Fact Sheet: Department of Labor Finalizes Rule to Address Conflicts of Interest in Retirement Advice, Saving Middle Class Families Billions of Dollars Every Year

U.S. Department of Labor
Employee Benefits Security Administration

I. Summary

Since 1974, when Congress enacted the Employee Retirement Income Security Act (ERISA), the Department of Labor (DOL or Department) has worked to protect America's tax-preferred retirement savings. In the ensuing decades, there has been a dramatic shift in the retirement savings marketplace from employer-sponsored defined benefit plans to participant-directed 401(k) plans, coupled with the widespread growth in assets in Individual Retirement Accounts and Annuities (IRAs). When the basic rules governing retirement investment advice were created in 1975, 401(k) plans did not exist and IRAs had just been authorized. These rules have not been meaningfully changed since 1975.

These changes in the retirement landscape over the last 40 years have increased the importance of sound investment advice for workers, their families and plan fiduciaries. While many advisers do act in their customers' best interest, not everyone is legally obligated to do so and some do not. Many investment professionals, consultants, brokers, insurance agents and other advisers operate within compensation structures that are misaligned with their customers' interests and often create strong incentives to steer customers into particular investment products. These conflicts of interest do not always have to be disclosed and advisers have limited liability under federal pension law for any harms resulting from the advice they provide to plan sponsors and retirement investors. These harms include the loss of billions of dollars a year for retirement investors in the form of eroded plan and IRA investment results, often after rollovers out of ERISA-protected plans and into IRAs.

The Department's conflict of interest final rule and related exemptions will protect investors by requiring all who provide retirement investment advice to plans, plan fiduciaries and IRAs to abide by a "fiduciary" standard—putting their clients' best interest before their own profits. This final rulemaking fulfills the Department's mission to protect, educate, and empower retirement investors as they face important choices in saving for retirement in their IRAs and employee benefit plans.

II. Background

Beginning in 2009, the Department of Labor undertook a multi-year regulatory project to address the problems with conflicts of interest in investment advice, balancing the need to better protect retirement savings while minimizing disruptions to the many good practices and good advice that the industry provides.

From the outset, the project involved significant input from interested stakeholders, including two separate proposals published for public comment in 2010 and 2015. The Department held multi-day public hearings on the 2010 and 2015 proposals, hundreds of individual meetings with a wide range of stakeholders, and published the public comments and hearing transcripts on the DOL website. Thousands of comments and petitions came from consumer groups, plan sponsors, financial services companies, academics, elected government officials, trade and industry associations, and others, both in support of and in opposition to the proposals.

After careful consideration of the issues raised by the written comments, hearing testimony, and the extensive public record, the Department adopted a final rule and related final exemptions. The final rule defines who is a fiduciary investment adviser, while accompanying prohibited transaction class exemptions allow certain broker-dealers, insurance agents and others that act as investment advice fiduciaries to continue to receive a variety of common forms of compensation as long as they are willing to adhere to standards aimed at ensuring that their advice is impartial and in the best interest of their customers. The rulemaking package also includes a regulatory impact analysis which demonstrates the monetary harm caused to retirement investors from conflicted advice and the gains that will result from the rule.

Going forward, those that provide investment advice to plans, plan sponsors, fiduciaries, plan participants, beneficiaries and IRAs and IRA owners must either avoid payments that create conflicts of interest or comply with the protective terms of an exemption issued by the Department. Under new exemptions adopted with the rule, firms will be obligated to acknowledge their status and the status of their individual advisers as "fiduciaries." Firms and advisers will be required to make prudent investment recommendations without regard to their own interests, or the interests of those other than the customer; charge only reasonable compensation; and make no misrepresentations to their customers regarding recommended investments. Together, the rule and exemptions impose basic standards of professional conduct that are intended to address an annual loss of billions of dollars to ordinary retirement investors as a result of conflicted advice.

III. Effect of the Rule on Small Entities

The final rule and accompanying prohibited transaction exemptions will provide benefits to small plans, small plan sponsors and IRA investors by ensuring that firms and advisers render investment advice to them that is in their best interest. Plan sponsors may offer a pension plan where the investment decisions are made by the sponsor or by investment professionals who either manage the actual investments made by the plan or advise the particular sponsor as to which investments to make. The plan sponsor may also offer participants an individually directed individual account pension plan where the participant can direct their investments among a menu of potential investment options that the sponsor selects. In selecting the menu of plan options, the sponsor may seek the advice of investment professionals. The sponsor may also be involved in the selection and monitoring of investment advisers or educators to plan participants and beneficiaries who will be selecting among these options.

The rule and exemptions will impose certain compliance requirements discussed below on small service providers, such as broker-dealers, registered investment advisers, insurance companies and agents, pension consultants and others providing investment advice to plans or IRA investors. These service providers will incur reporting, disclosure, recordkeeping and other costs to comply with the rule and exemptions.

The Department anticipates that broker-dealers and insurers will be the most impacted by the final rule and exemptions while registered investment advisers and other ERISA fiduciary service providers will experience less of a burden.

IV. What Is Covered Investment Advice Under the Rule?

The rule describes the kinds of communications that would constitute investment advice and then describes the types of relationships in which those communications would give rise to fiduciary investment advice responsibilities.

Covered investment advice is defined as a recommendation to a plan, plan fiduciary, plan participant and beneficiary or IRA owner for a fee or other compensation, direct or indirect, as to the advisability of buying, holding, selling or exchanging securities or other investment property, including recommendations as to the investment of securities or other property after the securities or other property are rolled over, transferred or distributed from a plan or IRA.

Covered investment advice also includes recommendations as to 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 (e.g., brokerage versus advisory); or recommendations with respect to rollovers, transfers, or distributions from a plan or IRA, including whether, in what amount, in what form, and to what destination such a rollover, transfer, or distribution should be made.

The fundamental threshold element in establishing the existence of fiduciary investment advice is whether a "recommendation" occurred. A "recommendation" is a communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action. The more individually tailored the communication is to a specific advice recipient or recipients, the more likely the communication will be viewed as a recommendation. The Department has taken an approach to defining "recommendation" that is consistent with and based upon the approach taken by the Financial Industry Regulatory Authority (FINRA), the independent regulatory authority of the broker-dealer industry, subject to the oversight of the Securities and Exchange Commission (SEC).

The types of relationships that must exist for such recommendations to give rise to fiduciary investment advice responsibilities include recommendations made either directly or indirectly (e.g. through or together with any affiliate) by a person who:

Represents or acknowledges that they are acting as a fiduciary within the meaning of ERISA or the Internal Revenue Code (Code);

Renders advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the particular investment needs of the advice recipient; or

Directs the advice to a specific recipient or recipients regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the plan or IRA.

In order for a recommendation to constitute fiduciary investment advice, it must be rendered for a "fee or other compensation." "Fee or other compensation, direct or indirect" means any explicit fee or compensation for the advice received by the person (or by an affiliate) from any source, and any other fee or compensation received from any source in connection with or as a result of the recommended purchase or sale of a security or the provision of investment advice services including, though not limited to, such things as commissions, loads, finder's fees, and revenue sharing payments. A fee or compensation is paid "in connection with or as a result of" such transaction or service if the fee or compensation would not have been paid but for the transaction or service or if eligibility for or the amount of the fee or compensation is based in whole or in part on the transaction or service.

V. What Is Not Covered Investment Advice Under the Rule?

Not all communications with financial advisers will be covered fiduciary investment advice. As a threshold issue, if the communications do not meet the definition of "recommendations" as described above, the communications will be considered non-fiduciary. The final rule also includes some specific examples of other communications that would not constitute a fiduciary investment advice communications.

Education

For example, the Department believes that education about retirement savings and general financial and investment information is not only beneficial and helpful to plans, plan participants, and IRA owners, but may not rise to the level of recommendations as defined in the final rule. Education as defined in the rule will not constitute advice regardless of who provides the educational information (e.g. the plan sponsor or service provider), the frequency with which the information is shared, or the form in which the information and materials are provided (e.g. on an individual or group basis, in writing or orally, via a call center, or by way of video or computer software).

The education provision allows specific investment alternatives to be included as examples in presenting hypothetical asset allocation models or in interactive investment materials intended to educate participants and beneficiaries as to what investment options are available under the plan so long as they are designated investment alternatives selected or monitored by an independent plan fiduciary and other conditions are met. In contrast, because there is no similar independent fiduciary in the IRA context, the investment education provision in the rule does not treat asset allocation models and interactive investment materials with references to specific investment alternatives as merely "education."

General Communications

Similarly, general communications that a reasonable person would not view as an investment recommendation, including general circulation newsletters; commentary in publicly broadcast talk shows; remarks and presentations in widely attended speeches and conferences; research or news reports prepared for general distribution; general marketing materials, and general market data including data on market performance, market indices, or trading volumes, price quotes, performance reports, or prospectuses, would not constitute communications that are considered recommendations.

Platform Providers

Service providers, such as recordkeepers and third-party administrators, often offer a "platform" or selection of investment alternatives to plan fiduciaries such as employers who choose the specific investment alternatives that will be made available to participants for investing funds in their individual accounts. Simply marketing or making available a platform of investment alternatives without regard to the individualized needs of the plan, its participants, or beneficiaries if the plan fiduciary is independent of such service provider are not recommendations under the final rule – provided that such provider also represents in writing to the plan fiduciary that they are not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity. Furthermore, identifying investment alternatives that meet the objective criteria provided by an employer for those alternatives, such as size of a fund, type of asset or expense ratio, also are not advice.

Transactions with Independent Plan Fiduciaries with Financial Expertise

Under the final rule, ERISA fiduciary obligations are not imposed on advisers when providing advice in connection with a sale, purchase, loan, exchange, or other investment transaction with independent plan fiduciaries if the adviser knows or reasonably believes that the independent fiduciary is a licensed and regulated provider of financial services (banks, insurance companies, registered investment advisers, broker-dealers) or those that have responsibility for the management of $50 million in assets, and other conditions are met. The conditions are designed to make sure this exclusion is limited to true arm's length transactions between advisers and investment professionals or large asset managers who do not have a legitimate expectation that they are in a relationship where they can rely on the other adviser for impartial advice. Employers, who are plan fiduciaries and who manage plan assets and other assets totaling over $50 million, should be aware that advisers seeking to rely upon this provision may ask for a written representation that the employer is exercising independent judgment and is capable of evaluating investment risks. Further, the employer must be informed of the existence of the advisers' financial interest, if any, in the transaction and the adviser cannot receive a direct fee in association with the advice being provided.

Swap and Security-Based Swap Transactions

Communications by advisers to ERISA-covered employee benefit plans in swap or security-based swap transactions do not cause the advisers to become investment advice fiduciaries to the plan if, among other things, the adviser obtains a representation that the plan fiduciary understands he is not receiving impartial advice. This provision in the final rule has been coordinated with both the SEC and the Commodity Futures Trading Commission to be sure there is no conflict with the swap and security-based swap rules promulgated by those agencies under the Dodd–Frank Wall Street Reform and Consumer Protection Act.

Employees of Plan Sponsors, Affiliates, Employee Benefit Plans, Employee Organizations, or Plan Fiduciaries

Employees working in a company's payroll, accounting, human resources, and financial departments who routinely develop reports and recommendations for the company and other named fiduciaries of the sponsors' plans are not investment advice fiduciaries if the employees receive no fee or other compensation in connection with any such recommendations beyond their normal compensation for work performed for their employer.

Further, this exclusion also covers communications between employees, such as human resources department staff who communicate information to other employees about the plan and distribution options in the plan, as long as they are not registered or licensed advisers under securities or insurance laws and receive only their normal compensation for work performed by the employer (basically, the job responsibilities of these employees do not involve the provision of investment advice).

In summary, it is important to emphasize that the final rule requires certain disclosures for communications to not be considered investment advice in four of the above contexts: (1) platform provider disclosures; (2) disclosures for investment education materials; (3) disclosures for transactions involving independent fiduciaries with financial expertise; and (4) a swap transaction disclosures.

VI. Plan Sponsor Responsibility for the Selection and Monitoring of Educators or Advisers

If plan sponsors become involved in providing educational materials or even if they provide advice but do not receive a fee or other compensation for those communications, they would not become fiduciaries. Also, as mentioned, a plan sponsor employer may be involved in the selection and monitoring of plan service providers who would be providing investment education or advice to plan participants or beneficiaries. As with any designation and monitoring of a service provider to a plan, the designation and monitoring of a person to provide investment education or even investment advice is an exercise of fiduciary authority that must be done prudently and solely in the interest of the plan participants or beneficiaries.

If a plan participant or beneficiary selects a third party to provide education or advice, the plan sponsor would not have fiduciary responsibility for the actions of the third party where the plan sponsor neither selects nor endorses the educator or adviser, nor otherwise makes arrangements with the educator or adviser to provide such services.

In addition, the designation of an investment adviser to serve as a fiduciary may give rise to co-fiduciary liability if the person making and continuing such designation fails its fiduciary duties in making such designation, or knowingly participates in, conceals or fails to make reasonable efforts to correct a known breach by the investment adviser. However, in the context of an ERISA section 404(c) plan where plan participants exercise independent control over their investment choices, neither the designation of a person to provide education nor the designation of a fiduciary to provide investment advice to participants and beneficiaries would, in itself, give rise to fiduciary liability for loss, that is the direct and necessary result of a participant's or beneficiary's exercise of independent control.

VII. The Best Interest Contract: Stronger Protections for Retirement Savings

The Department's Best Interest Contract Exemption (which some refer to as the BIC or BICE) ensures retirement investors receive advice that is in their best interest while also allowing advisers to continue receiving commission-based compensation. Under ERISA and the Code, individuals providing fiduciary investment advice to plan sponsors, plan participants, and IRA owners are not permitted to receive payments creating conflicts of interest without a prohibited transaction exemption (PTE). ERISA authorizes the Secretary of Labor to grant PTEs.

The Best Interest Contract Exemption permits firms to continue to rely on many current compensation and fee practices, as long as they meet specific conditions intended to ensure that financial institutions mitigate conflicts of interest and that they, and their individual advisers, provide investment advice that is in the best interests of their customers.

Specifically, in order to align the adviser's interests with those of the plan or IRA customer, the exemption requires the financial institution to acknowledge fiduciary status for itself and its advisers. The financial institution and advisers must adhere to basic standards of impartial conduct, including giving prudent advice that is in the customer's best interest, avoiding making misleading statements, and receiving no more than reasonable compensation. The financial institution also must have policies and procedures designed to mitigate harmful impacts of conflicts of interest and must disclose basic information about their conflicts of interest and the cost of their advice. Importantly, the financial institution may not give its advisers financial incentives to make recommendations that are not in the customer's best interest.

Although the Department does not believe that disclosure alone is sufficiently protective of investor rights in the absence of strong standards of conduct and other regulatory safeguards, it is nevertheless critical that customers receive the information they need to assess fees, costs, and material conflicts of interest. Accordingly, the Best Interest Contract Exemption includes requirements for full and fair disclosure of important information, including descriptions of material conflicts of interest, fees or charges paid by the retirement investor, and a statement of the types of compensation the firm expects to receive from third parties in connection with recommended investments. On request, investors also have the right to obtain detailed disclosure of costs, fees, and other compensation associated with specific investment recommendations. In addition, the financial institution must maintain a website that includes information about the financial institution's business model and associated material conflicts of interest (including any arrangements with third parties, such as mutual funds or insurance companies, compensating the firm for recommending particular investment products), a written description of the financial institution's policies and procedures that mitigate conflicts of interest, and disclosure of compensation and incentive arrangements with advisers, among other information.

The Best Interest Contract Exemption includes special provisions clarifying how it can be used for recommendation of proprietary products, including a requirement that firms determine that the limitations on the universe of investment products will not cause the firm or its advisers to recommend imprudent investments or receive more than reasonable compensation for their services. Financial institutions that are "level fee" fiduciaries and wish to take advantage of streamlined exemptive conditions will be required to disclose their fiduciary status to retirement investors, and document the reasons for the recommendation of a rollover from an ERISA plan to an IRA, or from another IRA or from a commission-based account to a fee-based account. The exemption provides for enforcement of the standards it establishes. When providing advice to an IRA owner, the financial institution must commit to these protective conditions as part of an enforceable contract. ERISA plan investors will be able to rely on their advisers' fiduciary acknowledgement to assert their rights under ERISA's statutory protections. If advisers and financial institutions do not adhere to the standards established in the exemption, retirement investors will have a way to hold them accountable—either through a breach of contract claim (for IRAs and other non-ERISA plans) or under the provisions of ERISA (for ERISA plans, participants, and beneficiaries).

Investors will not be able to use this enforcement mechanism simply because they do not like how an investment turned out. Consistent with long-existing ERISA jurisprudence, advisers usually can prove they have acted in their clients' best interest by documenting their use of a reasonable process and adherence to professional standards in making the recommendation and determining it was in the customer's best interest, and by documenting their compliance with the financial institution's policies and procedures required by the Best Interest Contract Exemption. This balance helps retirement savers get the best interest financial advice while leaving the adviser and financial institution the flexibility and discretion necessary to determine how best to satisfy the exemption's standards in light of the unique attributes of their business.

VIII. Additional Exemptive Relief

In addition to the Best Interest Contract Exemption, the Department also created a new Principal Transactions Exemption, which allows investment advice fiduciaries to sell or purchase certain recommended debt securities and other investments out of their own inventories to or from plans and IRAs. As with the Best Interest Contract Exemption, investment advice fiduciaries must, among other things, adhere to certain impartial conduct standards, including obligations to act in the customer's best interest, avoid misleading statements, and seek to obtain the best execution reasonably available under the circumstances for the transaction. Similarly, the financial institution must have policies and procedures designed to mitigate harmful impacts of conflicts of interest and must disclose basic information about its conflicts of interest and the cost of its advice. Importantly, the financial institution may not give its advisers financial incentives to make recommendations that are not in the customer's best interest.

The Department also amended an existing exemption, PTE 84-24, which provides relief for insurance agents and brokers, and insurance companies, to receive compensation for recommending fixed rate annuity contracts to plans and IRAs. As amended, PTE 84-24 contains increased safeguards for the protection of retirement investors who purchase these insurance products. This amended exemption has more streamlined conditions than the Best Interest Contract Exemption, and facilitates access by plans and IRAs to these relatively simple lifetime income products. More complex products, such as variable annuities and indexed annuities, may be recommended by advisers and financial institutions under the terms of the Best Interest Contract Exemption. In response to comments received by the Department, the Best Interest Contract Exemption has been revised to facilitate compliance with the exemption by insurers and their agents, and additional guidance for insurers has been provided.

The Department has amended other existing exemptions, as well, to ensure that plan and IRA investors receiving investment advice are consistently protected by impartial conduct standards, regardless of the particular exemption upon which the adviser relies.

IX. Applicability Date

The revised definition of fiduciary and the compliance with the new attendant requirements will not begin to be required until April 10, 2017. The Department has determined that, in light of the importance of the final rule's consumer protections and the significance of the continuing monetary harm to retirement investors without the rule's changes, an applicability date of one year after publication of the final rule in the Federal Register is appropriate and provides adequate time for plans and their affected financial services and other service providers to adjust to the change from non-fiduciary to fiduciary status.

The exemptions will generally become available upon the applicability date of the rule. However, the Department has adopted a "phased" implementation approach for the Best Interest Contract Exemption and the Principal Transactions Exemption. Both exemptions provide for a transition period, from the April 2017 applicability date to January 1, 2018, under which fewer conditions apply. This period gives financial institutions and advisers time to prepare for compliance with all the conditions of the exemptions while providing basic safeguards for the interests of retirement investors. During this period, firms and advisers must adhere to the impartial conduct standards, provide a notice to retirement investors that, among other things, acknowledges their fiduciary status and describes their material conflicts of interest, and designate a person responsible for addressing material conflicts of interest and monitoring advisers' adherence to the impartial conduct standards. For transactions on or after January 1, 2018, full compliance with the exemption will be required.

The Department will work with interested parties on compliance assistance activities and materials and invites stakeholders to identify areas or specific issues where they believe additional clarifying guidance is needed.

This fact sheet has been developed by the U.S. Department of Labor, Employee Benefits Security Administration, Washington, DC 20210. It will be made available in alternate formats upon request: Voice telephone: 202-693-8664; TTY: 202-501-3911. In addition, the information in this fact sheet constitutes a small entity compliance guide for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.