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Fiduciary Compliance Alert

Gallagher

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DOL Finalizes New Retirement Security Rule

On April 23, 2024, the Department of Labor (DOL) issued the final version of a 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 final regulation will make it easier for service providers to fall within the definition of fiduciary under ERISA. The DOL is referring to the final regulation as the "Retirement Security Rule."

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

Background

The prior 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 prior regulations were 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 2024 final regulations as the Retirement Security Rule as a way of distinguishing it as completely independent from the 2016 rule.

The DOL originally proposed the Retirement Security Rule in November 2023. The proposed rule generated much discussion and commentary, resulting in over 400 individual comments and just under 20,000 petition submissions. The final version of the Retirement Security Rule largely follows the proposed version, although with some noteworthy adjustments.

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Prior Rule for Investment Advisors

The prior DOL regulation imposed fiduciary status on those providing financial advice only if five requirements were met. Specifically, a provider gave fiduciary investment advice only if they receive a fee for (1) advising as to 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 that prior rule, advice that was provided on a one-time basis, such as the recommendation to roll funds from a qualified plan to an IRA, was not treated as fiduciary advice. Many advisors avoided fiduciary responsibility because they had no prior relationship with the investor at the time that the rollover recommendation was made. Additionally, service providers sometimes included boilerplate language in their service agreements indicating that there was no mutual agreement that the advice would serve as a primary basis for investment decisions. The Retirement Security Rule will make it harder for advice providers to avoid fiduciary status through those methods.

Final 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 make a recommendation of any investment transaction or strategy to a plan, plan fiduciary, plan participant or beneficiary for a fee. Fiduciary duties would also apply 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 (1) makes investment recommendations to investors on a regular basis as part of their business and (2) the recommendation is made under circumstances indicating to a reasonable investor in like circumstances that the recommendation is based on a review of the investor's particular needs or individual circumstances, reflects the application of professional judgment to the investor's particular needs, and may be relied upon to advance the investor's best interest; or
- The person making the recommendation represents that they are acting as a fiduciary with respect to the recommendation.

The DOL intends for the Retirement Security Rule to impose fiduciary duties specifically in cases where "an investor would reasonably expect that they can place their trust and confidence in the advice provider." 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.

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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 an investment advisor or manager. The mere execution of a securities transaction at the direction of a participant 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. A salesperson's investment recommendation is not advice if they do not represent fiduciary status and the other requirements of the fiduciary definition are not met. Providing investment information or education is not a fiduciary action. However, the Retirement Security Rule would differ from the prior regulations in some meaningful ways.

What Is A "Recommendation"?

Under the final regulations, making a "recommendation" is a threshold element in establishing fiduciary status. Whether a recommendation has been made depends on the facts and circumstances of the particular situation, including whether the communication could be viewed as a "call to action." The more individually tailored the advice is to the advice recipients, the greater the likelihood that the advice is a recommendation. Although the Retirement Security Rule uses a facts and circumstances approach, the preamble to the regulation insists that the determination is objective rather than subjective.

"Regular Basis"

The new provision requiring the advisor to provide investment recommendations "on a regular basis as part of their business" diverges from the prior rule. Under the prior regulation, "one-time advice" would never be fiduciary in nature. That's no longer the standard under the Retirement Security Rule. Fiduciary status could apply when the advisor regularly provides advice as part of their business. The new provision shifts the analysis from whether the advice is provided to the individual on a regular basis to whether the service provider provides the recommendations as a routine part of their services.

Accordingly, 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.

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“Mutual Agreement”

The Retirement Security Rule does not contain the “mutual agreement” requirement which appears in the prior five part test. Instead, the new regulation focuses on the circumstances surrounding the recommendation, including how the investment professional held themselves out to the retirement investor and the types of services performed. This change is intended to comply with the 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 prior five part test requires that that the advice be “a primary” basis for investment decisions. The Retirement Security Rule instead requires only that a reasonable investor would conclude that the advice may be relied upon by the investor to advance their best interest. 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 discussions with sophisticated investors.

Comparison with SEC Guidance

In 2019, the SEC issued Regulation Best Interest (Reg BI). While Reg BI addresses 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.

Changes to Prohibited Transaction Exemptions

As part of the Retirement Security Rule, the DOL has made some changes to existing prohibited transaction exemptions (PTEs). PTEs generally allow ERISA fiduciaries to engage in certain dealings – if specified requirements are met – that would otherwise be prohibited under ERISA and the Internal Revenue Code. Perhaps most significantly, the DOL is making 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 acknowledgment 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 exemption divides this standard into two components – the “care obligation” (effectively a duty of prudence), and the “loyalty obligation” (a duty to put the interest of the client first). The DOL’s changes to the exemption

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would require a written disclosure containing all "material facts" relating to any conflict of interest. The updated PTE would not impose any new contract or warranty requirements for advisors.

The DOL has also made changes to PTE 84-24. As amended, PTE 84-24 may only be relied upon by independent agents who sell the products of two or more 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 financial professionals have not been considered as acting in a fiduciary capacity in the sale of fixed or indexed annuities historically. Like PTE 2020-02, the independent producer would be subject to both a "care obligation" and a "loyalty obligation."

As updated, PTE 84-24 now requires the insurance company selling its products through the independent producer to exercise supervisory authority over the independent producer's recommendation of the insurance company's own products, but not over the 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.

Effective Date

The final regulations are effective 150 days after the publication of the final rule. That date will be in September 2024. At that point, advisors must acknowledge their fiduciary status and provide impartial advice. However, advisors will have until September 2025 to comply with the rest of the PTE requirements, including the mandated disclosures.

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While the Retirement Security Rule will 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. The newly finalized regulation will likely 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 producers who recommend products of two or more insurance carriers to plan participants or IRA holders will now be considered fiduciaries for the first time in their careers.

Lawsuits challenging the Retirement Security Rule are virtually assured, most likely in the Fifth Circuit. Those challenging the final regulation may request a stay delaying the September 2024

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effective date. Gallagher will continue to keep clients aware of developments relating the Retirement Security Rule.

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