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Memorandum

Key Takeaways for Fund Sponsors Navigating ERISA's New Investment Advice Rule

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On April 23, 2024, the Department of Labor released a new rule[1] (the "Retirement Security Rule") that re-defines the test for when one provides *non-discretionary* "investment advice" under ERISA. This memorandum focuses on the likely effect of the Retirement Security Rule, which goes into effect on September 23, 2024, on sponsors of both registered and unregistered (*i.e.*, private) funds, and includes key takeaways for sponsors of both types of funds below.

Fund sponsors may communicate and interact with prospective and current investors that are "benefit plan investors," such as ERISA plans and IRAs ("ERISA Investors")[2], in a variety of ways. For example:

- Registered fund sponsors usually engage directly with broker-dealers and other intermediaries and wholesalers, rather than with the underlying investors, who may include IRA owners and other retail retirement investors. Communications with intermediaries may involve sales pitches and providing information about the fund. These sponsors may have other touch points with the retirement community, including the fielding of investors' calls through a call center and promoting their funds to plan consultants and/or plan sponsors.
- Private fund sponsors may answer discrete diligence questions from, and negotiate side letters with, an ERISA pension plan investment committee or plan investment manager in connection with the acquisition of a limited partnership interest. These ERISA Investors may seek specific information on the differences among various funds offered by the sponsor, tax structuring options within a single fund family and co-investment opportunities. These fund sponsors may also engage in sales pitches directed to intermediaries, who may add the fund to an investment platform for the intermediaries' wealth management clients.

These communications and interactions were traditionally *not* treated as "investment advice" under ERISA because, under the historical rule, one was not considered an ERISA fiduciary that provided investment advice (an "Investment Advice Fiduciary") unless the advice was made, in part, on a "regular basis" and "pursuant to a mutual agreement" that the advice would "serve as a primary basis for investment decisions" and such advice was "individualized based on the particular needs" of the recipient of such advice.

[1] Available here.

[2] Communications with governmental plans and most foreign plans are *not* subject to the Retirement Security Rule.

The Retirement Security Rule presents a new paradigm for when one is deemed to provide non-discretionary investment advice to ERISA Investors. Importantly, the new rule provides that a *one-time* "recommendation" is sufficient to impute ERISA fiduciary status on the provider of such advice. Specifically, a person becomes an Investment Advice Fiduciary if such person provides a recommendation to the ERISA Investor (including a fiduciary representing the ERISA Investor that has control over the decision to invest in the fund) for a fee or other compensation with respect to a securities transaction, and such person either:

1. Directly or indirectly (*e.g.*, through or together with any affiliate) makes professional investment recommendations to investors on a regular basis as part of their business *and* the recommendation is made under circumstances that would indicate to a reasonable investor in like circumstances that the recommendation is based on a review of the ERISA Investor's particular needs or individual circumstances, reflects the application of professional or expert judgment to the ERISA Investor's particular needs or individual circumstances, and may be relied upon by the ERISA Investor as intended to advance the ERISA Investor's best interest; or,
2. Represents or acknowledges that they are acting as a fiduciary under Title I of ERISA, Section 4975 of the Internal Revenue Code of 1986, or both, with respect to the recommendation.

From a practical perspective, in the normal course of raising and operating a registered or private fund, we think it is relatively unlikely that a sponsor would be deemed to provide a "recommendation" to an ERISA Investor under the Retirement Security Rule. We highlight that (1) above would require making professional investment recommendations to investors on a regular basis to be a part of a fund sponsor's (or its affiliates') business. In our experience, most fund sponsors would likely not meet this requirement. Additionally, many funds' documents indicate that the sponsor did not provide investment advice, or otherwise act in a fiduciary capacity, to an ERISA Investor with respect to the ERISA Investor's decision to invest in the fund. Therefore, it is relatively unlikely that a typical fund sponsor would meet (2) above.

Further, we note that the test for whether "investment advice" has been provided is an *objective* one—the ERISA Investor's state of mind is not controlling. The linchpin, therefore, is how *a reasonable investor in like circumstances* would have viewed the recommendation and whether the fund sponsor has expressly acknowledged ERISA fiduciary status. Disclaimers of investment advice fiduciary status *can be* dispositive, provided such disclaimers are consistent with (i) other communications with the investor, (ii) marketing materials, and (iii) applicable state and federal law.

Key Takeaways for Registered Fund Sponsors

Communications with intermediaries and plan consultants present a relatively low risk that the fund sponsor will inadvertently provide investment advice under the Retirement Security Rule. This is because these entities are unlikely to be discretionary fiduciaries of the ERISA Investor, meaning, an inadvertent recommendation by the

fund sponsor to such intermediaries and plan consultants should fall outside the scope of the new rule. A sponsor may, however, wish to disclaim fiduciary status in its communications with intermediaries for additional protection.

Communications with sponsors of ERISA Investors (*i.e.*, plan sponsors) and retail ERISA Investors (*i.e.*, IRAs) present a higher risk under the Retirement Security Rule. Meetings with plan sponsors, for example, may lead to "individualized" discussions regarding the fund and the plan's needs. Similarly, an IRA owner may call the sponsor's call center and ask if the fund is appropriate for their IRA. We suggest that sponsors establish guardrails (*i.e.*, scripts or policies on what can and cannot be said) for these types of communications so as to mitigate the risk of the fund sponsor being deemed to provide investment advice under the Retirement Security Rule. A sponsor may also wish to disclaim fiduciary status in its communications with these investors for additional protection. It will be critical for sales and marketing communications—which are made to all investors—to be vetted in advance to ensure they do not suggest to the ERISA Investors that the sponsor is providing investment advice to them.

Key Takeaways for Private Fund Sponsors

Side letter negotiations and investment information that is shared with ERISA Investors has not traditionally been viewed by the sponsor or its limited partners to be ERISA investment advice, even though it may be related to the ERISA Investor's acquisition of an interest in the fund. We think this historical practice should have bearing on the Retirement Security Rule's objective test for whether investment advice has been provided in connection with these types of communications. Though the Department of Labor expressly declined to say that fund information provided to a class of investors (*e.g.*, ERISA limited partners) is *per se* not investment advice, we nevertheless think the new rule's objective standard should offer some protection to sponsors. Out of an abundance of caution, sponsors may wish to include new (or augment existing) disclaimers of ERISA fiduciary status in fund documents, particularly subscription agreements and private placement memoranda.

Sales and marketing communications similarly present a relatively low risk to private fund sponsors, particularly if made to intermediaries that are not discretionary fiduciaries to the ERISA Investor. It will be important for sales and marketing communications—which are made to all prospective limited partners and other clients—to be vetted in advance to ensure they do not suggest to the ERISA Investors that the sponsor is providing investment advice to them.

Takeaways for Fund Sponsors (Registered and Private)

A sponsor's most significant risk of inadvertently providing investment advice under the Retirement Security Rule is likely where it offers separate accounts or funds-of-one for ERISA Investors. Prior to the ERISA Investors' commitment of capital, sponsors may wish to consider entering into a letter of understanding with the ERISA Investor to ensure the parties agree that the communications are viewed as being at arm's length and not fiduciary in nature.

A sponsor's current and future portfolio companies that provide financial services may also be impacted by the Retirement Security Rule. We suggest engaging with the impacted portfolio companies to ensure steps are being taken to comply with the rule. A fund sponsor's M&A diligence should also be augmented when the target provides financial services to ferret out potential non-compliance with the Retirement Security Rule on a going-forward basis.

We note that the DOL amended several class exemptions (*i.e.*, DOL Prohibited Transaction Class Exemptions 2020-02, 84-24, 75-1, 77-4, 80-83, 83-1 and 86-128) that relate to the provision of investment advice under ERISA. Because most fund sponsors should not be viewed as providing non-discretionary ERISA investment advice to ERISA Investors, for the aforementioned reasons, reliance on a prohibited transaction exemption is not necessary and, therefore, we do not delve into these amendments here.

The Retirement Security Rule presents significant interpretive issues and challenges for certain other stakeholders—specifically, broker/dealers and those professionals selling certain insurance products and annuities may need to implement significant changes to their sales and marketing activities as a result of the new rule. We anticipate that there will be numerous court challenges to the Retirement Security Rule.[3]

Separate and apart from considerations presented under the Retirement Security Rule, we note that ERISA fiduciary status can also arise where the fund sponsor exercises any authority or control over the management of an ERISA Investor's assets. If the sponsor operates its fund by satisfying an exception from holding "plan assets" (*e.g.*, by reason of relying on the "registered investment company," "publicly-offered securities," "significant participation," "venture capital operating company," or "real estate operating company" exceptions), then the sponsor would *not* be acting as an ERISA fiduciary when managing the assets of that fund. However, if the sponsor manages the assets of an ERISA Investor's separate account, for example, it likely would be an ERISA fiduciary and the DOL's recent amendments to the QPAM Exemption, as described in our recent memorandum, may be germane.

Conclusion

The extent to which the Retirement Security Rule will impact a fund sponsor's day-to-day business will depend on a variety of factors, including whether such fund sponsor has direct communications with ERISA Investors. Fund sponsors should carefully consider the Retirement Security Rule in light of the discussion above; however, the ultimate impact of the new rule on normal fundraising activities may be minimal.

[3] A mere week after the Retirement Security Rule's release, a lawsuit was filed alleging the DOL exceeded its authority in promulgating the rule. *See Fed'n of Americans for Consumer Choice Inc. v. DOL*, No. 6:24-cv-00163 (E.D. Tex. May 2, 2024).

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