INVESTMENT ADVISER ALERT: Preparing For the Full Implementation of the DOL Fiduciary Rule

The second iteration of the Department of Labor Fiduciary Rule – PTE 2020-02 (DOL Fiduciary Rule) became effective on Feb. 16, 2021. However, the Department of Labor (DOL) provided that it would not pursue enforcement actions against firms who work "diligently" to comply with the Impartial Conduct Standards. The Impartial Conduct Standards consist of the following:

- Best Interest Standard of Care;
- Limitation to Reasonable Compensation; and
- No Materially Misleading Statements.

This enforcement waiver by the DOL is effective until Dec. 20, 2021. After this date, investment advisers will be required to comply with all of the requirements of the DOL Fiduciary Rule, in addition to the Impartial Conduct Standards, so as to rely upon the DOL Fiduciary Rule.

When Is an Investment Adviser Subject to a Prohibited Transaction?

The DOL Fiduciary Rule implements the previously applicable five-part test to determine if an investment adviser or any of its investment professionals is an investment advice fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (Code). The 2016 DOL Fiduciary Rule did away with this five-part test. Pursuant to the re-instituted five-part test, to be a fiduciary, an investment adviser or any of its investment professionals must:

1. 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 retirement plan subject to the terms of ERISA (Plan), Plan fiduciary or individual retirement account (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.

All of the elements of the five-part test must be satisfied for an investment adviser and its investment professionals to be a fiduciary under ERISA and the Code.

NEXT

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Pursuant to the provisions of ERISA and the Code, an investment adviser and its investment professionals may not deal with the income or assets of a Plan or an IRA in the investment adviser's or its investment professionals' own best interest or for its/their own account. If an investment adviser and its investment professionals, when acting as a fiduciary in regard to the assets of a Plan or an IRA, act in such a self-interested manner, they are engaging in a prohibited transaction under ERISA and the Code. An investment adviser and its investment professionals may not engage in a prohibited transaction except pursuant to a prohibited-transaction exemption.

An investment adviser whot charges only a level fee (assets under management based/flat fee) that does not vary on the basis of the investment advice provided is not engaging in a prohibited transaction. However, when an investment adviser or its investment professionals provide investment advice that causes the investment adviser and/or its investment professionals to receive the level fee, such as through advice to roll Plan assets to an IRA, the fee (including the ongoing management fee paid with respect to the IRA), is prohibited under ERISA and the Code. This same prohibited transaction analysis applies to investment advice relating to rollovers from a Plan to a Plan, from an IRA to another IRA or from one type of account to another (e.g. commission-based account to a fee-based account). Therefore, when providing fiduciary investment advice in the context of a rollover recommendation, an investment adviser and its investment professionals must rely on the DOL Fiduciary Rule prohibited-transaction exemption.

So as to be acting as a fiduciary when providing a rollover recommendation, an investment adviser and its investment professionals must satisfy all five elements of the five-part fiduciary test. The DOL provides some guidance in the DOL Fiduciary Rule relating to application of the five-part fiduciary test to rollover recommendations.

Regular Basis

The DOL provides that financial services professionals may engage in one-time transactions without becoming fiduciaries, including by assisting with a rollover. Parties can make clear in their communications that they do not intend to enter into an ongoing relationship to provide investment advice and act in conformity with that communication. In the event that assistance with a rollover does in fact mark the beginning of an ongoing relationship, however, the functional fiduciary test appropriately covers the entire fiduciary relationship, including the first instance of advice.

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Primary Basis for Investment Decisions

The DOL does not interpret the "primary basis" requirement as requiring proof that the advice was the single most important determinative factor in a client's or prospective client's (Retirement Investor) investment decision. If the parties reasonably understand that that advice is important to the Retirement Investor and could determine the outcome of the investor's decision, that is enough to satisfy the "primary basis" requirement. An investment adviser should not expect to avoid fiduciary status through a boilerplate disclaimer buried in the fine print while in all other communications it is holding itself out as rendering best-interest advice that can be relied upon by the Retirement Investor in making investment decisions. While financial services professionals may contractually disclaim engaging in activities that trigger elements of the five-part test, such as rendering advice that can be relied upon as a primary basis for the Retirement Investor's investment decisions, they must do so clearly and act accordingly to demonstrate that there is in fact no mutual agreement, arrangement, or understanding to the contrary.

Satisfying the Impartial Conduct Standards - Prior to Dec. 20, 2021

As described above, so as to rely upon the DOL Fiduciary Rule prior to Dec. 20, 2021, investment advisers must satisfy the Impartial Conduct Standards when acting as a fiduciary in providing a rollover recommendation. During this period, there is no specific requirement regarding documentation that must be maintained by an investment adviser evidencing satisfaction of the Impartial Conduct Standards. Regardless, it is recommended that investment advisers utilize some format for rollover recommendation information collection and analysis so as to evidence satisfaction of the Impartial Conduct Standards. See below for additional information under the heading Documentation of Rollover Recommendations.

Satisfying the Requirements of the DOL Fiduciary Rule - Beginning Dec. 20, 2021

Following is a summary of the requirements of the DOL Fiduciary Rule effective Dec. 20, 2021.

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Disclosure

The following disclosures are required to be provided to the Retirement Investor recipient of a rollover recommendation prior to engaging in any transactions:

- A written acknowledgement that the investment adviser and its investment professionals are fiduciaries under Title I of ERISA and the Code, as applicable, with respect to any fiduciary investment advice provided by the investment adviser and its investment professionals to the Retirement Investor; and
- A written description of the services to be provided and the investment adviser's and investment professionals' material conflicts of interest; and
- The Retirement Investor must provide documentation of the specific reasons that any recommendation to roll over assets from one Plan or IRA to another Plan or IRA, or from one type of account to another, is in the Retirement Investor's best interest.

The requirement can be satisfied through any disclosure, or combination of disclosures, including Form ADV Part 2A. Generally, investment advisers will satisfy the first two listed bullet points through delivery of its Form ADV Part 2A and form of advisory agreement.

The DOL provides model language that may be utilized by investment advisers relating to the required fiduciary acknowledgment – which can be included in investment advisers' Form ADV Part 2A. The model language is as follows:

When we provide investment advice to you regarding your retirement plan account or individual retirement account, we are fiduciaries within the meaning of Title I of the Employee Retirement Income Security Act and/or the Internal Revenue Code, as applicable, which are laws governing retirement accounts. The way we make money creates some conflicts with your interests, so we operate under a special rule that requires us to act in your best interest and not put our interest ahead of yours.

Once disclosure has been provided, the investment adviser is not obligated to provide it again, except at the Retirement Investor's request or if the information has materially changed.

Documentation of Rollover Recommendations

In regards to the documentation required to satisfy the third bullet under Disclosure listed above, the DOL provides some general guidance. The DOL provides that factors that an investment adviser and its investment professionals should consider and document (depending upon the type of rollover of assets) include the following:

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- **Rollover from a Plan to IRA – the Retirement Investors alternatives to a rollover, including:**
  - Leaving the money in the Plan, if permitted;
  - Selecting different investment options;
  - 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.
- **Rollover from an IRA to an IRA, or changes from a commission-based account to a fee-based arrangement, a prudent recommendation would include consideration and documentation of:**
  - Consideration and documentation of the services that would be provided under the new arrangement.

An investment adviser and its investment professionals can consider other factors, including those that are important to a Retirement Investor as part of their rollover recommendation.

To satisfy the conditions for a Plan to IRA rollover recommendation, the DOL expects that investment advisers and their investment professionals will make diligent and prudent efforts to obtain information about the existing Plan and the participant's interest in it. If the Retirement Investor is unwilling to provide the information, even after a full explanation of its significance, and the information is not readily available, the investment adviser and its investment professionals should make a reasonable estimation of expenses, asset values, risk and returns based upon publicly available information. An investment adviser and its investment professionals simply providing that the Retirement Investor would not provide the requested information is insufficient, and does not alleviate the requirements pursuant to the DOL Fiduciary Rule when making a rollover recommendation.

Furthermore, the DOL provides that a rollover recommendation should not be based solely on the Retirement Investor's existing investment allocation without any consideration of other investment options in the Plan. A "prudent fiduciary" would carefully consider the options available to the investor in the Plan, including options other than the Retirement Investor's current investments, before recommending that the participant roll assets out of the Plan.

Policies and Procedures

The DOL Fiduciary Rule requires that investment advisers establish, maintain and enforce written policies and procedures designed to ensure compliance with the Impartial Conduct Standards. The investment adviser's policies and procedures are required to mitigate conflicts of interest to the extent that a reasonable person reviewing the policies and procedures and incentive practices as a whole would conclude that they do not create an incentive for the investment adviser or its investment professionals to place their interest ahead of the Retirement Investor. In addition, the policies and procedures should address how to document rollover recommendations, consistent with the requirements detailed above.

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Periodic Review of Policies and Procedures

Investment advisers must periodically and reasonably review their policies and procedures and revise them as necessary to ensure that the policies and procedures continue to satisfy the conditions of the DOL Fiduciary Rule.

Retrospective Review

The DOL Fiduciary Rule requires investment advisers to conduct a retrospective review, at least annually, that is reasonably designed to assist the investment adviser in detecting and preventing violations of, and achieving compliance with, the Impartial Conduct Standards and the policies and procedures governing compliance with the DOL Fiduciary Rule.

The methodology and results of the retrospective review must be reduced to a written report that is provided to one of the investment adviser's Senior Executive Officers (CEO, President, CCO). That officer is required to certify annually that:

- The officer has reviewed the report of the retrospective review;
- The investment adviser has in place policies and procedures prudently designed to achieve compliance with the conditions of this exemption; and
- The investment adviser has in place a prudent process to modify such policies and procedures as business, regulatory and legislative changes and events dictate, and to test the effectiveness of the policies and procedures on a periodic basis, the timing and extent of which is reasonably designed to ensure continuing compliance with the conditions of this exemption.

This retrospective review, report and certification must be completed no later than six months following the end of the period covered by the review. Investment advisers are required to retain the report, certification, and supporting data for a period of six years.

Self-Correction

The DOL Fiduciary Rule also provides self-correction procedures. Specifically, a non-exempt prohibited transaction will not have occurred due to a violation of the DOL Fiduciary Rule's conditions, provided:

- Either the violation did not result in investment losses to the Retirement Investor or the investment adviser made the Retirement Investor whole for any resulting losses;
- The investment adviser corrects the violation and notifies the DOL via email at IIAWR@dol.gov within 30 days of the correction;
- The correction occurs no later than 90 days after the investment adviser learned of the violation or reasonably should have learned of the violation; and
- The investment adviser notifies the persons responsible for conducting the retrospective review during the applicable review cycle, and the violation correction is specifically set forth in the written report of the retrospective review.

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Eligibility

Pursuant to the provisions of the DOL Fiduciary Rule, there are circumstances under which an investment adviser or its investment professionals will become ineligible to rely on the DOL Fiduciary Rule for a period of 10 years. The grounds for ineligibility involve certain criminal convictions or certain egregious conduct with respect to compliance with the DOL Fiduciary Rule.

Recordkeeping

Investment advisers must maintain records for six years demonstrating compliance with the DOL Fiduciary Rule.

BACK

RETURN TO TOP

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