

November 2023

DOL Proposes New Retirement Security Rule

On October 31, 2023, the Department of Labor (“DOL”) issued a new proposed regulation that would change the definition of “fiduciary” under the Employee Retirement Income Security Act (ERISA). Specifically, it would amend the standards around which service providers are a fiduciary due to providing investment advice for a fee. In general, the proposed regulation would make it easier for service providers to fall within the definition of fiduciary under ERISA. The DOL is referring to the proposal as the “Retirement Security Rule.”

Through the process of preparing the Retirement Security Rule, the DOL claims that it has consulted with other regulatory bodies (including the Securities & Exchange Commission (the “SEC”), the Internal Revenue Service (the “IRS”) and the Financial Industry Regulatory Authority (“FINRA”). The DOL also has been discussing the proper approach with multiple stakeholders in the retirement industry, including financial advisors.

Background

The current DOL regulations defining the term “fiduciary” under ERISA were issued nearly 50 years ago. In the interim, the concept of retirement savings in America has changed significantly. When the current rule was drafted, most retirement plans were defined benefit plans, in which participants have no responsibility for selecting appropriate investments. Today, defined contribution plans and IRAs have become the dominant method for Americans to save for retirement.

The shift to individual accounts has moved the burden of selecting retirement savings investments largely to the individual. The variety and complexity of financial products and services have also increased significantly. These changes to the retirement landscape serve as the DOL’s primary motivation to revisit the responsibilities of those who give investment advice and sell retirement savings products.

The DOL has been working on updating the definition of “fiduciary” at least since 2010. In 2016, the DOL finalized a fiduciary rule that significantly changed the standards around who is an ERISA fiduciary due to giving investment advice. In 2018, the Fifth Circuit Court of Appeals struck down the 2016 fiduciary rule in its entirety. The DOL refers to the current proposal as the Retirement Security Rule as a way of distinguishing it as completely independent from the 2016 rule.

Current Rule for Investment Advisors

The current DOL regulation imposes fiduciary status on those providing financial advice only if five requirements are met. Specifically, a provider is giving fiduciary investment advice only if they receive a fee for advising as to (1) the value of securities or other property, or selling securities or other property, (2) on a regular, ongoing basis, (3) pursuant to a “mutual agreement” that (4) the advice will be a primary basis for investment decisions and (5) the advice will be individualized based on the particular needs of the plan.

Under the current rule, advice that is provided on a one-time basis, such as the recommendation to roll funds from a qualified plan to an IRA, is not treated as fiduciary advice. Many advisors avoid fiduciary responsibility because they have no prior relationship with the investor at the time that the rollover recommendation is made. Additionally, service providers sometimes include boilerplate language in their service agreements indicating that there is no mutual agreement that the advice will serve as a primary basis for investment decisions. The Retirement Security Rule would make it harder for advice providers to avoid fiduciary status through those methods.

Proposed Retirement Security Rule

Like the 2016 rule, the Retirement Security Rule attempts to prevent an investment advisor from avoiding fiduciary status by using fine print in its services agreement. Pursuant to the Retirement Security Rule, an advisor will be an ERISA fiduciary if they provide investment advice to a plan, plan fiduciary, plan participant or beneficiary for a fee. Fiduciary duties would also extend if the advice is provided to an IRA owner or beneficiary. However, the advisor must make the recommendation in one of these contexts:

- The person has discretionary authority with respect to purchasing or selling investment property for the retirement investor;
- The person (1) makes investment recommendations to investors on a regular basis as part of their business and (2) the recommendation is provided under circumstances indicating that the recommendation is based on the particular needs or individual circumstances of the retirement investor and may be relied upon by the retirement investor as a basis for investment decisions that are in the retirement investor’s best interest; or
- The person making the recommendation represents that they are acting as a fiduciary when making investment recommendations.

The DOL intends for the Retirement Security Rule to impose fiduciary duties specifically in cases where “retirement investors could reasonably place their trust and confidence in the advice provider.” Applying fiduciary duties in the first and third context above will not generate much controversy. However, the second bullet point above will be the basis of significant contention in the retirement services industry. The new standard would determine when fiduciary duties apply



on a case-by-case basis, given the circumstances of the communication and how it could be perceived by a reasonable investor.

Much of the Retirement Security Rule is consistent with the DOL's longstanding positions. For example, fiduciary duties would apply to the recommendation of another provider to serve as investment advisor or manager, but would not apply the marketing of advisory or management services. The mere execution of a securities transaction at the direction of a plan or IRA owner would not be fiduciary activity. A written disclaimer of fiduciary status would not control if an advisor met the standards to be a fiduciary under the new rule. However, the Retirement Security Rule would differ from the current regulations in some meaningful ways.

"Regular Basis"

The new provision requiring the advisor to provide investment recommendations "on a regular basis as part of their business" diverges from the current rule. The preamble to the proposed regulations makes clear that the DOL does not intend for the "regular basis" requirement to cause all "one-time advice" to be subject to fiduciary duties. However, fiduciary status could apply when the advisor "regularly makes investment recommendations to investors, and the circumstances indicate that the recommendation is based on the retiree's particular needs and circumstances." In this manner, the Retirement Security Rule effectively removes the "regular basis" part of the current five-part test.

The "regular basis" requirement would be met if the advisor provides investment recommendations as a routine part of the services they provide, even if the recommendation in question is given to someone with whom they have no prior relationship. Consequently, ERISA fiduciary duties would apply to any recommendation to roll funds from a retirement plan to an IRA, or to use retirement assets to purchase an annuity product. This change alone could expand fiduciary coverage in meaningful ways.

"Mutual Agreement"

The Retirement Security Rule does not contain the "mutual agreement" requirement which appears in the current five part test. Instead, the proposal focuses on the circumstances surrounding the recommendation, including how the investment professional held themselves out to the retirement investor and described the services offered. This change is intended to comply with emphasis on relationships of trust and confidence stressed by the Fifth Circuit's decision striking down the 2016 final regulation. The focus is on the ways advisors market themselves and describe their services, including their official titles.

Similarly, the current five part test requires that that the advice be "a primary" basis for investment decisions. The Retirement Security Rule instead requires only that the advice "may be relied upon by the retirement investor as a basis" for investment decisions. The recommendation no longer



needs to be a primary basis for the investor's decisions. These changes make it much more difficult for an advisor to avoid fiduciary status through the terms of their service agreement. Unlike the 2016 rule, the Retirement Security Rule does not have a carve-out for sales pitches given to sophisticated investors or plan fiduciaries.

Comparison with SEC Guidance

In 2019, the Securities and Exchange Commission ("SEC") issued Regulation Best Interest ("Reg BI"). While Reg BI addressed broker interactions with individual investors, it does not cover many arrangements where advice is provided in retirement plan or IRA settings. Retirement plan service providers have expressed concerns about applying multiple regulatory standards from different governmental agencies. The DOL intended to address that concern by making the standards of the Retirement Security Rule generally consistent with the requirements of Reg BI and other SEC rules.

Changes to Prohibited Transaction Exemptions

As part of the Retirement Security Rule proposal, the IRS is also proposing some changes to existing prohibited transaction exemptions ("PTEs"). PTEs generally allow ERISA fiduciaries to engage in certain dealings – if certain requirements are met – that would otherwise be prohibited under ERISA and the Internal Revenue Code. Perhaps most significantly, the DOL is offering some adjustments to PTE 2020-02, which is widely used by advisors and broker-dealers serving retirement plans.

To rely on PTE 2020-02, a financial institution must meet a number of requirements, including written acknowledgement of fiduciary status, disclosure of material conflicts of interest and adoption of procedures to help ensure compliance with impartial conduct standards. PTE 2020-02 requires advice to be in the "best interest" of the investor. The DOL's proposed changes to the exemption would require additional disclosures about the "significance and severity" of any investment advice fiduciary's conflicts of interest. The updated PTE would not impose any new contract or warranty requirements for advisors.

The DOL is also suggesting changes to PTE 84-24. The proposed amendments to PTE 84-24 will exclude investment advice fiduciaries from its relief, unless they are independent agents of an insurance company who can sell the product of at least two insurance companies. If an insurance company uses captive agents to sell its products it must rely on PTE 2020-02. An independent agent must acknowledge in writing their fiduciary status. The insurance company selling its products through the independent producer would not be required to acknowledge fiduciary status. This is significant because state insurance licensed only financial professionals have not been considered as acting in a fiduciary capacity in the sale of fixed indexed annuities or fixed annuities historically.



Another proposed amendment to PTE 84-24 requires the insurance company selling its products through the independent producer to exercise supervisory authority only over the independent producer's recommendation of the insurance company's own products, and not over the independent producer's recommendations of products offered by other insurance companies. The insurance company would not be treated as a fiduciary merely because it exercised such oversight responsibilities.

Gallagher Insight

It's important to remember that the Retirement Security Rule is simply a proposal at this point. The DOL must allow for a comment period and public hearing before moving forward. However, the DOL is likely to issue a final version of the regulation sometime before the 2024 presidential election. That gives retirement plan administrators some breathing room, but not a lot. Legal challenges to the Retirement Security Rule are certain, and may be brought before the DOL finalizes the regulation.

While the Retirement Security Rule could have a significant impact on retirement plan participants, it could also have an effect for retirement plan administrators. Individuals who serve on retirement plan committees should understand who the other plan fiduciaries are, and who may be providing fiduciary advice to participants. If finalized without substantial changes, the proposed regulation could expand the list of a plan's fiduciaries.

As for those financial professionals providing advice to participants to roll funds out of a plan or how assets are invested within an IRA, the impact will vary. Additional disclosure and compliance with the proposed amendments to PTE 2020-02 will be required for those affiliated with a broker dealer or registered investment advisors. Independent insurance only producers appointed with two or more insurance carriers recommending fixed insurance products to a plan participant will now be considered fiduciaries for the first time in their careers.

Gallagher will continue to keep clients aware of developments as the Retirement Security Rule progresses to a final regulation.

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