DOL's Retirement Security Rule Imposes New Fiduciary Standards on Financial Services, Insurance Industries

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The Legal Intelligencer
May 10, 2024
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The investment landscape has changed over time, and the U.S. Department of Labor (DOL) is intent on changing its regulatory scheme along with it. According to the IRS, in 2020 about 5.7 million Americans rolled a total of $618 billion from retirement plans such as 401(k)s into IRAs. That was approximately double the $300 billion rolled over a decade earlier. Two years later, Americans rolled over about $779 billion into IRAs.

In an attempt to extend more protections to IRA investments and related advice to move money to IRAs, the DOL finalized its new retirement security rule on April 23. Like many recent DOL rules related to retirement investing, the retirement security rule is polarizing and is sure to face significant legal challenges, including from the insurance industry to whom the rule applies a new, heightened duty.

Background of Regulatory Landscape for Retirement Accounts

The Employee Retirement Income Security Act, or ERISA, was enacted 50 years ago this year. Perhaps most importantly, it defines when a person becomes a fiduciary in the course of making investment recommendations to a retirement plan. Under Section 3(21) of ERISA, a person was a fiduciary with respect to a plan to the extent that the person exercises discretionary authority or control over the assets of the plan or renders (or has authority or responsibility to render) investment advice for a fee with respect to the assets of the plan.

As a fiduciary, the provider of investment advice owed duties of prudence and loyalty under a five-part test. That test defined a person as an investment advice fiduciary if he or she provided investment advice for a fee, on a regular basis, pursuant to a mutual understanding with the plan fiduciary, that the advice would serve as a primary basis for investment decisions with respect to the assets of the plan, and that the advice was individualized based on the particular needs of the plan.

Over the last 15 years, the DOL has attempted multiple times to expand the definition

of investment advice fiduciary. Specifically, in 2010, the DOL issued a proposal that established that investment advice would be held to a fiduciary standard if it was even a single recommendation given on a one-time basis or if the person was a registered investment adviser. The 2010 proposal was quickly abandoned due to industry reaction.

Next, in 2016, the DOL sought to establish a broad fiduciary standard for advisers to ERISA plans and IRAs by replacing the five-part test. The 2016 proposal ended up in a final rule before it was vacated by the U.S. Court of Appeals for the Fifth Circuit in *Chamber of Commerce v. U.S. Department of Labor*. In that 2018 decision, the court held that the rule had strayed too far from the common-law definition of the term Fiduciary and that persons engaged in such sales activities are not fiduciaries for purposes of ERISA and the Internal Revenue Code of 1986 absent a special relationship of "trust and confidence."

Then, in 2020, the DOL issued a a more expansive interpretation of the existing rule released in connection with an exemption for investment advice, PTE 2020-02. At that time, the DOL clarified that rollover advice met the "regular basis" requirement of the five-part test if the advice was part of or the beginning of an intended ongoing relationship. However, in March 2023, the U.S. District Court for the Middle District of Florida held that the DOL's new interpretation was arbitrary and capricious because it contradicted the plain language of the DOL's 1975 fiduciary investment advice regulation. *See American Securities Association v. U.S. Department of Labor*, Case No. 8:22-cv-330 (M.D. Fla. Feb. 13, 2023).

The Retirement Security Rule

On April 23, the DOL made its fourth attempt since 2010 to expand investment advice fiduciary status by issuing the retirement security rule. Under the new rule, which replaces the five-part test, a person is an investment advice fiduciary if they provide a recommendation in one of the following contexts:

The person either 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 review of the retirement investor's particular needs or individual circumstances,
- reflects the application of professional or expert judgment to the
- retirement investor's particular needs or individual circumstances, and
- may be relied upon by the retirement investor as intended to advance the retirement investor's best interest; or
- The person represents or acknowledges that they are acting as a fiduciary under Title I of ERISA, Title II of ERISA, or both with respect to the recommendation. The recommendation also must be provided "for a fee or other compensation, direct or indirect" as defined in the final rule.

The retirement security rule also amended prohibited transaction class exemptions. In

doing so, the rule requires that fiduciaries who want to accept compensation that would otherwise be prohibited must avoid conflicts or comply with certain exemptions. In other words, financial professionals who hold themselves out as providing individualized recommendations will be held as fiduciaries and will have to give "prudent, loyal, honest advice free from overcharges," according to the DOL.

The Rule's Most Significant Impact

Expanding ERISA's fiduciary protections to cover most rollover solicitations is one of the prominent features of the retirement security rule. While many rollover transactions are already overseen by other regulatory bodies, like the Securities and Exchange Commission and National Association of Insurance Commissioners, the retirement security rule is more stringent than these existing regulatory regimes.

For example, advisers previously were able to get around fiduciary responsibility because a rollover was a one-time transaction. Now, even one-time rollovers are covered. When making an IRA rollover recommendation, advisers must therefore consider numerous factors as well as the benefits and drawbacks when making a rollover recommendation. Importantly, financial institutions must then document the reasons for the rollover recommendation and provide the documentation to the investor.

Broker-dealers, investment advisers, banks and trust companies, and insurance agents and companies are now all held to the same standard for rollover recommendations. Insurance agents and companies are likely to see the biggest impact since insurance agents who help retirement savers roll qualified account assets into annuities, life insurance policies, or other insurance arrangements that are not regulated as securities by the SEC will be held to a fiduciary standard for the first time starting Sept. 23, 2024. Insurance agents and companies must, therefore, quickly ramp up training, policies, and procedures to meet the new standard.

The retirement security rule, already under fire from life insurance and annuity industry groups, is almost certainly going to be tested in court like its predecessors. Nonetheless, as it stands, the rule is the law of the land, with certain effective dates commencing as soon as September. Accordingly, insurance agents must be prepared to act in a fiduciary capacity, and insurance companies must be prepared to exercise supervisory authority over the agents' rollover recommendations.

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