

PTE 2020-02: Fiduciary Advice Exemption



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An ERISA fiduciary providing investment advice may not receive compensation that creates a potential conflict of interest unless the fiduciary complies with the protective conditions in PTE 2020-02

An advisor who receives compensation regarding rollover advice needs to comply with the exemption (significant expansion of what constitutes a prohibited transaction)

Advisor cannot rely on the exemption if:

- The advisor has been convicted within the previous 10 years of certain crimes regarding the provision of investment advice to retirement investors or**
- The advisor has engaged in a systematic or intentional violation of the exemption or has provided misleading information to the DOL**

PTE 2020-02 is not available to:

- **Advisors who are employers**
- **Named fiduciaries who are selected to provide advice that is not independent**
- **Providers of robo-advice**
- **Advisors acting as fiduciaries in another capacity**

The exemption covers the receipt of compensation from investment advice and rollover advice in respect of:

- Commissions
- 12b-1 fees
- Sales Loads
- Revenue sharing
- Proprietary investment products that generate payments from third-parties
- Revenue sharing from a custodian
- Other “conflicted” compensation

Exemption is available for rollover advice and non-discretionary investment advice, e.g., where the advisor executes the advice only after the approval of the retirement investor

Exemption does not apply to discretionary investment advice, e.g., where the advisor has the discretionary authority to execute the advice without the approval of the retirement investor

PTE 2020-02 generally became effective as of February 1, 2022 when the DOL's non-enforcement policy lapsed (PTE 2020-02 initially went into effect as of February 16, 2021)

DOL was not going to enforce the documentation and disclosure requirements for rollovers until June 30, 2022

- **DOL will not pursue claims for prior breaches of fiduciary duty or prohibited transactions based on previous rollover recommendations if the recommendations would have been considered non-fiduciary conduct under prior law**
- **DOL anticipates further regulatory action in this area**

PTE 2020-02 generally restores the prior definition of what constitutes fiduciary investment advice (the “five-part test”)

- **Render advice to a plan, plan fiduciary or IRA owner as to the value of securities or other property or make recommendations as to advisability of investments in securities or other property for a fee**
- **Provide the advice on a regular basis**
- **Provide the advice pursuant to mutual agreement or understanding with the plan, plan fiduciary or IRA owner**
- **The advice will serve as the primary basis an investment decision; and**
- **The advice will be individualized based on the needs of the plan, plan fiduciary or IRS owner**

Single discreet instance of advice is not rendered on a regular basis:

- **Advice will be on a regular basis where the advice is part of an ongoing relationship or rendered at the beginning of an intended ongoing relationship**
- **No free pass on the first instance of advice**

Expands the definition of investment advice to include advice on whether to take a distribution and rollover it over to another plan or IRA including:

- **Roll over assets from an ERISA plan to an IRA**
- **Roll over assets from one IRA to another IRA**
- **Roll over from one type of account to another, e.g., commission-based to fee-based**

Furnishing of educational information and materials does not constitute investment advice:

- **Plan information:** Benefits of participation, terms of the plan, operation of the plan, impact of withdrawals on retirement income, etc.
- **General Financial and Investment Information:** General financial concepts, historical returns on different asset classes, effects of inflation, estimating future retirement needs, risk tolerance, etc.
- **Asset Allocation Models:** Models of portfolios of hypothetical individuals with different time horizons and risk profiles
- **Interactive Investment Models:** Subject to certain conditions, questionnaires, worksheets and software to estimate needs and assets allocations

Boilerplate disclaimers cannot avoid fiduciary status

Fiduciary status exists where advisors hold themselves out in oral or written communications as providing individualized recommendations

General Requirements:

- **Provide advice in accordance with “impartial conduct standards”**
- **Acknowledge fiduciary status in writing (model language provided)**
- **Describe in writing the services to be provided**
- **Describe material conflicts of interest**
- **Document and provide reasons that a rollover is in the best interest of the retirement investor**
- **Adopt policies and procedures to ensure compliance with “impartial conduct standards” and to mitigate conflicts of interest**
- **Conduct annual compliance reviews**

Impartial Conduct Standards:

- **Must give the advice that is in the “best interest” of the retirement investor**
 - **Prudence – must meet professional standard of care**
 - **Loyalty – may not place advisor’s interest ahead of the retirement investor’s**
 - **Institution and advisor must have a reasonable basis to believe that recommendations are in the best interests of the retirement investor**
- **Must charge no more than reasonable compensation and comply with laws regarding “best execution” of transactions**
- **Must not make misleading statements**

Before rendering any advice, the advisor must provide the plan, plan fiduciary or IRA owner with:

- **An acknowledgement of fiduciary status under ERISA**
- **Disclosure of the scope of the relationship**
- **A written description of all material conflicts of interest**

The description must be accurate and not misleading in any material respects; disclose conflicts associated with proprietary products, payments received by the advisor from third parties, and other “conflicted compensation;” and not contain any material omissions that would render the disclosure as inadequate

With respect to rollover advice, the advisor must document why the rollover recommendation is in the best interests of the retirement investor:

- Must discuss the alternatives to a rollover (including leaving the funds in the employer's plan)**
- Must describe the fees and expenses associated with both the employer's plan in which the funds may stay and the IRA into which the funds may be rolled**
- Must disclose if the employer pays some or all of the plan's administrative costs**
- Must describe the different level of services and investments available under the employer's plan versus the IRA**

Other relevant considerations for rollover recommendations for the advisor:

- **Should not focus on existing investments**
- **Should document the differences in services between the alternatives**
- **Should consider the long-term impact of increased costs**
- **Should discuss why rollover may be appropriate despite increased costs**
- **Should consider the impact of significant investment features such as surrender schedules, index caps, participation rates**
- **Must obtain information about existing employer plan or provide reasonable estimates if the information is not available and document any assumptions used**

Adopt policies and procedures to ensure compliance with “impartial conduct standards” and to mitigate conflicts of interest:

- **Adopt policies to reflect impartial conduct standards**
- **Focus on policies that create incentives for the advisor to place the advisor’s interest ahead of the retirement investor’s**
- **Protect against excessive trades**
- **Protect against investment products or annuities not in the retirement investor’s best interest**
- **Protect against allocation of excessive amounts to illegal or risky investments**
- **Regularly review and update written policies**

Advisor must mitigate conflicts of interest:

- **Eliminate or mitigate misalignment with the retirement investor's best interests**
- **Duty to mitigate conflicts extends to conflicts with the individual advisor and overall institution**
- **No safe harbor relying upon other regulatory standards**
- **Examples of conflicts with the individual advisor: careful not to use quotas, bonuses, prizes, or performance standards as incentives**
- **Acknowledge that not all conflicts can be eliminated entirely**

Special considerations for compensation payout grids for advisors:

- **Cannot pass institution-level conflicts on to the individual advisors, e.g., individual advisor receives fixed percentage of commissions on investments the advisor recommends**
- **Policies must root out misaligned financial incentives**
- **Payout grids with payments for modest performance increases are likely to create impermissible incentives**
- **Increases in compensation should be prospective (not retroactive)**
- **Should establish a compliance system to monitor and supervise investment recommendations**

Institution must conduct annual compliance reviews (retrospective in nature):

- **Compliance review must be designed to detect and prevent violations of the “impartial conduct standards” and/or failures to comply with the institution’s policies and procedures, e.g., random sampling of account documentation**
- **Institution must prepare an annual written report to a senior executive officer, who must certify and sign the report**
- **The written report, certification and related data must be retained for at least six years and provided to DOL within 10 business days of any request**
- **Compliance review, written report and certification should be completed within six months after year-end**

Senior executive officer includes chief executive officer, president, chief financial officer or one of the three most senior officers

Written certification must:

- **Confirm the senior executive officer reviewed the report**
- **Certify that policies and procedures are prudently designed to achieve compliance with the exemption**
- **Certify that the institution has a prudent process to modify the policies and procedures as appropriate**

Correction of violations:

- **Advisor/institution can correct violations within 90 days after learning about the violation (or, if earlier, within 90 days after reasonably should have learned about the violation)**
- **The institution must make the retirement investor whole for any financial losses**
- **The institution must notify the DOL within 30 days after the correction**
- **A description of the violation and the correction must be included in the institution's annual compliance report**

DOL enforcement:

- **DOL will investigate violations of PTE 2020-02**
- **The retirement investor can bring a normal ERISA 502 claim against the advisor for breach of fiduciary duty and a prohibited transactions (but PTE 2020-02 does not expand the retirement investor's available claims under ERISA)**
- **Excise taxes on prohibited transaction of 15% of the amount involved (100% if not corrected)**
- **Fiduciary is liable to restore retirement investor to original position**

Review and revise advisor disclosures, e.g., investment management agreement, Form ADV Part 2A and other written materials to:

- **Incorporate the DOL model language on fiduciary status**
- **Describe limitations on advice and products, e.g., information about required proprietary products, and why proprietary funds are in the best interest of the retirement investor**
- **Describe how conflicts in interest are mitigated**
- **Prohibit special incentives that create conflicts in interest**
- **Disclose all payments and fees to be received by the advisor, e.g., referral fees, 12b-1 fees, revenue sharing**

- **Disclose clients or vendors who receive favorable treatment due to other business relationships**
- **Disclose affiliated service providers and how conflicts are mitigated**
- **Describe benefits the advisor or institution may receive from service providers, e.g., access to educational materials, participation in sales events or conferences**
- **Disclose outside business activities of advisors that might create conflicts in interest**

In providing investment advice, the advisor should:

- **Document the diligence performed on and the specific reasons for the recommended investments**
- **Determine if the specific recommendation is appropriate for the specific retirement investor and why**
- **Receive specific training to better understand information needed from retirement investor to recommend tailored investments and advise on rollovers**
- **Have supervisors review recommendations and approve material changes to investment strategies**
- **Perform diligence to confirm fees are reasonable**
- **Review materials for misleading statements**