

# U.S. DEPARTMENT OF LABOR ISSUES FINAL PROHIBITED TRANSACTION EXEMPTION REGARDING COMPENSATION FOR FIDUCIARY INVESTMENT ADVISERS OF RETIREMENT PLANS AND IRAS

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On December 15, 2020, the U.S. Department of Labor ("DOL") issued a final prohibited transaction exemption ("Final PTE") defining the conditions under which fiduciary investment advisers are allowed to receive compensation for advice to ERISA-covered benefit plans, plan participants, and IRAs, and to engage in principal transactions.

The prohibited transaction provisions of ERISA and the Internal Revenue Code ("Code") prohibit fiduciaries of ERISA plans and IRAs from engaging in self-dealing. Such investment advice fiduciaries are generally prohibited from receiving compensation regarding transactions involving ERISA plans and IRAs. The prohibited transaction rules also prohibit purchasing and selling investments with ERISA plans and IRAs when the fiduciaries are acting on behalf of their own accounts (so-called "principal transactions").

The relief afforded under the Final PTE represents the latest evolution in the rules under ERISA governing fiduciary investment advice that began with the DOL's 1975 five-part test defining who is an investment advice fiduciary under ERISA and Section 4975 of the Code. The DOL issued a final rule in 2016 that would have replaced these prior regulations with a new prohibited transaction exemption. However, the 2016 rule was vacated by the U.S. Court of Appeals for the Fifth Circuit in 2018, and the DOL issued a temporary non-enforcement policy under Field Advice Bulletin 2018-02, which provided relief from the prohibited transaction rules for investment advice fiduciaries who acted in good faith to comply with the "Impartial Conduct Standards" for transactions that would have been exempted under the vacated rule.

In the preambles, the Final PTE retains and interprets the five-part investment advisor test and updates its application for current market conditions. The regulatory provisions of the Final PTE then describe the conditions under which the new exemption is available.

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The Final PTE applies to registered investment advisers, broker-dealers, banks and insurance companies (“Financial Institutions”) and their employees and agents (“Investment Professionals”) who provide fiduciary investment advice to “Retirement Investors.” The exemption defines “Retirement Investors” broadly to include plan participants, IRA owners, and retirement plan and IRA fiduciaries. Under the conditions specified in the Final PTE, investment advice fiduciaries are permitted to receive compensation that would otherwise violate the prohibited transaction rules of ERISA and the Code, including commissions, 12b–1 fees, trailing commissions, sales loads, mark-ups and mark-downs, and revenue sharing payments. The exemption’s relief extends to prohibited transactions arising as a result of investment advice to roll over assets from a plan to an IRA, or from one IRA to another IRA. The exemption also allows Financial Institutions to engage in principal transactions with plans and IRAs in which the Financial Institution purchases or sells certain investments from its own account.

The Final PTE is intended to harmonize relief applicable to investment advice fiduciaries extended by other federal regulatory agencies. The DOL intends its Final PTE conduct standards to align with rulemaking regarding fiduciary conduct standards applicable to investment advisers under the SEC’s fiduciary interpretation of the Investment Advisers Act of 1940, the SEC’s Regulation Best Interest conduct standards for broker-dealers, and the NAIC’s Suitability in Annuity Transactions Model Regulation applicable to insurance agents and carriers.

The Final PTE departs in a few respects from the proposed exemption issued on July 7, 2020:

1. The recordkeeping requirements have been narrowed to allow only the DOL and Department of Treasury to obtain access to a Financial Institution’s records, rather than allowing Retirement Investors and plan fiduciaries to have access;
2. The disclosure requirements now include a special written disclosure to Retirement Investors regarding the reasons a rollover recommendation satisfies the best interest standard;
3. The retrospective review provision now requires that certification be provided by a senior executive officer, rather than the CEO of the Financial Institution; and
4. A self-correction procedure has been added to address violations of the Final PTE conditions and standards.

To obtain the relief offered under the Final PTE, Investment Professionals and Financial Institutions must comply with the following conditions:

### Impartial Conduct Standards

- *Best Interest* – The investment advice must be such that it “reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, and does not place the financial or other interests of the Investment Professional, Financial Institution or any affiliate, related entity, or other party ahead of the interests of the Retirement Investor, or subordinate the Retirement Investor’s interests to their own.”

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- *Reasonable Compensation* – A Financial Institution and its Investment Professionals, and their affiliates are not permitted to receive compensation for investment recommendations in that exceeds “reasonable compensation” within the meaning of section 408(b)(2) of ERISA and section 4975(d)(2) of the Code. The determination of reasonableness depends on the facts and circumstances, and requires consideration of the market value of the services, rights and benefits provided by the Financial Institution and Investment Professional delivering the advice.
- *Best Execution* – The Financial Institution and its Investment Professionals must obtain the best execution of the investment transaction reasonably available under the circumstances, as required by federal securities laws.
- *Not Materially Misleading* – Any statements made by the Financial Institution and its Investment Professionals to the Retirement Investor about the recommended investment transaction and other relevant matters must not be materially misleading.

Disclosure Requirements

The following disclosures must be made by the Financial Institution prior to entering the transaction with the Retirement Investor:

- A written acknowledgment from the Financial Institution that it and its Investment Professionals are fiduciaries under ERISA and the Code with respect to the fiduciary investment advice it provides to the Retirement Investor.
- A written description of the services to be provided, and identifying the Financial Institution’s and Investment Professional’s material conflicts of interest that is accurate and not misleading in all material respects.
- Documentation of the specific reasons why any recommendation to rollover assets from a plan to another plan or IRA, or from and IRA to another IRA is in the best interest of the Retirement Investor.

Policies and Procedures

The Final PTE requires Financial Institutions to establish, maintain and enforce written policies and procedures to facilitate compliance with the exemption. The policies must be prudently designed to ensure that the Financial Institution and its Investment Professionals comply with the Impartial Conduct Standards. In addition, the policies must mitigate the Investment Professional’s and Financial Institution’s conflicts of interests, such that a reasonable person would not view the Financial Institution’s incentive practices as a whole as creating an incentive for the Financial Institution and Investment Professionals to place their interests ahead of the interests of the Retirement Investors.

Retrospective Review

The Final PTE requires Financial Institutions to conduct an annual retrospective review reasonably designed to assist in detecting and preventing violations of, and achieving compliance with, the Impartial Conduct Standards and the Financial Institution’s policies and procedures in place to facilitate compliance with the exemption. The results of the retrospective review must be reported in written form and delivered to a “Senior Executive Officer” of the Financial Institution, including the CEO, Chief Compliance Officer, Chief Financial Officer, President, or one of the three most senior officers of the Financial Institution.

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The Senior Executive Office must certify within six months of the end of the annual respective review period that: (i) the officer reviewed the report; (ii) the Financial Institution has in place policies and procedures prudently designed to achieve compliance with the conditions of the Final PTE; and (iii) the Financial Institution 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 such policies and procedures on a periodic basis, the timing and extent of which is reasonably designed to ensure continuing compliance with the conditions of the Final PTE.

The Financial Institution must retain the report, certification, and supporting data for a period of six years. The documentation of the retrospective review must be made available to the DOL within 10 business days of DOL's request.

### Self-Correction

Financial Institutions are able to self-correct violations of the conditions of the Final PTE that result in an investment loss. The self-correction action must make the Retirement Investor whole for any loss, and must be reported to the DOL within thirty days of the violation and correction. The Financial Institution must self-correct within 90 days of the date it learned of the violation, or should have reasonably learned of the violation. The self-correction must be documented and included in the retrospective review report.

### Exclusions

The exemption is not available to Financial Institutions and Investment Professionals if the fiduciary is the employer of the employees covered by the ERISA plan, or a named fiduciary or plan administrator with respect to the plan. The Final PTE is not applicable to transactions undertaken by Retirement Investors where advice is generated through computer interactive models and applications (so-called "robo-advice").

In addition, investment advice fiduciaries are barred from relying upon the exemption for ten years following conviction of any crime under ERISA Section 411 related to the provision of investment advice to Retirement Investors. However, the DOL may grant a petition to allow Financial Institutions to have continued reliance on the exemption to the extent granting such a waiver is not contrary to the purposes of the Final PTE.

Finally, the DOL may also impose a ten-year bar from reliance upon the exemption for Financial Institutions and Investment Professionals who are provided written notice of ineligibility by the DOL based on having: (i) engaged in a systematic pattern or practice of violating the conditions of the exemption in connection with otherwise non-exempt prohibited transactions; (ii) intentionally violated the conditions of the exemption in connection with otherwise non-exempt prohibited transactions; or (iii) provided materially misleading information to the DOL in connection with the Financial Institution's or Investment Professional's conduct under the exemption.

### Recordkeeping

The Financial Institution has to maintain for a period of six years, records demonstrating compliance with the exemption, and it must make such records available to authorized representatives of the DOL or U.S. Department of Treasury.

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Exemption for Principal Transactions

The Final PTE permits Financial Institutions to enter into certain principal transactions with Retirement Investors where the institution purchases or sells certain investments from its own account, including:

*Riskless Principal Transactions* – A transaction where a Financial Institution, after having received an order from a Retirement Investor to buy or sell an investment product, purchases or sells the same investment product for the Financial Institution's own account to offset the contemporaneous transaction with the Retirement Investor.

*Covered Principal Transactions* – A transaction involving certain specified types of investments:

- Purchases of any securities or investment property by the Financial Institution from an ERISA plan or IRA; and
- Sales to an ERISA plan or IRA by the Financial Institution, the following: (i) corporate debt securities offered pursuant to a registration statement under the Securities Act of 1933; (ii) U.S. Treasury securities; (iii) debt securities issued or guaranteed by a U.S. federal government agency other than the Department of Treasury; (iv) debt securities issued or guaranteed by a government-sponsored enterprise; (v) municipal bonds; (vi) certificates of deposit; and (vii) interests in Unit Investment Trusts.

The Final PTE becomes effective February 16, 2021.

*Department of Labor, Employee Benefits Security Administration, 29 CFR Part 2550, Prohibited Transaction Exemption 2020-02, Improving Investment Advice for Workers & Retirees, 85 Fed. Reg. 82798 (December 18, 2020).*