DOL Reinstates Five-Part-Test for Investment Advice Fiduciaries and Proposes New Exemption

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After several years of uncertainty as to the appropriate standard for determining when an investment adviser will be deemed to be a fiduciary under ERISA, the U.S. Department of Labor (the "DOL") has finally issued clear guidance reinstating its prior rule (the "Five-Part Test") for determining what constitutes "investment advice" under ERISA. The DOL also proposed a prohibited transaction exemption (the "Proposed Exemption") for certain financial institutions and investment professionals providing investment advice to retirement investors.

Reinstatement of the Five-Part Test

Under the Five-Part Test, for advice to constitute "investment advice," a financial institution or investment professional must (1) render advice to the plan or IRA 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, (2) on a regular basis, (3) pursuant to a mutual agreement, arrangement, or understanding with the plan, plan fiduciary or IRA owner, that (4) the advice will serve as a primary basis for investment decisions with respect to plan or IRA assets, and that (5) the advice will be individualized based on the particular needs of the plan or IRA.

In 2016, the DOL had issued a new fiduciary rule (the "2016 Rule") intended to replace the Five-Part Test, which had been in effect since 1975. The 2016 Rule was controversial in many respects and generally would have broadened the definition of when a person is acting as an ERISA fiduciary. Notably, there was concern that general sales and marketing activities that targeted groups of investors including retirement plans and IRA owners could have caused fund managers and others to be treated as ERISA fiduciaries even if the funds at issue did not hold ERISA plan assets.

The 2016 Rule was challenged in court and ultimately vacated by the U.S. Court of Appeals for the Fifth Circuit in 2018. On June 29, 2020, the DOL issued a final rule reinstating the Five-Part Test. No changes were made to the text of the Five- Part Test, but the DOL has provided interpretive guidance (in the preamble to the Proposed Exemption) on application of certain aspects of the Five-Part Test, particularly in the context of rollover advice.[1] The return to the Five-Part Test and the DOL's new interpretive guidance generally do not present concerns for private funds' sales and marketing activities as were present in the 2016 Rule, but do still present concerns for any adviser providing guidance on potential rollovers of ERISA accounts.

New Proposed Exemption

In addition to reinstating the Five-Part Test, the DOL reinstated various class exemptions and Interpretive Bulletin 96-1 (relating to what constitutes investment education and not fiduciary advice), as they were in effect prior to the now-vacated 2016 Rule. The DOL also removed the new prohibited transaction exemptions that were issued with connection with the 2016 Rule and, in their place, issued the Proposed Exemption.

The Proposed Exemption would allow registered investment advisers, broker-dealers, insurance companies and banks (and their investment professionals) providing investment advice to retirement investors to enter into a variety of compensation arrangements and engage in certain principal transactions that are otherwise prohibited under ERISA, provided that a number of protective conditions are satisfied. Generally, these conditions would require investment advisers to, among other things, comply with certain "impartial conduct standards," provide written acknowledgement of their fiduciary status and other written disclosures, establish policies and procedures designed to mitigate conflicts of interest, and conduct annual retrospective reviews to detect and prevent violations of the impartial

conduct standards and comply with the related written report and CEO certification requirements.

The period for submitting comments on the Proposed Exemption ended August 6, 2020. If finalized, the Proposed Exemption would be available 60 days after the date of publication of the final exemption.

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[1] The DOL clarified, among other things, that: (i) limited advice with respect to a rollover would likely not satisfy the "regular basis" prong of the Five-Part Test, but this prong could be satisfied if there was an expectation that advice would be provided on an ongoing basis after the rollover; (ii) the advice at issue does not need to be "the" primary basis for an investment decision, but need only be "a" primary basis; and (iii) the existence of a mutual agreement may be based on the reasonable understandings of the parties, and contractual provisions disclaiming mutual agreement or forbidding reliance may be considered but are not determinative.

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