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# Conflict of Interest in Investment Advice Within Retirement Plans: An Overview

## Introduction

A pension is a voluntary benefit offered by employers to assist employees in preparing for retirement. Pension plans can be classified along several dimensions, such as whether the plan is a defined benefit (DB) plan (sometimes called a *traditional* pension) or a defined contribution (DC) plan (like a 401(k) plan), whether the plan sponsor is a private sector or public sector employer, and whether the plan is sponsored by one employer or more than one employer.

Federal pensions laws and regulations govern many aspects of pension plans, such as setting standards for individuals who provide recommendations to private sector plans and plan participants. The Department of Labor (DOL) issued regulations in 1975 that defined *investment advice* using a five-part test, and in 2016, DOL expanded the definition of *investment advice* so that more such individuals were subject to a higher standard of conduct. A U.S. court of appeals vacated the rule in 2018, meaning that the five-part test was reinstated. DOL guidance and regulations apply only to private sector plans and do not apply to public sector plans.

In September 2023, DOL submitted a proposed rule for review to the Office of Management and Budget (OMB) that DOL said would more appropriately define when recommendations constituted investment advice.

## Recommendations Within Pension Plans

Retirement plans are complex, and individuals often rely on financial-services professionals to assist with decisionmaking. For example, an employer might seek out assistance in determining what investments to offer in a 401(k) plan it has established, participants in 401(k) plans might seek assistance in choosing their investments from among the options offered by the plans, or workers who participate in employer-sponsored 401(k) plans might seek assistance on whether to leave their 401(k) account balance in the plan or roll it over into an Individual Retirement Account (IRA) or into another employer's DC plan either upon job change or at retirement.

The compensation structure of some financial-services professionals may give rise to conflicts of interest, particularly if these professionals' recommendations result in larger commissions or otherwise benefit them. These potential conflicts could lead to recommendations that are not in the interests of their clients. By contrast, some financial-services professionals have compensation structures that do not vary based on which products clients choose. This type of compensation structure could mitigate some conflicts of interest. Individuals who provide recommendations to pension plans are required to meet

standards of conduct that depend on the individuals' roles and the actions they are taking.

## Federal Pensions Law

To protect the interests of private sector pension plan participants and beneficiaries, Congress enacted the Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406). ERISA is included in the *U.S. Code* in both Title 26 (the Internal Revenue Code) and in Title 29 (often called the Labor Code). ERISA contains fiduciary standards, which require that individuals who make decisions for private sector pension plans and their participants (referred to as *fiduciaries*) adhere to specified standards of conduct.

## Prohibited Transaction Exemptions (PTEs)

ERISA also prohibits fiduciaries from engaging in transactions deemed likely to injure pension plans, referred to as *prohibited transactions*. ERISA bars certain transactions between a plan and persons connected to a plan (referred to as a *party in interest*) and between a plan and a plan fiduciary. To facilitate transactions between pension plans and service providers that would otherwise be prohibited by ERISA, a number of *Prohibited Transaction Exemptions (PTEs)* exist, either in statute or as issued by DOL.

## Current Investment Advice Regulations

Following the enactment of ERISA, DOL issued regulations in 1975 that created a five-part test to determine whether an individual provided *investment advice* and thus was subject to the fiduciary standard (see 29 C.F.R. §2510.3-21). In addition, DOL issued a PTE to ensure that fiduciaries could continue to engage in practices that would otherwise be prohibited (such as brokers receiving commissions for products they recommend).

To be held to the 1975 fiduciary standard with respect to his or her recommendations, an individual must (1) make recommendations on investing in, purchasing, or selling securities or other property or give advice as to the value (2) on a regular basis, (3) pursuant to a mutual understanding that the advice (4) would serve as a primary basis for investment decisions and (5) would be individualized to the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments. An individual is not treated as a fiduciary unless each of the five elements of the test is satisfied.

Individuals who provide investment services to retirement investors or plans may also be subject to other regulatory structures. For example, broker-dealers who provide

investment recommendations but whose actions do not meet ERISA’s five-part test are subject to Securities and Exchange Commission’s (SEC’s) Regulation Best Interest (Reg BI), which requires that brokers and dealers act in the best interest of their clients. For more information, see CRS Report R47431, *Capital Markets: Overview and Selected Policy Issues in the 118th Congress*.

## Recent Regulatory Actions

In October 2010, DOL proposed, and subsequently withdrew in September 2011, an expansion of the definition of *fiduciary advice* that would have made more individuals and their actions subject to the fiduciary advice regulation. In April 2015, DOL issued a revised proposal to broaden the definition of *investment advice* and, in April 2016, issued a final rule and new and amended PTEs.

Under the 2016 rule, the types of activities that would constitute investment advice, if they are done for a fee or other compensation, are recommendations pertaining to the advisability of buying, selling, holding, or exchanging investments; how investments should be invested after being rolled over, transferred, or distributed from an IRA; the management of investments; or IRAs, including whether, in what form, in what amount, and to what destination rollovers, distributions from IRAs, and transfers from IRAs should be made. The rule also described certain activities that did *not* constitute investment advice (e.g., marketing by platform providers, providing general investment education, and executing securities transactions).

Among the new and amended PTEs accompanying the final rule were the Best Interest Contract Exemption, Principal Transactions Exemption, and an amended PTE 84-24, which affects the sale of annuity products. For more information on the 2016 proposed and final rule and PTEs, see CRS Report R44884, *Department of Labor’s 2016 Fiduciary Rule: Background and Issues*.

## Actions Under the Trump Administration

In March 2017, DOL issued a Temporary Enforcement Policy that indicated it would not initiate enforcement actions against financial advisers or financial institutions that failed to satisfy the conditions of the 2016 regulation or PTE (see Field Assistance Bulletin 2017-01). In March 2018, a U.S. District Court ruled that the 2016 rule was improperly promulgated and in March 2018, a U.S. court of appeals vacated the 2016 rule. This meant that the five-part test was reinstated (see 85 *Federal Register* 40589-40594, July 20, 2020).

In October 2020, DOL issued PTE 2020-02 which, as with previous PTEs, allows fiduciaries to conduct transactions which are otherwise prohibited. Investment advice fiduciaries who rely on PTE 2020-02 must comply with *Impartial Conduct Standards*, which require them to provide advice that is in the best interest of the retirement investor, charge no more than reasonable compensation, and make no misleading statements about investment transactions.

In addition, PTE 2020-02 noted that rollover recommendations from an employer plan to an IRA *could* be considered investment advice if specified conditions are met—for example, if the investment recommendation were expected to be part of an ongoing relationship. On February 13, 2023, a federal district court struck down the portion of PTE 2020-02 related to the rollover recommendations, and on June 30, 2023, a different federal district court recommended that the guidance related to rollover advice be vacated.

## Actions Under the Biden Administration

Since spring 2021, DOL has indicated its intent to release a proposed rule that it said would more appropriately define when a person providing investment advice would be a fiduciary. In September 2023, DOL submitted a proposed rule for review to OMB that DOL said would more appropriately define when recommendations constituted investment advice.

Proponents of a new rule cite the changing retirement landscape since 1975, when most individuals in retirement plans had DB plans compared to the DC plans that are common today. In DC plans, participants have more responsibilities regarding plan contributions, investments, and withdrawals and may need more assistance from financial services professional regarding their choices.

## Responses to Notice of Proposed Rule in the 118<sup>th</sup> Congress

In an August 2023 letter to DOL, Senator Bill Cassidy and Representative Virginia Foxx wrote that they opposed a rule that would revise the definition of *fiduciary* under ERISA, noting that shifting interpretations “created confusion in the marketplace and unwarranted compliance expenses.”

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