



Third Time's a Charm? The DOL's Latest Attempt to Redefine Investment Advice Fiduciary

This past October, the U.S. Department of Labor (DOL) announced a new rule (the Proposed Rule) that expands the definition of an investment advice fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA). The Proposed Rule modernizes the DOL's 1975 regulation that defines investment advice fiduciary, commonly known as the Five-Part Test and this proposal is the DOL's third attempt since 2010 to modify the Five-Part Test. (For more on the history of the DOL's efforts, see our December 29, 2020 [post](#).)

The Proposed Rule aims to better reflect changes across the retirement landscape that have happened since 1975, specifically the major shift from defined benefit plans to defined contribution plans. The proposal revamps the current Five-Part Test, expanding the rule to fill gaps that exist in the regulatory structure of investment advice fiduciaries. Overall, the proposal would make it harder to avoid fiduciary status, enhancing the trust and confidence of plan sponsors and participants.

Under the current Five-Part Test, a person is considered an investment advice fiduciary if the person: (1) provides investment advice for a fee, (2) on a regular basis, (3) pursuant to a mutual understanding with the plan fiduciary, (4) that the advice will serve as a primary basis for investment decisions with respect to the assets of the plan, and (5) that the advice is individualized based on the particular needs of the plan.

If finalized, the Proposed Rule would replace this long-standing bright line test with a more objective, fact-dependent standard. Under the new standard, a person would be considered an investment-advice fiduciary if the person: (1) makes a recommendation; (2) involving any securities, investment transaction, or investment

strategy; (3) to a “retirement investor” (*i.e.*, an ERISA plan, plan fiduciary, plan participant or beneficiary, or an IRA, IRA fiduciary, or IRA owner or beneficiary); and (4) the person either acknowledges fiduciary status, has direct or indirect discretionary investment authority for the retirement investor, or directly or indirectly makes investment recommendations on a regular basis as part of its business.

The proposal focuses on the aspects of the Five-Part Test that the DOL deems insufficient: The “regular basis” requirement, the “mutual agreement, arrangement, or understanding” requirement, and the “primary basis” requirement. It replaces those requirements with a broader test that is based on the advice recipient’s reasonable expectations and the context.

“Regular Basis” Requirement

Under the 1975 Five-Part Test, a one-time interaction generally was not treated as sufficient to create fiduciary status under ERISA. The Proposed Rule significantly broadens what it means to provide advice on a “regular basis.” Rather than focusing on the frequency of advice to a particular investor, the Proposed Rule would evaluate whether investment advice is a regular component of the advisor’s business. It could impose ERISA fiduciary status on anyone who makes investment recommendations to *any* investors on a regular basis as part of their business. The recommendation must be based on the advice recipient’s needs and circumstances and must be one that could be relied on for investment decisions. The Proposed Rule would cover advice on whether to take a distribution or roll over assets from a plan, even if there is no recommendation about how to invest the assets after the rollover happens, and other one-time transactions.

“Mutual Agreement, Arrangement, or Understanding”

The Proposed Rule also focuses on the objective circumstances surrounding a recommendation instead of whether it is made pursuant to a “mutual agreement, arrangement or understanding.” Under the new rule, whether a recommendation satisfies this requirement would be based on how the investment professional markets itself to retirement investors.

“Primary Basis”

The Proposed Rule also would revise the “primary basis” element of the Five-Part Test. Again, the proposal would look at the surrounding circumstances to identify whether a recommendation could be relied upon by the retirement investor as “a basis” for investment decisions.

As with the prior attempts to modify what it means to be an investment advice fiduciary under ERISA, the DOL is facing pushback against the proposal from various sources in the financial services industry. Previous proposed changes to the fiduciary definition have been withdrawn by the DOL or challenged in court, ultimately proving unsuccessful in changing the well-known test. The verdict is still out if the DOL’s third attempt will be “a charm.”

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