Retirement Account Rollovers: How to Comply with the DOL's New Fiduciary "Rule"

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Recommendations to retirement plan participants to roll their accounts from a plan to an individual retirement account (IRA) or annuity will generally be viewed as fiduciary advice under new Department of Labor (DOL) guidance. That guidance is in Prohibited Transaction Exemption (PTE) 2020–02, which allows investment advisers and their firms (called "investment professionals" and "financial institutions," respectively, in the PTE) to receive compensation from rollover IRAs in connection with rollover recommendations by satisfying certain conditions, including the requirement that the recommendation is in the best interest of the participant (called "retirement investor" in the new guidance).

Roadmap

This article starts with an overview of PTE 2020–02, describing the DOL's new and expanded interpretation of fiduciary advice for rollover recommendations and then explaining the conflict of interest (or prohibited transaction) requirements that apply to investment professionals in relation to rollover recommendations. It then discusses considerations for investment professionals who make rollover recommendations, particularly where PTE 2020–02 differs from the SEC guidance on rollover recommendations.

Overview of PTE 2020–02

Under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (the "Code"), transactions involving retirement plans, participants, or IRAs that involve financial conflicts of interest are treated as prohibited transactions. "Prohibited" in this sense means that an investment professional acting as a fiduciary in making recommendations cannot cause a plan, participant, or IRA to enter into the transaction unless there is an exemption. In the context of rollover recommendations, investment professionals who make fiduciary recommendations cannot comply by only disclosing the financial conflict of interest, that is, the prohibited transaction; instead, they must also satisfy the conditions of an exemption in order to undertake the transaction. One of the prohibitions under ERISA and the Code is that a fiduciary (e.g., an investment professional who provides fiduciary advice) cannot use its authority to cause itself or an affiliate to receive compensation, e.g., an advisory fee from the rollover IRA.

A key issue is whether a rollover recommendation is fiduciary advice. A DOL regulation defines fiduciary investment advice using a five-part test. One element of that test is whether the advice is given on a "regular basis." The DOL previously took the position that a rollover recommendation did not satisfy this part of the test unless the investment professional was already a fiduciary to the plan. In the preamble to PTE 2020–02, the DOL reverses this position and then further expands on its view in a series of Frequently Asked Questions (FAQs) issued after PTE 2020–02 went into effect.

In the FAQs, the DOL indicates that a "single, discrete instance of advice to roll over assets" from a plan to an IRA would not meet the regular basis requirement. However, it indicates that the rollover recommendation would be considered to be on a regular basis when it is part of an ongoing relationship or the "beginning of an intended future ongoing relationship" with the participant. The DOL explains its analysis as follows:

> "Similarly, when the investment advice provider has **not previously provided advice** but **expects** to regularly make investment recommendations regarding the IRA as part of an ongoing relationship, the **advice to roll assets out** of an employee benefit plan into an IRA **would be the start of an advice relationship that satisfies the regular basis requirement.** The 1975 test extends to the entire advice relationship and does not exclude the first instance of advice, such as a recommendation to roll plan assets to an IRA, in an ongoing advice relationship." [Emphasis added]

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As a result, even if the investment professional has not given financial advice to a participant in the past (for example, to another IRA owned by the participant), the expectation that it will do so in the future satisfies the "regular basis" requirement. If the other four parts of the test are satisfied, and they usually are in the ordinary course of business, then the rollover recommendation will be fiduciary advice, and an investment professional will need to engage in a defined prudent process to make that recommendation.

Since a rollover recommendation will ordinarily be fiduciary advice and will almost always result in increased compensation to the professional, an exemption is needed in order to retain the compensation earned as a result of the recommendation. (The Department of Labor uses the term "rollover recommendation" to mean a rollover from an ERISA-governed retirement plan to an IRA, from an IRA to a plan, from one IRA to another, and the transfer of retirement assets from one type of account, such as a brokerage account, to another, such as an advisory account.) PTE 2020–02 includes all of those recommendations within its scope and provides relief for rollover recommendations that result in a prohibited transaction, so long as its conditions are satisfied.

The relief provided by PTE 2020–02, though, extends only to prohibited transactions associated with nondiscretionary recommendations. While a rollover recommendation is, by definition, a nondiscretionary recommendation and therefore eligible for relief under the PTE, the same is not true of certain other prohibited financial conflicts of interest; for example, conflicts in an IRA that are managed with discretion. Where an investment professional has discretion over the investments for a retirement investor, e.g., in an IRA, and a financial conflict occurs, the PTE does not provide relief, even if its conditions are satisfied.

PTE 2020–02 took effect on February 16, 2021, but the DOL and Internal Revenue Service (IRS) indicated that its requirements would not be enforced until after December 20, 2021. In the interim, the DOL and IRS said they would follow a non-enforcement policy with respect to prohibited transaction claims against investment advice fiduciaries who are working diligently and in good faith to comply with "Impartial Conduct Standards."

When the exemption fully applies on December 21, 2021, if an investment professional gives fiduciary advice to a retirement investor, the financial institution (i.e., the registered investment adviser firm) is also considered a fiduciary. In order to obtain the relief provided by PTE 2020–02, the financial institution and investment professional must:

1. **Acknowledge their fiduciary status in writing.** The acknowledgment of fiduciary status must be clear and unequivocal—ambiguous statements of fiduciary status that would leave a reasonable investor unsure of whether a recommendation is rendered in a fiduciary capacity are insufficient. To assist financial institutions in complying with this condition, the DOL has provided model language in its FAQs that will satisfy the fiduciary acknowledgment requirement, though financial institutions are not required to use the model language.
2. **Disclose their services and material conflicts of interest.** Before recommending a rollover, a financial institution must give a retirement investor a written description of material conflicts of interest arising out of the financial institution's services, including a rollover recommendation. Financial institutions must disclose, for example, conflicts associated with proprietary products, payments from third parties, and compensation arrangements for both the financial institution and investment professional. The disclosure cannot be merely a "check-the-box" activity; it must be designed to allow a reasonable person to assess the scope and severity of the financial institution's and investment professional's conflicts of interest.
3. **Adhere to "Impartial Conduct Standards."**

The Impartial Conduct Standards require financial institutions and investment professionals to:

- Give advice that is in the "best interest" of the retirement investor. The best interest standard has two chief components: prudence and loyalty.
  - o Under the prudence standard, the advice must meet a standard of care virtually identical to the ERISA prudent process standard.
  - o Under the loyalty standard, advice providers may not place their own interests ahead of the interests of the retirement investor or subordinate the retirement investor's interests to their own.
- Charge no more than reasonable compensation and comply with federal securities laws regarding "best execution."
- Make no misleading statements about investment transactions and other relevant matters.

Note that the best interest standard does not prevent financial institutions and investment professionals from receiving payment for their advice. Instead, the best interest standard allows investment professionals and financial institutions to provide investment advice (e.g., a rollover recommendation) despite having a financial interest in the transaction (e.g., compensation from the rollover IRA) so long as they engage in a best interest, or prudent, process to develop the recommendation and do not place their interests ahead of the retirement investor's or subordinate the retirement investor's interests to their own.

4. **Adopt policies and procedures designed to ensure compliance with the Impartial Conduct Standards and to mitigate conflicts of interest.** Financial institutions must establish and enforce policies and procedures prudently designed to ensure that the financial institution and its investment professionals comply with the Impartial Conduct Standards. In addition, the policies and procedures must mitigate conflicts of interest to the extent that a reasonable person would conclude that their practices do not create an incentive for the financial institution or investment professional to place their interests ahead of the retirement investor's.
5. **Document and disclose to the retirement investor the specific reasons that a rollover recommendation is in the participant's best interest.** For recommendations to roll over assets, the relevant factors to be considered include, but are not limited to:
   - the alternatives to a rollover, including leaving the money in the plan, if permitted;
   - the fees and expenses associated with both the plan and the IRA;
   - whether the employer pays for some or all of the plan's administrative expenses; and
   - the different levels of services and investments available under the plan and the IRA.

   When considering the alternatives to a rollover, the financial institution and investment professional generally should not focus solely on the retirement investor's existing investment allocation, without any consideration of other investment options in the plan. Since the DOL definition of rollover is broader than the common usage of that term, investment professionals should keep in mind that this requirement also applies to other "rollover" recommendations, including a recommendation that a retirement investor transfer his or her IRA from another firm.
6. **Conduct an annual retrospective compliance review.** Financial institutions must

conduct an annual retrospective review that is reasonably designed to detect and prevent violations of, and achieve compliance with, the Impartial Conduct Standards and their policies and procedures. The methodology and results of the retrospective review must be reduced to a written report that is certified by one of the financial institution's senior executive officers. The financial institution must retain the report, certification, and supporting data for six years and provide these documents to the DOL within 10 business days of a request. The DOL expects financial institutions to use the results of the review to find more effective ways to help ensure that investment professionals are providing investment advice in accordance with the Impartial Conduct Standards and to correct any deficiencies in existing policies and procedures.

Discussion

PTE 2020–02 applies where there is a financial conflict of interest resulting from a nondiscretionary fiduciary recommendation. Since an investment professional will almost certainly receive more compensation if a plan participant agrees to a rollover recommendation, that recommendation will result in a prohibited transaction (i.e., the advisory fees from the rollover IRA) so that the firm, as the financial institution, and the investment professional will need to rely on PTE 2020–02 to avoid violating the prohibited transaction rules. The PTE's relief for the rollover recommendation and advisory fee from the IRA will be available even if the investment professional will be exercising investment discretion once the assets are transferred into the IRA because the rollover recommendation itself is nondiscretionary.

For those firms and investment professionals that find compliance with PTE 2020–02 overly burdensome, an alternative is available: rollover education. That is, a financial institution and investment professional may provide information about a participant's alternatives (e.g., leave the assets in the plan, roll to a new employer's plan, take a taxable distribution, or roll over the assets to an IRA), along with an explanation of the advantages and disadvantages of each option. So long as the information is not biased in favor of the rollover option, and there is not an implicit or explicit recommendation of which option a participant should choose, the education will not be considered fiduciary advice. As a result, an exemption will not be needed. If a firm chooses this approach, it should consider, for risk management purposes, preparing a written explanation of the alternatives and the considerations to be given to a participant, as well as an acknowledgement that the participant was provided with education and not a recommendation.

Conclusion

PTE 2020–02 conditions its relief from the prohibited transaction provisions in ERISA and the Code if the conditions of the exemption are satisfied, including the rollover Impartial Conduct Standards, which include a requirement that the recommendation be in the "best interest" of the retirement investor. Financial institutions must document the reasons that a rollover recommendation is in the best interest of the retirement investor and provide that documentation to the retirement investor. In addition, the PTE's conditions require that financial institutions adopt policies and procedures that are prudently designed to ensure compliance with the Impartial Conduct Standards and that mitigate permitted conflicts of interest; and conduct and document an annual retrospective review of compliance. ■