GROOM LAW GROUP

Publications

DOL Finalizes PTE 2020-02 Amendments

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On April 25, 2024, the U.S. Department of Labor ("DOL") published its much-anticipated final regulation on the definition of "fiduciary" under section 3(21)(a)(ii) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). This marks the latest chapter of the DOL's long-running effort to expand the circumstances under which a person is considered an investment advice fiduciary for purposes of ERISA and the parallel provisions of the Internal Revenue Code of 1986, as amended (the "Code"), and to change the landscape of prohibited transaction exemptions available to those fiduciaries.

The package of materials published by DOL includes:

- A final regulation re-defining who is a "fiduciary" by reason of providing investment advice to a plan or an IRA (the "2024 Final Rule");
- Final amendments to Prohibited Transaction Exemption 2020-02 ("PTE 2020-02"), which DOL intends to be the primary source of exemptive relief for eligible investment advice fiduciaries going forward;
- Final amendments to PTE 84-24, providing a narrow alternative to PTE 2020-02 for recommendations of non-securities annuity and insurance products by Independent Producers; and
- Final amendments to PTEs 77-4, 75-1, 80-83, 83-1, and 86-128 (the "Mass Amendment") that eliminate the availability of the exemption for investment advice fiduciaries and makes other changes to PTEs 75-1 and 86-128.

Groom Law Group has prepared summaries of each of these rules both as proposals and now as finalized, including our initial observations on their impact and scope.

This client alert provides an overview of the amendments to PTE 2020-02. In addition to changing PTE 2020-02, DOL also changed the definition of "investment advice" and other exemptions, prompting Financial Institutions and distributors who had not previously used PTE 2020-02 to rely on it . All of the summaries are available on Groom's investment advice resource hub and are linked here: DOL Amends Fiduciary

Advice Definition Regulation; DOL Finalizes PTE 84-24 Amendments; DOL Finalizes Changes to Other Exemptions Through Mass Amendment

I. Summary of PTE 2020-02

Broadly speaking, PTE 2020-02 allows Financial Institutions to give fiduciary investment advice to ERISA plans, ERISA plan participants, and IRAs and to receive otherwise prohibited compensation resulting from that advice if certain conditions are satisfied. Unlike other transaction-specific PTEs that only cover certain types of investment assets, PTE 2020-02 provides relief for an extensive array of investment products and compensation arrangements. It also explicitly covers a recommendation to rollover from a plan or IRA.

The 2024 Final Rule makes PTE 2020-02 more important than ever for two key reasons. First, the 2024 Final Rule expands the universe of entities that would be considered investment advice fiduciaries under ERISA and corresponding provisions of the Code. In order to receive compensation that varies based upon their recommendations, investment advice fiduciaries must find exemptive relief, which PTE 2020-02 supplies. Second, DOL has made many other exemptions unavailable to investment advice fiduciaries, with the result that PTE 2020-02 largely stands as the only available option for exemptive relief in many cases. DOL views the amended PTEs 2020-02, 84-24, and the Mass Amendment as supplying a "uniform regulatory structure" to ensure that investment advice fiduciaries are held to a "common set of standards."

II. Key Changes

The final amendments generally retain the structure of the exemption in its current form. PTE 2020-02 continues to be available as a source of broad exemptive relief for the receipt of compensation in connection with the provision of non-discretionary investment advice. However, the final amendments make several important changes to the exemption, including:

- Expanding the availability of PTE 2020-02. PTE 2020-02 will cover recommendations to engage in any kind of principal transaction as well as investment advice provided in connection with robo-advice arrangements. Additionally, PTE 2020-02 will allow pooled plan providers to provide investment advice to the extent they are engaged by an independent plan fiduciary and will allow IRS-approved non-bank health savings account ("HSA") custodians to act as Financial Institutions.
- Adding new disclosure requirements, including with respect to compensation and conflicts of interest. Moreover, the amendments require Financial Institutions and Investment Professionals to provide an acknowledgment of fiduciary status that is not qualified by the use of "to the extent" language. The disclosures may be provided when the recommendation is made, or, if later, when the Financial Institution or Investment Professional becomes entitled to compensation as a result of providing the recommendation.
- Widening the circumstances under which a Financial Institution could be disqualified from reliance on PTE 2020-02 to include, among other things, a larger list of criminal convictions, convictions in foreign courts, and other misconduct that is the subject of a final judgment or court approved settlement.
- Including a correction procedure that allows Financial Institutions to self-correct violations of the exemption without reporting to the DOL.
- Affirmatively requiring Financial Institutions to correct, report to the IRS, and pay Code section 4975 excise taxes in connection with any non-exempt prohibited transactions the Financial Institution engaged in as a result of providing fiduciary investment advice.

We provide a more detailed analysis of the final amendments to PTE 2020-02 below.

III. Detailed Overview of Changes to PTE 2020-02

A. Covered Transactions and Relief Provided

PTE 2020-02 provides relief from the restrictions of ERISA sections 406(a)(1)(A),(D), and 406(b) and Code sections 4975(c)(1)(A),(D), (E), and (F) for the receipt of prohibited compensation in connection with the provision of non-discretionary investment advice. PTE 2020-02 exempts prohibited transactions that arise from the payment of otherwise prohibited compensation in connection with the recommendation of any security or investment product, fiduciary rollover recommendations, recommendations of investment managers, and investment advice provider recommendations. Additionally, PTE 2020-02 covers recommendations of a

Financial Institution's proprietary investment products or investment products that generate payments from third parties. The final amendments also explicitly provide that PTE 2020-02 covers recommendations of insurance and annuity products.

Prior to the final amendments, PTE 2020-02 provided limited relief when a Financial Institution sold securities to a Retirement Investor in a recommended principal transaction; this relief applied only to principal sales of only certain types of investment assets. The final amendments remove this limitation, meaning that PTE 2020-02 covers principal transactions involving any type of investment product. However, DOL cautioned in the preamble to the final amendments that Financial Institutions selling products on a principal basis must carefully address how they will mitigate the inherent conflicts of interest associated with recommending principal transactions in their policies and procedures.

B. Covered Recipients of Advice

As amended, PTE 2020-02 applies to investment advice given to "Retirement Investors", which include (a) a plan subject to Title I of ERISA, or a plan described in section 4975(e)(1)(A) of the Code but not subject to Title I of ERISA[1]; (b) a participant or beneficiary of a plan of such a plan; (c) an IRA;[2] (d) an owner or beneficiary of an IRA; and (e) a fiduciary within the meaning of ERISA section (3)(21)(A)(i) or (iii) and Code section 4975(e)(3)(A) or (C). In substance, the amendments remove an investment advice fiduciary from the definition of a covered Retirement Investor. The DOL explained that because advice given to an investment advice fiduciary will not be considered fiduciary investment advice under the 2024 Final Rule, coverage under PTE 2020-02 will not be necessary. This change reflects concerns on the part of the regulated community over wholesaling activity, which frequently involves the delivery of recommendations to intermediaries who may themselves be advice fiduciaries to one or more ERISA plans or IRAs.

C. Covered Providers of Advice

Prior to the amendment, PTE 2020-02 provided relief for advice provided by a covered Financial Institution (i.e., a registered investment adviser, bank, insurance company, or registered broker-dealer) through an Investment Professional the Financial Institution employs or otherwise supervises. The final amendments expand the definition of a covered Financial Institution to include an IRS-approved, non-bank HSA trustee or custodian but only to the extent the entity is serving as an HSA trustee or custodian. This change appears intended to allow a non-bank HSA trustee or custodian to provide advice to the HSAs they serve and advice to conduct an HSA rollover.

D. Exclusions from Coverage

PTE 2020-02 did not provide exemptive relief for advice generated by an interactive website in which computer software models or applications provide investment advice if there was no personal interaction or advice with an investment professional (*i.e.*, robo-advice). The final amendments remove this exclusion so as to allow Financial Institutions to provide robo-advice in reliance on PTE 2020-02 without the participation of an Investment Professional.

In addition, PTE 2020-02 is unavailable where the Investment Professional or Financial Institution is a named fiduciary or plan administrator (or an affiliate thereof) of an ERISA-covered plan, unless the Investment Professional or Financial Institution was selected to provide advice by an independent fiduciary. In connection with the final amendments, the DOL clarified that employers participating in a pooled employer plan would be able to act as an independent fiduciary for purposes of selecting a pooled plan provider to provide investment advice.

E. Care and Loyalty Obligations

PTE 2020-02 has required Financial Institutions and investment professionals to meet several Impartial Conduct Standards, the first of which is to provide investment advice in the "best interest" of the retirement investor. PTE 2020-02 defined "best interest" to include components of the fiduciary duties of prudence and loyalty under ERISA. The final amendments replace and bifurcate the best interest standard into a "care obligation" and "loyalty obligation." The definitions of the care and loyalty obligations generally track the best interest standard:

- The care obligation requires that advice reflect 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
- The loyalty obligation requires that advice must 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.

However, the final amendments also provide that the loyalty requirement specifically requires Investment Professionals to make recommendations of investment strategy and account type by carefully considering the expected total costs over time, based on the

financial interests of the Retirement Investor, and without subordinating the Retirement Investor's interests to the competing financial interests of the Investment Professional. The final amendments also add examples of specific activities that would violate the loyalty obligation:

- In choosing between two commission-based investments offered and available to the Retirement Investor on a Financial Institution's product menu, it would be impermissible for the Investment Professional to recommend the investment that is worse for the retirement investor but better or more profitable for the Investment Professional or the Financial Institution; and
- An Investment Professional generally could not recommend that the Retirement Investor enter into an arrangement requiring the Retirement Investor to pay an ongoing advisory fee to the Investment Professional, if the Retirement Investor's interests were better served by the payment of a one-time commission to buy and hold a long-term investment. The DOL also stated in the preamble to the final amendments that Financial Institutions should be careful to avoid harm to retirement investors' existing holdings in connection with transitional efforts to move to other compensation models or policies or procedures. For example, if a retirement investor has already invested in and borne the expense of front-end load shares, the Financial Institution should consider whether transition to other share classes would satisfy the care and loyalty obligations.

The DOL explained that it was bifurcating PTE 2020-02's best interest obligation into care and loyalty obligations to avoid potential confusion between the standard of care required by PTE 2020-02 with the 2020 NAIC Suitability in Annuity Transactions Model Regulation 275, SEC Regulation Best Interest, and references in the 2024 Final Rule to a retirement investor's understanding that advice will be given in its best interest.

F. Other Impartial Conduct Standards

In addition to the care and loyalty obligations, PTE 2020-02's impartial conduct standards require Financial Institutions and investment professionals to:

- Receive only reasonable compensation;
- Seek to obtain best execution of the investment transaction reasonably available under the circumstances; and
- Avoid making statements about the recommended transaction and other relevant matters that are materially misleading.

The final amendments to PTE 2020-02 largely maintain these impartial conduct standards in their current form. However, the final amendments revise the requirement to avoid making materially misleading statements to explicitly prohibit Financial Institutions and investment professionals from omitting information that is needed to prevent its statements from being, under the circumstances, not misleading. The final amendments also clarify that this requirement applies to both written and oral statements.

G. Disclosure Conditions

PTE 2020-02 has required that Financial Institutions provide certain disclosures to retirement investors prior to engaging in a recommended transaction. The final amendments define when a recommended transaction is deemed to occur as the later of (a) the date the recommendation is made or (b) the date the Financial Institution or Investment Professional becomes entitled to compensation by reason of making the recommendation. The DOL made this change to clarify that it is not necessary to provide the disclosures, including the fiduciary acknowledgment, at the first meeting with a retirement investor. As modified, PTE 2020-02's disclosure requirements include:

1. Acknowledgment of Fiduciary Status

PTE 2020-02 has required that the investment professional and its supervisory Financial Institution provide a written acknowledgment that they are fiduciaries under ERISA and the Code, as applicable, with respect to fiduciary investment advice provided to the retirement investor. The final amendments require a statement that, with respect to the recommendation, the investment professional and Financial Institution are providing "fiduciary investment advice." In the preamble to the final amendments, DOL stated its view that a conditional acknowledgment that an investment professional or Financial Institution "may" be fiduciaries or that they are fiduciaries to the extent they meet the definition of fiduciary investment advice under the ERISA or the Code would not be sufficient to meet this requirement.

2. Statement of Care and Loyalty Obligations

The final amendments require Financial Institutions to provide a written statement of PTE 2020-02's care obligation and loyalty obligation.

3. Relationship and Conflict of Interest Disclosure

PTE 2020-02 has required Financial Institutions to provide a written description of the Financial Institution's and investment professional's services and material conflicts of interest that is not misleading. The final amendments alter this requirement by obliging Financial Institutions to provide disclosure of:

- All material facts relating to the scope and terms of the relationship with the retirement investor, including
  - The material fees and costs that apply to the retirement investor's transactions, holdings, and accounts;
  - The type and scope of services provided to the retirement investor, including any material limitations on the recommendations that may be made to them; and
- All material facts relating to conflicts of interest that are associated with the recommendation.

The DOL stated these requirements are intended to align with SEC Regulation Best Interest. Notably, this change requires an up-front disclosure with respect to fees and costs. The proposed amendments would have required Financial Institutions to provide fee and cost information only upon request.

4. Rollover Disclosure

PTE 2020-02 has required, with respect to rollover recommendations only, disclosure of the specific reasons why the rollover recommendation is in the best interest of the retirement investor. This requirement applied regardless of whether the rollover is made from an ERISA-covered plan or an IRA. The final amendments provide that the rollover disclosure requirement is only applicable in connection with a recommendation to rollover from an ERISA-covered plan or a recommendation to invest assets following a rollover from an ERISA covered plan. Thus, this requirement does not apply in connection with a recommendation to rollover from one IRA to another.

The final amendments also codify guidance DOL had previously provided stating that Financial Institutions should document and disclose: (a) the retirement investor's alternatives to a rollover, including leaving the money in his or her current employer's plan, if applicable; (b) the fees and expenses associated with both the plan and the recommended investment or account; (c) whether the employer pays for some or all of the plan's administrative expenses; and (d) the different levels of services and investments available under the plan and the recommended investment or account. Consistent with prior guidance, the DOL stated in the preamble to the final amendments that a Financial Institution and investment professional should make an attempt to obtain this information through the disclosures provided to plan participants under the DOL's 404a-5 regulation, but if the information is still not available after a full explanation of its significance, then alternate data sources may be relied upon, such as the plan's most recent Form 5500 or reliable benchmarks on typical fees and expenses for the type and size of the plan that holds the retirement investor's assets.

5. Correction of Good Faith Disclosure Errors

The final amendments to PTE 2020-02 include a provision allowing a Financial Institution to self-correct a good faith error or omission in providing the required disclosures, so long as the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission.

F. Policies and Procedures

PTE 2020-02 has required Financial Institutions to establish, maintain, and enforce policies and procedures that (a) are prudently designed to ensure compliance with the impartial conduct standards of PTE 2020-02 and (b) mitigate the investment professional's and Financial Institution's conflicts of interests to such an extent that a reasonable person would not view the Financial Institution's incentive practices to create an incentive for the Financial Institution and investment professional to place their interests ahead of those of retirement investors. The changes to PTE 2020-02 revise these policies and procedures requirements in three respects.

- First, Financial Institutions are required to update their policies and procedures so that they can ensure compliance with all of PTE 2020-02's conditions rather than only the impartial conduct standards.

- Second, Financial Institutions may not use quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation, or other similar actions or incentives in a manner that is intended, or that a reasonable person would conclude are likely, to result in recommendations that do not meet the care obligation or loyalty obligation. In the preamble to the final amendments, DOL stated this condition should not be read as a prohibition on educational conferences so long as they are not likely to lead investment professionals to make recommendations that do not meet the exemption's care obligation or loyalty obligation. DOL cautioned that Financial Institutions should avoid providing luxury vacations where training is merely incidentally offered as an incentive for making recommendations to retirement investors. However, DOL noted that it may be appropriate to provide incentives aimed at promoting retirement savings without favoring any particular product and to tie eligibility for attendance to an education conference to sales thresholds to ensure that only investment professionals recommending particular products receive education for that product.
- Third, Financial Institutions would be required to provide their policies and procedures to DOL within 30 calendar days of request.

G. Annual Retrospective Compliance Review

PTE 2020-02 has required Financial Institutions to conduct an annual retrospective review reasonably designed to assist in detecting and preventing violations of the impartial conduct standards and the Financial Institution's policies and procedures. The methodology and results of the review must be set forth in a written report submitted to the Senior Executive Officer of the Financial Institution (the CEO, Chief Compliance Officer, Chief Financial Officer, President, or one of the three most senior officers of the Financial Institution), who must certify, within six months of the end of the annual review period that:

- The officer reviewed the report;
- The Financial Institution has in place policies and procedures required by PTE 2020-02; and
- The Financial Institution has in place a prudent process to modify such policies and procedures.

The Financial Institution needed to retain the report, certification, and supporting data for a period of six years and make them available to DOL within 10 business days of DOL's request.

The final amendments expand the retrospective review to require the Financial Institution to test compliance with all of PTE 2020-02's conditions, rather than the impartial conduct standards alone. Further, as included in the proposed amendments to PTE 2020-02, the Senior Executive Officer must certify that the Financial Institution has corrected, filed reporting with the IRS, and paid excise taxes with respect to any non-exempt prohibited transactions the Financial Institution engaged in as a result of providing fiduciary investment advice. This requirement does not appear limited to instances where the Financial Institution intended to comply with PTE 2020-02 but violated the conditions of the exemption. Thus, for example, if the Financial Institution intended to avoid acting as an investment advice fiduciary but inadvertently provided fiduciary investment advice and received compensation as a result of that advice, then the conditions of PTE 2020-02 would appear to require the Financial Institution to correct the transaction, file with the IRS, and pay excise tax. Presumably this requirement could also apply without regard to when a prohibited transaction is "discovered" by the Financial Institution. Thus, if a Financial Institution were to discover a prohibited transaction years after it occurred (after the applicable limitations period on excises taxes has already run), the Financial Institution could nonetheless need to correct the prohibited transaction and pay excise taxes if the Financial Institution intends to rely on PTE 2020-02 in acting as an investment advice fiduciary.

Finally, the time to respond to provide the report, certification, and supporting data has been extended from 10 business to 30 calendar days following a DOL request.

H. PTE 2020-02's Self-Correction Procedure

PTE 2020-02 permits Financial Institutions to self-correct violations of the exemption. If a Financial Institution follows the self-correction procedure, a non-exempt prohibited transaction would not be deemed to occur. In order to self-correct, a Financial Institution was required to:

- Correct the violation within 90 days of the date the Financial Institution learns or should have learned of the violation;
- Make the retirement investor whole for investment losses, if any;
- Notify DOL within 30 days of the correction; and
- Report the correction in the Financial Institution's annual retrospective compliance review.

In a significant change, the final amendments remove the requirement to report each self-correction to the DOL. However, each self-correction still needs to be reported in the Financial Institution's annual retrospective compliance review, and the DOL would have the authority to obtain information concerning self-corrections through its enforcement process.

In the preamble to the final amendments, the DOL discussed the extent to which violations of PTE 2020-02 can be corrected through the procedure. Although the DOL had previously expressed doubt as to whether a rollover recommendation that was not in the retirement investor's best interest can be corrected, the DOL suggested that if a rollover out of an ERISA-covered plan cannot be undone, the transaction may nonetheless be corrected by restoring to the retirement investor a calculated amount of losses, including estimated investment and tax losses.

I. Disqualification Provisions

PTE 2020-02 has provided that a Financial Institution or investment professional may be disqualified from reliance on the exemption, in each case for a period of ten years, upon:

- The investment professional, Financial Institution, or a member of the Financial Institution's controlled group[3] is convicted of a crime described in section 411 of ERISA arising out of investment advice to a retirement investor; or
- The DOL issuing a finding that the investment professional, Financial Institution, or a member of the Financial Institution's controlled group has (a) engaged in a systematic pattern or practice of violating the conditions of PTE 2020-02 in connection with otherwise non-exempt prohibited transactions; (b) intentionally violated the conditions of PTE 2020-02 in connection with otherwise non-exempt prohibited transactions; or (c) provided materially misleading information to the DOL in connection with the Financial Institution's conduct under the exemption.

The final amendments expand the scope of disqualifying crimes to (a) remove the stipulation that the crime must arise from the provision of investment advice to be disqualifying, (b) add a long list of disqualifying financial crimes that would also be considered disqualifying crimes under PTE 84-14 (the Qualified Professional Asset Manager or "QPAM" Exemption), and (c) expressly include convictions in foreign courts (with the exception of jurisdictions on the Department of Commerce's list of foreign adversaries—China, Cuba, Iran, North Korea, Russia and the Maduro Regime of Venezuela) as disqualifying. Additionally, the final amendments add engaging in a systematic pattern or practice of failing to: (1) correct, (2) file reporting with the IRS, and (3) pay excise taxes with respect to any non-exempt prohibited transactions the Financial Institution, its affiliate, investment professional, or engaged in as a result of providing fiduciary investment advice as additional disqualifying conduct.

However, consistent with the DOL's recent changes to the QPAM Exemption, the final amendments significantly limit the DOL's authority to disqualify an investment professional or Financial Institution. With respect to non-criminal conduct, disqualification only occurs if the investment professional, Financial Institution, or a member of the Financial Institution's controlled group is found or determined to have participated in one or more categories of the non-criminal conduct in a final judgment or court-approved settlement in a Federal or State criminal or civil court proceeding brought by the DOL, the Department of the Treasury, the Internal Revenue Service, the Securities and Exchange Commission, the Department of Justice, the Federal Reserve, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Commodity Futures Trading Commission, a State insurance or securities regulator, or State attorney general.

PTE 2020-02 allows a disqualified investment professional or Financial Institution to continue to rely on the exemption for a transition period of 12 months following disqualification, so long as notice is provided to the DOL within 30 days of the disqualifying event. A disqualified person may apply to the DOL for an individual exemption that would permit it to rely on exemptive relief similar to PTE 2020-02, but the DOL did not discuss the conditions on which it would grant such an exemption other than to state that it may require "additional prospective compliance conditions" if retroactive relief is necessary.

J. Streamlined Relief for 3(38) Investment Managers' RFP Responses

The DOL stated in the preamble to the 2024 Final Rule that a person does not become a fiduciary "merely by engaging in the normal activity of marketing" or "touting the quality of one's own advisory or investment management services." However, to the extent the person's marketing communications include covered investment recommendations, those recommendations are evaluated separately and may cause the person to become an investment advice fiduciary. The DOL added to PTE 2020-02 streamlined conditions for those who provide recommendations that cause them to act as investment advice fiduciaries as part of a response to a request for proposal ("RFP") for services to be provided as an investment manager within the meaning of section 3(38) of ERISA. To qualify for the streamlined relief, the RFP responder must comply with the impartial conduct standards of PTE 2020-02. The streamlined relief applies to recommendations the RFP responder provides as part of its RFP response but not to any activities it engages in after it is hired as an investment manager.

The scope and potential utility of this streamlined relief is somewhat narrow. In this respect, not all investment managers are selected pursuant to an RFP process. Further, this streamlined relief would not be available to providers of non-discretionary investment advice, such as a plan consultant, who might similarly provide investment recommendations in the course of marketing its services but would not otherwise need to rely on PTE 2020-02 after it is engaged.

IV. Effective Date Considerations

The final amendments to PTE 2020-02 are effective for transactions made pursuant to investment advice that is provided on and after September 23, 2024. However, the final amendments provide a one-year "Phase-In Period." During the Phase-In Period, exemptive relief for the receipt of compensation in connection with the provision of investment advice is available so long as the Impartial Conduct Standards and fiduciary acknowledgment conditions of PTE 2020-02 (each discussed in more detail below) are met.

The Phase-In Period appears to be available to Financial Institutions regardless of whether they already rely on PTE 2020-02 and comply with the full set of conditions included in the current version of the exemption. However, exemptive relief for engaging in principal transactions does not appear to be explicitly covered for the Phase-In Period. Consequently, Financial Institutions seeking to engage in principal transactions in connection with investment advice under PTE 2020-02 may need to comply with the full set of conditions as of the September 23, 2024 effective date.