DOL Reinstates Five-Part Test for Fiduciary Investment Advice | Fiduciary Focus Series

Aug 03, 2020

Categories:

Blogs
Fiduciary Focus
Tax Law Defined™ Blog

Authors:

Sarah N. Lowe

On June 29, 2020, the U.S. Department of Labor (DOL) proposed a new prohibited transaction exemption from the rules of ERISA and the Internal Revenue Code that would allow qualifying investment advice fiduciaries to receive what would otherwise be prohibited compensation ("Proposed Exemption")[1]. In conjunction with the Proposed Exemption, the DOL also issued a technical amendment which reinstated certain guidance that applied prior to the DOL's 2016 final fiduciary rule and its subsequent vacatur in 2018 by the U.S. Court of Appeals for the Fifth Circuit.

These rules are important for plan administrative, investment and other service providers to 401(k) and other retirement plans. In general, employers are typically not the fiduciary involved in a potential prohibited transaction related to investment advice, but employers should always be alert to services being marketed by plan vendors by reviewing information provided to participants related to plan distributions and IRA rollovers.

Background

ERISA's "conflict of interest" rules generally prohibit ERISA fiduciaries from dealing with the assets of plans for their own account, acting on both sides of a transaction and receiving fees from a third party in connection with a transaction involving plan assets. As a result, fiduciaries commit a prohibited transaction if they cause themselves or their affiliates to receive additional compensation, including from third parties.

ERISA's definition of fiduciary includes those persons and institutions who exercise discretion or possess discretionary responsibility or authority over a plan's assets or administration, and this definition has remained constant for some time. However, the fiduciary definition also includes those who render, or have the authority to render, investment advice for a fee or other

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

FBT Gibbons

compensation, direct or indirect, with respect to plan assets and this prong of the definition has been more controversial.

In 1975, shortly after ERISA's passage when traditionally defined benefit plans still dominated the retirement landscape, the DOL issued a five-part test that provided persons and institutions would be deemed to provide "investment advice" for purposes of the fiduciary definition if they (1) 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 plan fiduciary, (4) where such advice serves as a primary basis for investment decisions with respect to such plan assets, and (5) such advice is tailored to the particular needs of the plan. If such investment advice was provided for a fee or other compensation, then the person or institution providing the investment advice would be a fiduciary and subject to the fiduciary standard of care.

The DOL's 2016 final rule was the culmination of a regulatory effort that first began in 2010, reflecting the DOL's concern that investment professionals guiding plan and IRA investments were shielded from ERISA's fiduciary and prohibited transaction rules by the five-part test. The five-part test, after all, pre-dated a retirement landscape of participant-directed 401(k) plans and practices by plan vendors and others to encourage rollovers from 401(k) plans to IRAs. The DOL's 2016 final fiduciary rule dramatically expanded the circumstances when a person or entity became a fiduciary by virtue of providing advice on investments and recommendations to take distributions or rollovers from plans and IRAs.

Reverting to the five-part test acknowledges the investment advice fiduciary definition has narrowed. Nevertheless, in the preamble to the Proposed Exemption, the DOL has announced a "refreshed" interpretation of the five-part test in certain respects.

Reinterpretation of the Five-Part Test: The Rollover Context

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

First, in the preamble to the Proposed Exemption, the DOL announced that it is effectively overruling its Advisory Opinion 2005-23[2] which provided that advice to rollover assets from a plan did not constitute investment advice even when accompanied by a recommendation as to where the distribution would be invested. The DOL now reasons that advice to take a distribution from a plan necessarily is advice to liquidate or transfer the plan's property interest in the affected assets and to change the fiduciary oversight structure that applies to the assets. Of course, the other requirements of the five-part test would need to be met in order for a recommendation to roll over plan assets to constitute investment advice.

The DOL then examines how advice to take a rollover for a fee or other compensation might satisfy the other prongs of the five-part test. Presumably, DOL's interpretive approach to the other parts of the restored five-part test could be extended outside of a rollover context.

The DOL acknowledges that whether advice to take a plan distribution and rollover assets to an IRA satisfies the "regular basis" prong is a facts and circumstances determination. While such advice could be isolated and independent, it also could satisfy the "regular basis" prong based upon advice provided outside of the plan context (i.e., an advisor manages a plan participant's taxable account). Additionally, the DOL noted that the advice to take a rollover could be the "first step in an ongoing advice relationship that could satisfy the regular basis prong" of the five-part test, which seems to suggest potential retroactive application.

Whether there is an understanding or mutual agreement that investment advice will serve as "a primary basis" for investment decisions is based upon the reasonable understanding of the parties if no agreement or arrangement is demonstrated. Written disclaimers to the contrary will not be determinative, but rather will only be considered in assessing whether a mutual understanding exists. The DOL also clarifies that the requirement that there be an understanding or mutual agreement that the advice constitute "a primary basis" for investment decisions is not the same as requiring it to be "the primary basis."

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

In addition to the requirements of the five-part test, a person or institution must receive a fee or other compensation to be deemed an investment advice fiduciary. In the context of a rollover, the fees would be broadly interpreted to include fees received in connection with the rollover, including brokerage commissions, mutual fund and insurance sales commissions. However, once plan assets are rolled to an IRA, the DOL acknowledges the IRA is outside of ERISA's purview.

Advice to rollover assets from a plan to an IRA can constitute investment advice and cause the person or institution providing investment advice to be an investment advice fiduciary and therefore, subject to the conflict of interest prohibitions. Notably, once plan money is invested in an IRA, it is then subject only to the Code's prohibited transaction provisions. While this is not the broad authority that the DOL originally sought over IRAs, the refreshed interpretation causes some rollover solicitations to be subject to the applicable fiduciary and prohibited transaction provisions of ERISA and/or the Code.

The Proposed Exemption

The Proposed Exemption allows qualifying financial institutions and investment professionals who provide investment advice using "impartial conduct standards" to retirement investors to generally receive compensation that varies based upon their investment advice or which is paid by third parties and to engage in certain prohibited principle transactions in connection with their advice, notwithstanding the conflict of interest rules of ERISA and the Code. As is typical with prohibited transaction exemptions, certain transactions are excluded from relief under the Proposed Exemption (e.g., robo-advice without any personal interaction with an investment professional).

- Financial institutions include registered investment advisers, banks, insurance companies and broker-dealers.
- Investment professionals include certain employees, independent contractors, agents or representatives of financial institutions who have satisfied certain regulatory and

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

licensing requirements.

- The Proposed Exemption sets forth standards that can cause financial institutions and investment professional to become ineligible to use the exemption.

- Retirement investors are participants or beneficiaries with the ability to direct the investment of their account or take a distribution, the owner of an IRA acting on behalf of the IRA and a fiduciary of a plan or IRA.

The impartial conduct standards require:

- The investment advice must be in the best interest of the retirement investor at the time it is provided.
- The best interest standard requires prudence and requires that the qualifying investment advice fiduciary cannot put its or a related party's interest ahead of the retirement investor's or subordinate the retirement investor's interest to their own. The standard is intended to be interpreted with the SEC's Regulation Best Interest.
- No more than "reasonable compensation" within the meaning of ERISA section 408(b)(2) and the related Code provision can be paid.
- A best execution obligation applies.
- No materially misleading statements about the recommended transaction.

Prior to a recommended transaction, the financial institution or investment professional must provide to the retirement investor a written acknowledgment of fiduciary status under ERISA or the Code, a description of the services they will be providing and any material conflicts of interest they have in connection with the transaction.

Other requirements apply to financial institutions that use the exemption, including:

- Maintenance of policies and procedures designed to mitigate conflicts between financial institutions and investment professionals and retirement investors in connection with

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

covered fiduciary investment advice and transactions.

  - A financial institution must document the specific reasons any rollover recommendations, from one plan or IRA to another plan or IRA or one type of account to another (e.g., commission-based to fee-based), is in the best interest of the retirement investor.

- An annual retrospective review and written report of its compliance with the impartial conduct standards.
- An annual certification by its CEO (or equivalent officer) that he or she has reviewed the written report and that the financial institution has in place a process reasonably designed to ensure continuing compliance with the Proposed Exemption.
- A six-year recordkeeping requirement that generally allows those retirement investors involved in a fiduciary investment advice transaction to examine the records relating to their transaction (and allows the DOL access to all such records).

Harmonizing Regulation with SEC's Regulation Best Interest

The Proposed Exemption was published on the same day that the SEC's Regulation Best Interest (Regulation BI) became fully effective. Regulation BI establishes a "best interest" standard of conduct for broker-dealers and associated persons when they make a recommendation to a retail customer of any securities transaction or investment strategy involving securities. The Proposed Exemption, when viewed in light of Regulation BI's requirements, appears to harmonize the standards of conduct for investment professionals to act in the best interest of retail investors. Regulation BI enhances the broker-dealer standard of conduct beyond mere "suitability" to require that a broker-dealer not put its financial interests ahead of the interests of a retail customer when making recommendations.

If you have questions about the DOL's new (old) rule on fiduciary investment advice and the Proposed Exemption, contact Sarah

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

Lowe or any attorney in Frost Brown Todd's Employee Benefits & ERISA group.

Check out related articles in Frost Brown Todd's Fiduciary Focus Series, which provides critical updates and practical guidance related to retirement plans. You can also SIGN UP to receive updates on employee benefits and ERISA sent directly to your inbox.

---

[1] The exemption would also allow qualifying investment advice fiduciaries to engage in certain principal transactions.

[2] Advisory Opinion 2005-23 had been superseded by the 2016 final fiduciary rule, but the vacatur of such rule left Advisory Opinion 2005-23 ostensibly intact.

© 2026 FBT Gibbons LLP. May be considered attorney advertising in some jurisdictions.

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

FBT Gibbons