Participant Investment Advice and Education Considerations for Retirement Plan Fiduciaries

**A Lexis Practice Advisor® Practice Note by
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This practice note addresses issues faced by plan administrators and service providers under the Employee Retirement Income Security Act (ERISA) as they provide investment education and advice to retirement plan participants. Providing participants with investment assistance can have important implications regarding ERISA fiduciary status. Practitioners who advise plan sponsors, administrators, and other plan fiduciaries contemplating providing such plan-related services need to be aware of these issues and the relevant administrative guidance.

This practice note is organized in the following sections:

- Need for Participant Investment Advice and Education
- Distinguishing Investment Advice and Investment Education
- Considerations for Providing Investment Education
- Considerations for Providing Investment Advice
- Best Practices for Providing Investment Advice and Education

Need for Participant Investment Advice and Education

Repeated studies show that a significant portion of the general public is stressed about their financial situation. See, e.g., American Psychological Association, Stress in America: Paying with Our Health (2015) (reporting that 72% of adults felt stressed about money at least some of the time during the prior month and nearly 22% reported extreme stress about finances during that month); PriceWaterhouseCoopers, Employee Financial Wellness Survey (2019) (which reported that 67% of employees reported financial stress). Many individuals lack basic financial literacy skills like budgeting and understanding investments, much less mastery of more complicated topics like modern portfolio theory. Without those tools, they are ill-equipped to determine how much they will need to have saved at retirement, how to change their savings pattern to contribute more, how to create a diversified portfolio that mitigates risk and helps them reach their retirement goals, or how to draw down their retirement savings after they retire.

Currently, most employees participate in defined contribution retirement plans which rely on participants making prudent decisions about their contribution rates, investment allocations, and distribution decisions for their individual accounts. Unfortunately, many employees do not have the knowledge necessary to make those decisions. In 1996, the Department of Labor (DOL) released Interpretive Bulletin 96-1 (codified at 29 C.F.R. § 2509.96-1, hereafter "Interpretive Bulletin 96-1"), which attempted to eliminate hurdles that had prevented plans from providing investment education. In that Interpretive Bulletin, the DOL recognized the increasing importance of providing investment assistance to participants due to the proliferation of both the number of participant-directed individual account plans and the investment options available under them. See 61 Fed. Reg. 29,588 (June 11, 1996).

Not much has changed in subsequent decades. The investment education materials every plan vendor has on

their website sit mostly untouched. Even participants who are motivated to actually access and read the materials frequently report that the materials are unhelpful because they are too generic and lack any meaningful instruction on making investment decisions.

ERISA plan fiduciaries face a difficult challenge: do they try to help educate plan participants about financial planning and risk a fiduciary breach claim arising out of the education materials, or do they leave participants to fend for themselves and risk having a workforce distracted by financial worry and unprepared to meet their retirement needs?

Distinguishing Investment Advice and Investment Education

It is important to distinguish between providing investment advice (which is subject to ERISA's fiduciary duties) and providing investment education (which is not). Providing investment advice for compensation is one of the "functional" tests for determining ERISA fiduciary status. Under ERISA § 3(21)(A)(2) (29 U.S.C. § 1002(21)(A)(2)), an individual is a "fiduciary" if the individual "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan." If an individual is found to have given investment advice to a plan participant, and that individual received any compensation, then the participant can sue that individual for a breach of fiduciary duty related to the rendering of that investment advice. Indeed, participants frequently sue fiduciaries and service providers regarding advice that the participant alleges was imprudent or impacted by an undisclosed conflict of interest.

For example, many recordkeepers historically have encouraged participants to roll over their plan accounts to an individual retirement account with an affiliate of the recordkeeper, without considering whether the affiliate's IRA imposes higher fees than its competitors or the plan from which the distribution would be made. That advice has clear benefits for the recordkeeper/affiliate, but it is difficult to articulate how such a recommendation could be made by an ERISA fiduciary without a conflict of interest and violation of the fiduciary's duty to act solely in the interest of the participant pursuant to ERISA § 404(a)(1) (29 U.S.C. § 1104(a)(1)). If instead the communication is investment education, and does not cross over the line into advice, the participant has little recourse against any educator who provides conflicted information. Merely providing general education on investing does not constitute investment advice for purposes of ERISA's fiduciary definition.

The problem is that the line between investment advice and investment education is difficult to define. In fact, the definition of "investment advice" under ERISA was a significant part of the DOL's so-called Fiduciary Rule issued in 2016. 81 Fed. Reg. 20,946 (April 8, 2016). Note that, the DOL subsequently abandoned the Fiduciary Rule after the Fifth Circuit Court of Appeals ruled that the Fiduciary Rule had not been validly adopted and that it exceeded the DOL's authority. See Chamber of Commerce of the United States v. U.S. Dep't of Labor, 885 F.3d 360 (5th Cir. 2018). The withdrawal of the Fiduciary Rule has the effect of resurrecting the pre-Fiduciary Rule standards. For more information, see ERISA Fiduciary Duties and Expert Interview – Unwinding the Department of Labor's Fiduciary Rule. For a case discussion regarding the now-repealed Fiduciary Rule, which discusses the unnecessary expansion of the term "investment advice," see Nat'l Assn. for Fixed Annuities v. Perez, 217 F. Supp. 3d 1 (D.D.C. 2016).

The Fiduciary Rule generally expanded the scope of the investment advice trigger for ERISA fiduciary status, as discussed below, but the Fiduciary Rule also retained and expanded the existing exception for investment education. See Preamble, 81 Fed. Reg. 20,946, 20,976 (June 7, 2016).

Investment Advice / Education Standard under Pre-Fiduciary Rule (and Current) Regulations – The Five-Part Test

Prior to April 8, 2016 (and after the Fiduciary Rule's repeal), an individual is deemed to provide investment advice to a plan for purposes of ERISA's fiduciary definition if five criteria are satisfied:

- The individual renders advice as to the value of securities or other property or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property.
- That advice is provided on a regular basis.
- That advice is provided pursuant to a mutual agreement, arrangement, or understanding with the plan or a plan fiduciary.
- The advice serves as a primary basis for investment decisions with respect to plan assets.
- The advice is individualized based on the particular needs of the plan.

29 C.F.R. § 2510.3-21(c) (as adopted on October 28, 1975).

Investment Education under Interpretive Bulletin 96-1

In Interpretive Bulletin 96-1, the DOL extended the foregoing facts and circumstances standard to investment advice rendered to plan participants and beneficiaries. 29 C.F.R. § 2509.96-1(c). The guidance also established an exception where disclosures would be treated as investment education, and not as investment advice. 29 C.F.R. § 2509.96-1(c).

Interpretive Bulletin 96-1 defined investment education to include any of the following:

- **Plan information.** This includes basic information about the plan and the investment options offered, such as descriptions of the terms and operations of the plan, the benefits of plan participation and increasing plan contributions, the impact of preretirement withdrawals on retirement income, and the following information about the investment alternatives available under the plan:
    - Investment objectives or philosophy
    - Risk and return characteristics
    - Historical return information
    - Prospectus documents for the plan's investment options

  Importantly, the exception is lost if the education materials reference the appropriateness of any individual investment option for a particular participant or beneficiary.

- **General financial, investment, and retirement information.** This includes describing general financial and investment concepts (e.g., risk and return, diversification, dollar cost averaging, compounded return, and tax-deferred investment); historic differences in rates of return between different asset classes (e.g., equities, bonds, or cash) based on standard market indices; the effects of inflation; the need to estimate future retirement income needs and determine investment time horizons; and risk tolerance.
- **Asset allocation models.** These are models, charts, or case studies of alternative asset allocation portfolios for individuals having different time horizons and risk profiles. The model must describe all material facts and assumptions on which the model is based. If the model identifies a specific investment alternative, the model must be accompanied by a statement indicating that other investment alternatives having a similar risk and return characteristic may be available under the plan. In addition, the model must remind participants to consider other assets, income, and investments.
- **Interactive investment materials.** These materials include questionnaires, worksheets, and interactive models to estimate future retirement income needs and assess the impact of different asset allocations on retirement income, based on supplemental information and assumptions provided by the participant.

29 C.F.R. § 2509.96-1(d). Most lawsuits related to investment recommendations (in which the plaintiffs claim defendants breached their fiduciary duties) fail because the individual who provided the recommendation wasn't a fiduciary under one or more of the following standards:

- The information they provided qualifies as investment education.
- The advice was not the primary basis for the investment decision.
- The advice was not provided on a regular basis.
- The advice was not individualized.

See, e.g., Beeson v. Fireman's Fund Ins. Co., 2009 U.S. Dist. LEXIS 83105 (N.D. Cal. 2009).

Expanded Investment Advice / Education Standards under the (Withdrawn) Fiduciary Rule

Under the withdrawn Fiduciary Rule, the DOL expanded both the scope of investment advice and the investment education exception. Investment advice was defined in the context of a "recommendation" regarding a particular investment. This meant 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." 29 C.F.R. § 2510.3-21(a) (as adopted in 81 Fed. Reg. 20,946). The more tailored the communication was to a participant's situation, the more likely the communication would be classified as a recommendation. Importantly, the requirements that the advice be provided regularly or be the primary basis for the investment decision were both removed from the five-part test.

In addition, the withdrawn Fiduciary Rule expanded the "plan information" and "general financial, investment, and retirement information" portions of the investment education exception. Importantly, the exemption was still lost if the education materials included recommendations regarding specific investment products or specific plan alternatives, or recommendations regarding the investment

or management of a particular security or securities or other investment property.

The withdrawn Fiduciary Rule also expanded the "plan information" category to include materials describing retirement income needs; the advantages, disadvantages, and risks of different forms of distributions; and provided an expanded list of educational information about investments alternatives available under the plan, which allowed information consisting of participant education, to include:

- Product features (new)
- Investor rights and obligations (new)
- Fee and expense information (new)
- Trading restrictions (new)
- Investment objectives or philosophy
- Risk and return characteristics
- Historical return information
- Prospectus documents for the plan's investment options

29 C.F.R. § 2510.3-21(a) (as adopted in 81 Fed. Reg. 20,946). The "general financial, investment, and retirement information" category was expanded to include (in addition to the information listed above) materials describing the effects of fees and expenses on rates of return; retirement-related risks (e.g., longevity risks, market/interest rates during draw-down periods, inflationary effects, and adequate budgeting for healthcare and other expenses); and strategies for managing assets in retirement.

While these changes contained under the withdrawn Fiduciary Rule no longer represent formal regulatory guidance, they nevertheless may offer insight as to the view of the DOL when evaluating whether the advice—education divide has been crossed in a particular case.

State of the Marketplace

Plan sponsors face a confusing landscape and rely on their experts to guide them. Frequently, the plan's vendors (third-party administrator and investment managers) are unwilling to risk being classified as a fiduciary with respect to individual participants and therefore refuse to provide more aggressive investment education. This means that many tools are not available to plans or their participants.

Other plan vendors provide communications that may mislead the average plan participant. For example, most participants would expect that information provided by a "certified financial planner" or a "robo-advice" tool based on their particular situation would qualify as investment advice provided by a fiduciary. However, most vendors providing those services take the position that they are not fiduciaries with respect to those services.

In general, robo-advice is investment information generated by computer software-based model based on plan data and personal information input by the plan participant, without any personal interaction with the participant.

Often a vendor will be a fiduciary with respect to advice provided to the plan sponsor and not with respect to information provided to plan participants. It's important that a plan sponsor understands the status of its vendors when those vendors provide participant communications.

Considerations for Providing Investment Education

Plan fiduciaries should consider the following as they decide whether to provide participant investment education.

Arguments against Providing Investment Education

Most plans have investment education materials available on the vendor's website, but few plans actively try to educate participants.

Some plans don't promote participant investment education because it is hard to meaningfully impact employee behavior on this topic. It is a complicated topic with lots of jargon that is overwhelming for the typical employee. It is difficult to get employees to devote sufficient time to such a daunting topic. In the face of this uphill battle, some employers prioritize other education opportunities that have more direct business impact (like business strategy training) or are more likely to change employee behavior (like increasing plan contributions or participating in physical wellness programs).

In addition, most plans don't push participant education because they fear being treated as a fiduciary regarding a participant's individual investment decisions. To the extent that the participant is unprepared for retirement (due to a failure to contribute enough, unlucky investments, inflation exceeding expectations, longevity exceeding mortality assumptions, or other reasons), the participant may argue that the education materials provided "bad" investment advice to the point that it constituted a fiduciary breach. Thus, plan sponsors avoid even permissible education of their participants.

Arguments for Providing Investment Education

The best argument for providing investment education is that equipping employees to succeed is just the right thing to do.

There may also be productivity gains. For example, employees who feel trapped by their financial circumstances are a drag on morale and productivity. See PriceWaterhouseCoopers, Employee Financial Wellness Survey (2019), which found:

- 35% reported that personal finance issues have been a distraction at work.
- 49% of these financially distracted employees reported spending at least three work hours each week thinking about or dealing with issues related to their personal finances.
- 21% admitted that their work productivity had been impacted by their financial worries.

An employee who is focused on personal issues may make mistakes or simply not be friendly to coworkers and customers. An employee who cannot afford to retire may continue to work after they are no longer physically or mentally able to perform. All of these are examples of productivity losses caused by financially stressed employees. The elimination of their financial stress could result in happier and more focused (and therefore more productive) employees.

The elimination of financial stress also may reduce other employer costs. For example, the reduction of financial stress could reduce the medical plan cost for the treatment of stress related illnesses.

Finally, an employee who understands budgeting, deferred gratification, and market cycles could think more strategically about those issues for the employer's business. Such a strategic focus could result in improved company results, reduced expenses, and streamlined business processes.

Considerations for Providing Investment Advice

Some plans engage a third-party financial services provider to provide investment advice to plan participants for an additional fee paid by the participants who enroll in those services. Such programs are often designed to provide different levels of services, that range from providing general investment education to providing customized investment advice or even asset management. Since most of the services definitively involve ERISA fiduciary activities, the vendors and the plan fiduciaries that retain them must be cognizant of the risks and responsibilities involved.

Any provider of investment advice, whether to a plan or to participants, must take care not to engage in a nonexempt prohibited transaction under ERISA (ERISA § 406 (29 U.S.C. § 1106)) and the Internal Revenue Code (I.R.C. § 4975). In general, the use of plan assets to pay for investment advice is a prohibited transaction unless the arrangement is structured to fit within a statutory, class, or individual prohibited transaction exemption. The prohibited transaction rules can impede the ability of financial advisors to furnish specific investment advice to ERISA plan participants since the advice will frequently involve investment vehicles and products that the financial advisor provides, are provided by its affiliates, or the ultimate selection of which might otherwise benefit the advisor or its affiliates.

The Pension Protection Act of 2006 (the PPA) added a statutory prohibited transaction exemption for plan participant investment advice. See ERISA § 408(b)(14) (29 U.S.C. § 1108(b)(14)) and I.R.C. § 4975(d)(17). In general, these sections exempt investment advice provided to participants and beneficiaries in individual account plans related to the investment of the individual's plan account. This exemption requires:

- **Authorization.** A plan fiduciary must expressly authorize the provision of the investment advice. ERISA § 408(g)(4) (29 U.S.C. § 1108(g)(4)).
- **Audit.** The investment advice must be audited annually by an independent expert demonstrating compliance. ERISA § 408(g)(5) (29 U.S.C. § 1108(g)(5)).
- **Disclosure.** The investment advisor must fully comply with the initial and ongoing disclosure obligations described in ERISA § 408(g)(6) to (9) (29 U.S.C. § 1108(g)(6) to (g)(9)).
- **Arm's length terms.** The arrangement must be conducted on arms' length terms and for reasonable compensation. ERISA § 408(g)(7) (29 U.S.C. § 1108(g)(7)).
- **Either:**
  - **Level-fee option.** The fees paid to the investment adviser for the investment advice do not vary based on the participant's selected investment options. ERISA § 408(g)(2)(A)(i) (29 U.S.C. § 1108(g)(2)(A)(i)). –or–
  - **Computer model option.** The investment advice must be generated by a computer model that applies

generally accepted investment theories and relevant participant information in an objective and unbiased algorithm that takes into account all investment options under the plan to generate advice as to how the participant's account balance should be invested. The computer model must be the sole basis of the advice. ERISA § 408(g)(3) (29 U.S.C. § 1108(g)(3)).

For a broader discussion on the topic, see Investment Advisers: Law & Compliance § 15.14, at paragraph [5][f].

In general, plan sponsors who prudently select and regularly monitor the performance of a service provider should not have fiduciary liability for the actions of a duly selected advisor. The exception to that rule is ERISA § 405 (29 U.S.C. § 1105), which provides that a fiduciary is liable for a known breach by another fiduciary unless certain actions are taken. A discussion of co-fiduciary liability is beyond the scope of this practice note. For information in that regard, see ERISA § 405 (29 U.S.C. § 1105) and ERISA Fiduciary Duties — Fiduciary Liability under ERISA.

It is important to remember that ERISA § 406(b) (29 U.S.C. § 1106(b)) prohibits fiduciary self-dealing. Even if a transaction fully complies with the prohibited transaction exemption, the transaction is still prohibited if the DOL finds that the fiduciary has dealt with the plan assets in the fiduciary's own interests, has an impermissible conflict of interest, or violates the anti-kickback limitations.

Best Practices for Providing Investment Advice and Education

Investment education provided to retirement plan participants can improve their financial literacy and help them succeed in their savings goals. Plan sponsors engaging in participant investment education should consider the following best practices:

- **Prudently select and monitor vendors.** Remember that the selection of the investment education provider is a fiduciary decision, if paid for with plan assets. Consider the qualifications and costs of the proposed providers.
- **Use a variety of teaching styles.** Most effective are videos that combine graphics, examples, and explanations. Similarly, a series of short videos (each under five minutes) are more effective than one long, comprehensive tutorial.
- **Make materials engaging and accessible.** If the educational information uses too much jargon or is too long, the average employee will become overwhelmed and will give up. Materials are not effective if the employee won't access them.
- **Remember the value of repetition.** Investment education is not a one-time campaign. It is an ongoing effort.
- **List broader asset classes and all of the investment alternatives in that asset class instead of listing specific investments available under the plan.** Although models with specific investment breakdowns are significantly more helpful for employees, it is highly likely that such a model would be deemed to have crossed the line to be investment advice.
- **Follow the safe harbor.** Be mindful not to exceed the parameters of the investment education safe harbor under DOL Interpretive Bulletin 96-1 (29 C.F.R. § 2509.96-1). A wealth of valuable investment educational information can be provided without providing specific customized investment advice, which can needlessly expose the investment education provider to increased fiduciary liability risk.
- **Use a fiduciary vendor.** Consider hiring a vendor to serve as a fiduciary providing investment advice to participants (see additional considerations below).

Plan sponsors desiring to take the additional step of making investment advice available to plan participants should consider the following points:

- **Prudently select and monitor vendors.**
  - o Remember that the selection, retention, designation, and monitoring of a service provider to provide investment advice to participants are fiduciary acts. The responsible fiduciaries must act prudently and solely in the interest of the plan participants and beneficiaries.
  - o The selection process should be objective and should gather and consider information necessary to assess the provider's qualifications, quality of services, reasonableness of compensation, potential conflicts of interest, whether the provider will acknowledge of ERISA fiduciary status in the vendor contract, the provider's registration status under applicable federal and/or state securities law, the provider's reputation, and the propriety of the models or other basis the vendor will use when furnishing advice under the program.
- **Evaluate compliance with applicable prohibited transaction exemptions.** Consider an investment advice program that is eligible for the prohibited transaction exemption under ERISA § 408(b)(14) (29 U.S.C. § 1108(b)(14)) and I.R.C. § 4975(d)(17).

- **Evaluate potential self-dealing concerns.** Often these are the most difficult to discern.
- **Regularly monitor performance.** Periodically (and as events may demand), monitor the services of designated investment advisors. For periodic reviews, consider the reasonableness of fees, the adequacy of disclosures, the proportion of participants electing to use the service, participants' satisfaction with the investment services, and the advisor's continued compliance with its registered status and other contractual representations.

Remember to document prudent processes and retain the records to prove that process for as long as the plan may be at risk for a potential breach of fiduciary duty claim.

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Jen is a partner in the Vorys Columbus office and a member of the labor and employment group. Her practice focuses on employee benefits and executive compensation plans. As former Managing Corporate Counsel for a large, publicly traded employer, Jen has extensive experience in the design, implementation and administration of retirement plans, deferred compensation, health and welfare plans, insurance benefits, short- and long-term cash and equity-based incentive plans, and early retirement programs; public company disclosure obligations and merger and acquisition activity.

Career highlights include:

- Regularly advising clients on voluntary corrections for qualified and non-qualified retirement plans; Jen's correction applications are often approved without any questions from the IRS or DOL reviewers
- Regularly advising clients of all sizes, including publicly traded, private and non-profit companies, regarding their executive compensation structures, advising through design, drafting, implementation, ongoing administration and termination
- Assisting clients to defend against proposed assessments of taxes under the Affordable Care Act (Code Section 4980H)
- Managing contract negotiation, due diligence disclosure, integration and separation issues in connection with mergers and acquisitions as both an acquirer and a target
- Assisting clients with IRS and DOL audits of retirement plans and health plans

Jen is actively involved with the American Bar Association. She is a frequent speaker on benefits issues including executive compensation, IRS and DOL audits, qualified retirement plans and health insurance.

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