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INSIGHT
AUGUST
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IMPROVING INVESTMENT ADVICE FOR WORKERS AND RETIREES ACT

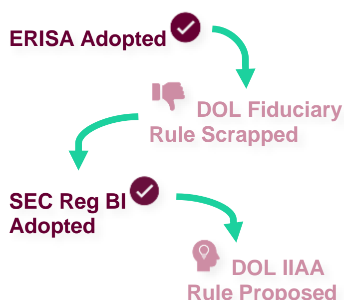
A New Advice Model for ERISA Accounts

Background

In 1974, the Employee Retirement Income Security Act (ERISA) was enacted to address public concern over private pension funds being mismanaged or abused, with the goal of protecting the interests of participants and their beneficiaries in employee benefit plans. Strict guidelines were enacted regarding information availability, standards of conduct, disclosures, protections and favored tax treatment.

In 2016, the Department of Labor (DOL) proposed a Fiduciary Rule. That rule amended the regulatory definition of a fiduciary of an employee benefit plan to replace the restrictive five-part test (to determine fiduciary status) with a definition more in accordance with the statutory language in ERISA. That legislation was ultimately struck down by the court in 2018.

In 2019, the Securities and Exchange Commission (SEC) proposed the Regulation Best Interest (Regulation BI) rule, and ultimately adopted it in 2020. The Best Interest standard raised the bar when it came to client protections for non-fiduciary investment advice. The rule established clear guidelines between a fiduciary and non-fiduciary and included disclosure of conflicts, transparency around services and recommendations.



Revised DOL Proposal

As a second act to the now scrapped DOL Fiduciary Rule, the DOL proposed a rule (The Proposal) in June 2020 affecting ERISA and the Internal Revenue Code (IRC) of 1986, as amended (the Code), which would allow Investment Professionals managing ERISA retirement plans to engage in “exemptions” to previously dubbed “prohibited transactions” if they follow the strict set of guidelines.

For advisors acting as fiduciaries, the guidance will allow those managing ERISA accounts to charge a fee for services rendered as long as they pass the five-part test. The DOL proposed to reinstate a previous rule from 1975 that reestablishes this five-part test for determining the advisor’s fiduciary status, and all five parts need to be met to qualify for the “prohibited transactions exemption”.

The Proposal is intended to align its enforcement and oversight with the SEC’s current Regulation BI rule and it borrows significant terminology and definitions from that rule.

The DOL view is that recommendations from an advisor to take a distribution or to transfer assets out of an ERISA plan constitutes a decision to sell which would (if all other requirements are met) allow the advisor to collect a fee for the recommendation. Additionally, full rollover transactions are also covered as long as there is a reasonable belief that those assets will continue to be serviced by the advisor on an ongoing basis. The Proposal would also apply to standard buy/sell recommendations within an existing relationship.

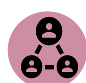
Additionally, The Proposal will not prohibit investment firms from collecting revenue on principal transactions. Principal transactions in all forms will be allowed as long as they also comply with the exemption criteria.

Those who comply with the rule in order to gain ERISA exemptions will need to comply with “impartial conduct standards” consisting of a Best Interest standard, reasonable compensation standard, as well as a requirement that no materially misleading statements about the transaction were made.

Theme	ERISA Rule	Reg BI	DOL Proposed Rule
3rd Party Compensation	✓	✓	✓
Variable Compensation on ERISA Advice Allowed	✗	✗	✓
Five Part Test Required	✓	✗	✓
Rollover Covered	✗	✓	✓
Private Right of Action	✗	✗	✗
Principal Trading Allowed	✗	✓	✓

Qualifying for the Exemption

In order to qualify for the exemption, the advisor will be required to comply with all parts of a five-part test. The test reinstates a guidance from a rule from 1975 and consists of the following parts:



Giving Advice or a Recommendation
The advisor must provide advice as to the value of securities or other property

Ongoing Relationship
There needs to be the reasonable assumption or explicit knowledge of an ongoing relationship with recommendations occurring on a regular basis

Primary Basis
The advice rendered needs to be considered the primary basis for the actions taken by the advisor

Individualized Advice
The advice needs to be tailored to the needs of the individual

Mutual Agreement
The advisor and client must have a mutual agreement with regard to the scope of services rendered

Impacts and Implications

The proposed exemption gives advisors new opportunity to service retirement accounts and extends to both advisors and insurance providers as well as financial institutions and affiliates. The range of reasonable payments includes but is not limited to commissions, 12b-1 fees, trailing commissions, sales loads, mark-ups, mark-downs, and revenue sharing payments from investors or third parties.

As in Regulation Best Interest, there is no private right of action for the investor, but advisors will need to adopt policies and procedures that prove that they are compliant with the standard when taking an exemption. The advisor must also be considered a fiduciary to be eligible for the exemption and conflicts of interest must be mitigated.

The current proposal was out for public comment until August 6th, 2020 and may evolve as industry opinions are taken into consideration by the DOL prior to the distribution of a final rule and implementation schedule.

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Your contacts

BHARAT SAWHNEY

Partner
Wealth & Asset Management Practice
314-749-5755
bharat.sawhney@sia-partners.com

CHRIS GROTZ

Managing Director
Wealth & Asset Management Practice
215-527-4961
chris.grotz@sia-partners.com

ZOYA ASHIROV

Senior Manager
Regulatory Compliance Practice
917-330-5536
zoya.ashirov@sia-partners.com

STEVEN SZEKERES

Supervising Senior Consultant
Wealth & Asset Management Practice
781-752-8169
steven.szekeres@sia-partners.com

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