



Executive Compensation and Benefits Alert

If you have any questions regarding the matters discussed in this memorandum, please contact the attorney listed below or call your regular Skadden contact.

Jeffrey Lieberman

Counsel / New York

212.735.2734

jeffrey.lieberman@skadden.com

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West
New York, NY 10001
212.735.3000

DOL Proposes Amendments to Definition of Investment Advice Fiduciary

On October 31, 2023, the U.S. Department of Labor (DOL) released proposed amendments to the regulations under Section 3(21) of the Employee Retirement Income Security Act of 1974 (ERISA) to the definition of an “investment advice fiduciary” as well as to certain related prohibited transaction class exemptions (collectively, the Proposal). The Proposal is the latest in over a decade of efforts by the DOL to increase the scope of activities and relationships that make a person a fiduciary under ERISA and Section 4975 of the Internal Revenue Code (Code). The amendments would subject more advisers to the stringent fiduciary standards under ERISA with respect to plans subject to the act, and to the prohibited transaction rules under ERISA and Section 4975 of the Code, including with respect to receipt of compensation as a result of such advice.

The Five-Part Test

Currently, DOL regulations apply a five-part test in determining who is an investment advice fiduciary, which provides that a person is a fiduciary only if: (1) they render advice 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 or a plan fiduciary, (4) the advice serves as a primary basis for investment decisions with respect to plan assets and (5) the advice is individualized based on the particular needs of the plan.

The Proposed Standard

The Proposal provides that a person would be an investment advice fiduciary under Title I and Title II of ERISA if they provide investment advice or make an investment recommendation to a “retirement investor” (a plan, plan fiduciary, plan participant or beneficiary; IRA, IRA owner or beneficiary; or IRA fiduciary) for a fee or other compensation, direct or indirect, and:

- A. the person either directly or indirectly (*e.g.*, through or together with any affiliate) has discretionary authority or control, whether or not pursuant to an agreement, arrangement or understanding, with respect to purchasing or selling securities or other investment property for the retirement investor;
- B. the person either directly or indirectly (*e.g.*, through or together with any affiliate) makes investment recommendations to investors on a regular basis as part of their business and the recommendation is provided under circumstances indicating that it is based on the particular needs or individual circumstances of the retirement

Executive Compensation and Benefits Alert

investor and may be relied upon by the investor as a basis for investment decisions that are in their best interest; and

- C. the person making the recommendation represents or acknowledges that they are acting as a fiduciary when making investment recommendations.

Notably, unlike under the current test, Clause B would eliminate the requirement that advice be provided to the investor “on a regular basis” and that advice be provided pursuant to an agreement or understanding that the investment advice will serve as a primary basis for a retirement investor’s investment decision. Instead, the Proposal focuses on whether the adviser is a person who makes investment recommendations to investors “on a regular basis as part of their business” (*i.e.*, investment professionals). Rather than a “primary basis” test, the Proposal requires consideration as to whether the circumstances under which the advice is given indicate that it is based on the particular needs or circumstances of the investor. In the preamble to the proposed regulation, the DOL makes clear that, under the Proposal, one-time advice could be fiduciary in nature and there is no specific exclusion for transactions involving “sophisticated investors.”

‘Recommendation’

Under the Proposal, a “recommendation” is a communication that, based on its content, context and presentation, would reasonably be viewed as a suggestion that the retirement investor engage in or refrain from taking a particular course of action. The Proposal also defines the scope of the phrase “recommendation of any securities transaction or other investment transaction or any investment strategy involving securities or other investment property” as a recommendation as to:

- The advisability of acquiring, holding, disposing of or exchanging securities or other investment property, as to investment strategy, or as to how securities or other investment property should be invested after such securities or other investment property is rolled over, transferred or distributed from the plan or IRA.
- The management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, selection of other persons to provide investment advice or investment management services, selection of investment account arrangements (for example, brokerage versus advisory accounts), or voting of proxies appurtenant to securities.
- Rolling over, transferring or distributing assets from a plan or IRA, including recommendations as to whether to engage in the transaction, the amount, the form and the destination of such a rollover, transfer or distribution.

The DOL states that it aims to align the definition of “recommendation” with guidance adopted by the Securities and Exchange Commission (SEC) and other governmental agencies.

Therefore, the Proposal provides that advice to a plan participant regarding a decision to roll over assets from the plan (or otherwise, including from one IRA to another) would generally be fiduciary advice, regardless of whether the assets are rolled over to an account that the adviser or an affiliate manages, or whether the rollover advice includes any specifics on how to invest such assets. The preamble to the proposed regulation indicates that providing general educational materials continues to not be a recommendation.

Amendments to Prohibited Transaction Class Exemptions

The Proposal also includes amendments to certain related prohibited transaction class exemptions (PTCEs), 75-1, 77-4, 80-83, 83-1 and 86-128, generally to eliminate coverage of a number of transactions arising from fiduciary investment advice (as opposed to discretionary actions). The effect would be that fiduciaries (as the definition is proposed to be expanded) would generally need to rely on PTCE 2020-02 or potentially 84-24 (with respect to “Independent Producers” as described below) both of which would be amended by the Proposal, for transactions that would result in compensation that is otherwise prohibited due to such status.

PTCE 2020-02 permits various types of otherwise prohibited variable compensation to be paid to financial institutions and investment professionals as fiduciaries, provided they acknowledge their fiduciary status in writing, disclose their services and material conflicts of interest, adhere to certain impartial conduct standards, adopt policies and procedures prudently designed to ensure compliance with the impartial conduct standards and mitigate conflicts of interest. Among other requirements, the reasons for a rollover recommendation must be specifically documented and disclosed to explain how a recommendation is in the retirement investor’s best interest. Financial institutions are required to conduct an annual retrospective compliance review. The Proposal increases certain disclosures and review requirements, including with respect to rollovers, and provides some additional context for compliance with the impartial conduct standards and policies and procedures (including compensation programs).

PTCE 84-24 allows fiduciaries to receive compensation when plans and IRAs enter into certain insurance and mutual fund transactions recommended by the fiduciary (or affiliates), as well as certain related transactions. The Proposal would, among other things, amend PTCE 84-24 to cover only commissions and certain fees for “Independent Producers” (that sell only insurance products of two or more unrelated insurers) selling non-securities

Executive Compensation and Benefits Alert

annuities or other insurance products not regulated by the SEC, if certain conditions are satisfied, including that the Independent Producer acknowledges fiduciary status, and meets certain disclosure requirements and conduct standards similar to PTCE 2022-2. The insurer whose policy is sold would need to establish appropriate policies and procedures and meet other criteria also similar to PTCE 2002-2, but would not be required to acknowledge fiduciary status, and would not be treated as a fiduciary simply by virtue of such supervisory activities.

* * *

This note is intended as an overview of some of the important revisions set forth in the Proposal, which is subject to a 60-day comment period that can be extended by the DOL. It is expected that many comments, and potentially legal challenges, will be made by different groups opposed to its implementation. How those comments and challenges affect what may be ultimately adopted by the DOL remains to be seen.