employees of a plan sponsor or employee organization and do not receive compensation for the advice beyond their normal compensation are not considered to be providing investment advice.

Prohibited Transaction Exemptions

In addition to requiring plan fiduciaries to adhere to certain standards of conduct, ERISA prohibits fiduciaries from engaging in transactions deemed likely to injure a pension plan. A number of prohibited transaction exemptions (PTEs) have been issued, both in statute and via DOL-issued exemptions, which allow individuals or classes of individuals to engage in specified transactions that would otherwise be prohibited under ERISA. Accompanying the 2016 final rule, DOL has issued or modified a number of PTEs.

Best Interest Contract Exemption

DOL issued a best interest contract (BIC) exemption so that certain broker-dealers and others who act as plan fiduciaries are able to continue to receive compensation that is otherwise prohibited. For example, absent the exemption, broker-dealers acting as fiduciaries would not be able to receive commissions, load fees, or other fees as a result of their advice.

The final BIC exemption requires compliance with certain conditions, including the following:

- The financial institution must acknowledge fiduciary status with the retirement investor.
- The financial institution must adhere to Impartial Conduct Standards, which include acting in the best interest of the retirement investor, not accepting more than reasonable compensation, and not making misleading statements about investment transactions, compensation, and conflicts of interest.

- The financial institution must warrant that it has adopted written policies to adhere to the Impartial Conduct Standards, documented Material Conflicts of Interest, and does not rely on bonuses, quotas, or contests to compensate advisors.

To comply with the BIC exemption, the financial institution must provide a number of disclosures to the retirement investor, such as describing the Impartial Conduct Standards and any Material Conflicts of Interest. In addition, the financial institution's contract may not contain clauses that waive the retirement investor's right to bring or participate in a class action in court in a dispute with the advisor or financial institution.

Other Prohibited Transactions Exemptions

DOL issued a Principal Transactions Exemption that allows for sales and investment advice from individuals and financial institutions that engage in principal transactions, which are purchases and sales of assets out of an individual's or financial institutions own inventory. This PTE allows for the sale of debt securities, unit investment trusts, and certificates of deposit to a plan or IRA provided the institutions and advisor adhere to specified conditions, such as following Impartial Conduct Standards.

DOL also amended other PTE's including PTE 84-24. As amended, PTE 84-24 allows individuals who sell fixed annuities to receive commissions provided they adhere to certain conditions (such as Impartial Conduct Standards). However, individuals who sell other types of annuities, such as variable annuities and index annuities need to use the more stringent BIC exemption if their compensation includes commissions.

Changes from the Proposed to the Final Rule

DOL received over 3,000 comments on the 2015 proposed rule and made a number of changes that addressed some stakeholders' concerns. For example, DOL expanded the definition of investment education that allow specific investment alternatives to be identified, streamlined the disclosure requirements, and grandfathered compensation arrangements made prior to the applicability date.

Although the changes were welcome by some, some stakeholders remain opposed to the rule.

Rationale for the Rule

The Obama Administration argued that the definition of investment advice needed to be revised because the nature of how Americans prepare for retirement has changed since 1975, following the enactment of ERISA. Specifically, the number of participants in traditional defined benefit (DB) plans has decreased, whereas the number of participants in defined contribution (DC) plans, such as 401(k) plans, has increased. Participants in DC plans have more decisions (such as contribution amounts, investment allocations, rollovers, and withdrawals) to make than participants in DB plans and may be in greater need of or be offered assistance and advice.

The Regulatory Impact Analysis (RIA) issued by DOL with the proposed rule made the following points:

- The structure of the market in which retirement plans operate creates conflicts of interest that were not adequately addressed by current regulations.
- Advisers that offer advice to plans regarding which investment options to include in their plans (platform providers) might have fee arrangements that create conflicts of interest.
- DOL found enforcement challenges because it had to demonstrate that an individual met each element of the five-part test.

Stakeholder Viewpoints

Support for Best Interest Standard. Professionals in the financial services industry generally indicated that they support a best interest standard; that is, they contend that they should be required to operate in the best interests of their clients. Many have indicated that they already do so.

Unworkable Disclosures. Some industry professionals expressed concerns about the BIC exemption. They indicated that the disclosures required from service providers could make the BIC unworkable. If firms do not use the BIC exemption, they might be unwilling to service smaller retirement accounts because the fee structure could then be cost prohibitive.

Support from Some Consumer Advocacy Groups. Some consumer advocacy groups (such as the Consumer Federation of America, AARP, and the AFL-CIO) are supportive of the DOL rule.

Actions by the Trump Administration

On February 3, 2017, the President issued a memorandum on the fiduciary rule that directed DOL to (1) review the rule to determine whether it adversely affects access to retirement information and financial advice, and if it finds that it does so then (2) publish a proposed rule to rescind or revise the rule. On March 2, 2017, DOL proposed delaying the applicability date of the rule by 60 days.

On April 7, 2017, DOL issued a delay of the applicability date of the final rule while it reviews the effects of the rule pursuant to the presidential memorandum of February 3, 2017. DOL delayed the applicability date by 60 days from April 10, 2017, to June 9, 2017, of (1) the expanded definition of investment advice and (2) the Impartial Conduct Standard of the BIC exemption. Although these two aspects of the rule are currently in effect, other aspects of the exemptions, such as requirements to make specific disclosures and warrant policies and procedures and to execute written contracts, become applicable on January 1, 2018.

John J. Topoleski, Analyst in Income Security

IFI0686

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.