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ERISA Update

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Department of Labor Retirement Security Rule

On April 25, 2024, the Department of Labor (Department or DOL) published in the Federal Register its final *Retirement Security Rule: Definition of an Investment Advice Fiduciary* (Advice Regulation). The Department also published its *Amendment to Prohibited Transaction Exemption 2020–02* (PTE 2020-02) and *Amendment to Prohibited Transaction 84-24*, which are used to address prohibited transactions that arise when providing investment advice in connection with accounts covered by the Employee Retirement Income Security Act of 1974, as amended (ERISA) and Section 4975 of the Internal Revenue Code of 1986, as amended (Code). Just as it attempted to do in 2016, the Department substantially expanded the definition of investment advice. However, just as in 2016, the Department faces legal challenges, particularly aimed at its authority to define "investment advice" in such an expansive manner.

The primary purpose of this article is to summarize the definition of investment advice in the Advice Regulation and flag some key issues that financial services firms should consider in the event the Advice Regulation becomes effective. The article also highlights some key issues involving implementation of PTE 2020-02 and PTE 84-24 that will arise in the event amendments to these exemptions become effective. However, in light of recent litigation that has resulted in the indefinite delay of the Advice Regulation's and amendments to the exemptions' original September 23, 2024 effective date, the future of the Advice Regulation and any such amendments is questionable. To provide some additional color regarding what the industry should expect in the coming months, we provide a summary of legal actions brought against the Department and how they might affect the Advice Regulation, PTE 2020-02, and PTE 84-24.

Background

By way of background, the DOL issued a regulation in 1975 that defined the definition of investment advice (1975 Regulation). The definition applies when providing advice in connection with ERISA-covered accounts (ERISA Accounts) and accounts subject to the prohibited transaction provisions in Section 4975 of the Code (Non-ERISA Accounts), which include individual retirement accounts (IRAs). The 1975 Regulation defined "investment advice" in terms of what became known as the "5-part test" pursuant to which a person provides investment advice if he or she—

1. renders advice to an Account 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;
2. on a regular basis;
3. pursuant to a mutual understanding;
4. that such advice will be a primary basis for investment decisions; and
5. the advice will be individualized to the plan.

In 2005, the DOL issued Advisory Opinion 2005-23A to Deseret Mutual Benefit Administrators (Deseret Letter) in which it stated that recommendation to take a distribution from an ERISA-covered plan and roll over to an IRA was not investment advice under the 5-part test because it did not meet the first prong of the test.

In 2016, the agency issued a new regulation (2016 Regulation) through which it intended to broaden the definition of investment advice. Persons would have been fiduciaries in more circumstances including when making one-time purchase and sale recommendations and when making rollover and transfer recommendations. In 2018, the Fifth Circuit Court of Appeals vacated the 2016 Regulation in *Chamber of Commerce of the U.S. v. U.S. Dept. of Labor*, which resulted in the reinstatement of the 1975 Regulation and the 5-part test.

The DOL subsequently issued Prohibited Transaction Exemption 2020-02, *Improving Investment Advice for Workers & Retirees* on December 18, 2020 in which the agency changed its prior interpretations of the 5-part test. The Department revoked the Deseret Letter and stated that a recommendation to take a distribution from an ERISA-covered plan and rollover to an IRA or to transfer from one IRA to another IRA could be investment advice under the 5-part test if it was the first recommendation of a "regular basis" advice relationship and the person meets the other prongs of the 5-part test. The Department's interpretation is the subject of legal challenges, but until September 23, 2024 it is the law that applies.

On November 3, 2023, the Department published in the Federal Register its proposed *Retirement Security Rule: Definition of an Investment Advice Fiduciary* (2023 Proposal). After receiving written comments and conducting a public hearing on the 2023 Proposal, the agency issued the Advice Regulation on April 25, 2024. While there were some improvements between the 2023 Proposal and the Advice Regulation, the Advice Regulation substantially broadens the definition of investment advice, closer to what we saw in the 2016 Regulation. Readers should note that the Advice Regulation, if it were to become effective in its current form, applies to broker-dealers, wealth managers, asset managers, banks, insurers, insurance agents, and other providers of financial services and products to the retail and institutional marketplace.

Overview of Advice Regulation

The Advice Regulation replaces this five-part test with a new definition of "investment advice," under which a person is an investment advice fiduciary if, for a fee or other compensation, he or she:

(1) Makes a recommendation;
(2) Of any securities transaction, any other investment transaction or any investment strategy involving securities or other investment property;
(3) To a Retirement Investor; and
(4) The person making the recommendation either:

   i. Makes professional investment recommendations to investors as a regular part of their business; under circumstances that a reasonable investor would view as indicating the recommendation is based on a review of, and reflects the application of professional judgment to, the investor's particular needs or individual circumstances and which may be relied upon as intended to advance the Retirement Investor's best interest; or

ii. Acknowledges or represents that they are acting as a fiduciary under ERISA or the Code with respect to the recommendation.

Note that a "person" for purposes of ERISA and the Code includes an individual and an entity.

The person provides investment advice for purposes of the Advice Regulation only if he or she provides advice to a Retirement Investor. A Retirement Investor includes, among other things, an ERISA-covered plan, a participant or beneficiary in an ERISA-covered plan, a fiduciary responsible for the management of the plan, for example, the plan sponsor or investment committee, an IRA, IRA owner, and an IRA beneficiary. However, the definition of Retirement Investor does not include a person who provides investment advice to these parties.

The Department intends that a broad swath of recommended transactions be included in the definition of investment advice. A recommendation of "any securities transaction, any other investment transaction or any investment strategy involving securities or other investment property" is defined to include recommendations related to:

1. The advisability of acquiring, holding, disposing of or exchanging securities or other investment property, including after a rollover, transfer or distribution from a plan or IRA;
2. The management of securities or other investment property, including:
   - Recommendations as to investment strategies and policies;
   - Portfolio composition – even where no specific security is mentioned;
   - Selection of other persons to provide investment advice or investment management services;
   - Selection of investment account arrangements; and
   - Voting of proxies;
3. Rolling over, transferring or distributing assets from a plan or IRA including:
   - Whether to engage in the transaction; and
   - The amount, form and destination of a rollover, transfer or distribution.

The Advice Regulation applies to recommendations related to securities and "other investment property." The Advice Regulation defines "investment property" only in terms of what it does not include. The Advice Regulation states Investment Property does not include "health insurance policies, disability insurance policies, term life insurance policies, or other property to the extent the policies or property do not contain an investment component." By inference, investment property is anything else so long as it has an "investment component," which is not defined.

The Advice Regulation requires that a person receive "compensation" in order for recommendations to be investment advice. The Advice Regulation defines the term broadly to include any "fee or other compensation, direct or indirect." The definition specifically identifies compensation to include (but not be limited to) commissions, loads, finder's fees, revenue sharing payments, shareholder servicing fees, marketing or distribution fees, mark ups or mark downs, underwriting compensation, shelf-space payments, recruitment compensation, expense reimbursements, gifts, gratuities, or other non-cash compensation. Additionally, the compensation need not be paid to the party providing advice. The payment of compensation to the advice provider's affiliate is sufficient. Note that a person receives compensation for purposes of the Advice Regulation if he or she will receive compensation as a result of providing the advice.

Potential Impacts on Broker-Dealers, Advisers, and Other Market Participants

The Advice Regulation applies to banks, insurance companies, insurance agents, broker-dealers, investment advisers, and other market participants that sell or provide securities, investment

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products, investment property, and investment services to ERISA Investors, IRAs, and other Non-ERISA Investors subject to Section 4975 of the Code, for example, health savings accounts. Indeed, market participants may find it useful to look back to their efforts in 2015 to comply with the 2016 Regulation with regard to identifying fiduciary status under the current Advice Regulation. The following are some examples of how the Advice Regulation might apply in the event it becomes effective.

Rollover and Distribution Recommendations

Four years ago, the Department in PTE 2020-02 stated that providing recommendations regarding whether to take a distribution from an ERISA Plan and rollover to an IRA so that the advice provider or an affiliate can provide ongoing investment advice or discretionary management services with regard to the IRA assets was investment advice. The Department also expressed its opinion in PTE 2020-02 that such a recommendation would subject the advice provider to ERISA's fiduciary provisions when making the rollover recommendation. Transfer recommendations from one IRA to another IRA could also be investment advice though not subject to ERISA, just Section 4975 of the Code. The Advice Regulation codifies this concept. However, the Advice Regulation also provides for a broader set of circumstances where a distribution recommendation is investment advice. For example, a recommendation by a financial professional to take a distribution from a plan and use those proceeds to purchase something, for example, insurance, in many cases could be investment advice.

Recommendations to Purchase and Sell Securities or Other Investment Property

Financial firms and their representatives that provide investment advice for purposes of the Investment Advisers Act of 1940, as amended (Advisers Act) in connection with an ERISA-covered plan or IRA generally understand they also provide investment advice for purposes of ERISA and the Code. However, broker-dealers should understand that they also likely provide investment advice with regard to purchase and sale transactions within these accounts. Indeed, if the representative makes a recommendation with regard to an ERISA-covered account or IRA that triggers the Securities and Exchange Commission's Regulation Best Interest, the firm should assume the Advice Regulation is also triggered.

Recommendations by Retail Bank Employees

Many banks at the branch level believe that the Advice Regulation does not apply to them because the bank is not subject to the securities law requirements. However, this is not necessarily the case. For example, recommendations by such employees to take distributions from an ERISA-covered plan to purchase a certificate of deposit (CD) IRA would likely be investment advice. Even the sale of CD IRAs could be investment advice depending on how the branch employee conducts the conversation. Similarly, branch employee referral programs to affiliates and others that provide investment advice or management services can be investment advice unless they avoid making recommendations.

Recommendations by Insurance Agents

Insurance agents may provide investment advice pursuant to the Advice Regulation. In particular, they often recommend that participants in ERISA-covered plans and IRAs take distributions and use the proceeds to purchase a variety of products. The DOL, based on the language in the Advice Regulation and the preamble to the Advice Regulation, intends to treat many such recommendations as investment advice. This is the case even if the agent is independent from any particular insurance company.

Discretionary Wealth Managers

Wealth management firms that manage ERISA-covered retirement plan assets on a discretionary basis still may provide investment advice under the Advice Regulation. This is the case because the wealth manager may provide investment advice in connection with trying to get the wealth management business, for example, through an ERISA-covered plan rollover recommendation or an IRA transfer recommendation.

Recommendations of Investment Management Services (Separate Accounts and Unregistered Funds)

Asset managers that market their management services to ERISA-covered plans and IRAs may provide investment advice whether they provide such services through a separate account or through a pooled investment vehicle such as an unregistered fund. Obviously, these assets managers would not make rollover recommendations, but they still could provide investment advice in recommending their services during the sales process. There is no specific carve out or exception for interactions with large investors. However, there may be arguments to be made that the asset manager does not provide investment advice through a disclaimer, pointing out that the investor should know the manager does not provide investment advice, and/or making recommendations through independent investment consultants.

IPOs and Underwritings

Broker-dealers that operate in the retail marketplace generally are familiar with the possibility that they may provide investment advice because of the 2016 Regulation and the DOL's interpretation of investment advice under PTE 2020-02. However, broker-dealers that sell securities as a part of initial public offerings (IPOs) and other underwriting are less likely to be familiar with this issue because such broker-dealers do not provide rollover recommendations or purchase and sale recommendations on a "regular basis" and thus do not provide investment advice under the 5-part test. This may no longer be the case because under the Advice Regulation because a single recommendation to purchase or sell a security can be investment advice. However, at least with regard to some of its customers, the broker-dealer may be able to make arguments that they do not provide investment advice, similar to those described above related to asset managers.

Investment Education

The Department states in the preamble to the Advice Regulation that the provision of investment education continues to not be investment advice. The Department's *Interpretive Bulletin 96–1; Participant Investment Education* provides some safe harbors regarding what information may be provided to ERISA-covered plan participants without providing investment advice. This Interpretive Bulletin also serves as guidance on how investment education may be provided to IRA owners and beneficiaries even though it specifically applies to plan participants. However, as explained below, firms should be cautious in using an investment education approach when dealing with rollovers.

Distribution and Rollover Education

As discussed, the Department affirmed in the preamble to the Advice Regulation the concept that investment education is not investment advice. However, the Department also stated that if a firm or its representative provides recommendations as to how they will invest plan assets if the participant in an ERISA-covered plan chooses to rollover to an IRA, the firm and its representative have made an implicit recommendation to rollover. Therefore, the approach that many firms take where they provide distribution and rollover education and provide recommendations as to how they will invest once rolled over or distributed will be difficult to support under the Advice Regulation unless, possibly, the firm and representative change the timing of these two discussions.

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Application of PTE 2020-02 and Other Prohibited Transaction Exemptions

While the focus of this article is on the Advice Regulation, it is worth discussing at a high level how firms should be addressing prohibited transactions that arise if they or their representatives, agents, or other personnel provide investment advice in the event the Advice Regulation and amended exemptions, as written, become effective. The prohibited transaction exemptions on which Financial Institutions will most likely rely are PTE 2020-02, which was amended by the DOL on April 25, 2024, and, to a lesser extent, Prohibited Transaction Exemption 84-24 (PTE 84-24), which also was amended on that date. However, there may be some, limited statutory exemptive relief in the case of certain deposit accounts, collective investment trusts, and pooled separate accounts.

Currently, many financial institutions rely on PTE 2020-02, particularly in connection with rollover and transfer recommendations. Such firms may have to apply to PTE 2020-02 to a wider array of transactions as a result of the Advice Regulation. As we discuss below, two courts have delayed the effective date, as such additional actions are not necessary at this time, although financial institutions may want to revisit their compliance programs to assure that the do in fact comply with the PTE 2020-02 requirements in effect since 2021. Unfortunately, certain provisions found in the amended PTE 2020-02 that many financial institutions found helpful will not become effective. Such provisions include broad exemptive relief for principal transactions, elimination of the requirement to disclose the basis for IRA-to-IRA recommendations, and the need to report the self-correction PTE 2020-02 violations to the DOL.

In the event that the revised PTE 2020-02 becomes effective, financial institutions and their financial professionals need only comply with PTE 2020-02's fiduciary acknowledgment and impartial conduct standards for a period of time. Note that amendments to PTE 2020-02 may require revisions to existing fiduciary acknowledgments. The impartial conduct standard condition requires compliance with a duty of prudence (formerly called "best interest"), a duty of loyalty, a prohibition on making false or misleading statements, a best execution standard, and the receipt of only reasonable compensation. All other conditions of PTE 2020-02, including several that the Department amended, would not be effective until September 23, 2025 or such other date established by the Department. In light of recent litigation activity, financial institutions will likely not make changes to their current PTE 2020-02 efforts.

In the context of providing investment advice, the Department amended PTE 84-24, although the effective date of such amendments also has been delayed. In the event the amendments were to become effective, the exemption may only be relied on by certain Independent Producers, as such term is defined in the exemption, to address prohibited transactions that arise when recommending the purchase of insurance products that are not securities under applicable law. The DOL made PTE 84-24 available to Independent Producers, rather than complying with PTE 2020-02, because they are not typically associated with any one insurance company and cannot meet some of the conditions of PTE 2020-02. PTE 84-24, as amended by the DOL, for the most part includes conditions like those found in PTE 2020-02. However, in light of the delay of the effective date, financial institutions need not change how they currently apply PTE 84-24.

Delay of Effective Date and Possibility of Advice Regulation Vacatur or Similar

As discussed, the Fifth Circuit vacated the 2016 Regulation. In reaction to the 2024 Advice Regulation and amendments to PTE 2020-02 and PTE 84-24, constituencies that represent the interest of financial institutions filed three lawsuits in the Fifth Circuit against the DOL for exceeding its regulatory authority in promulgating the Advice Regulation just as the plaintiffs did in 2016. As noted earlier, two courts in the cases styled as

Federation of Americans for Consumer Choice Inc. et al. v. U.S. Department of Labor et. al. and *American Council of Life Insurers, et. al. v. U.S. Department of Labor et. al.* issued injunctive relief to the plaintiffs on July 25, 2024 and July 26, 2024, respectively. Both courts indefinitely stayed the Advice Regulation effective date and the latter court also indefinitely stayed the amendments to the exemptions. This means that the Advice Regulation and the amendments to PTE 2020-02 and PTE 84-24 will not become effective unless the DOL successfully challenges on appeal the courts' granting of injunctive relief or successfully wins the lawsuits on the merits, either at trial or on appeal. The litigation process will take months.

Additionally, an effort to get Congress to overturn the Advice Regulation vis-à-vis the Congressional Review Act is underway though, even if Congress voted down the regulation, President Biden will veto such action, and an override of that veto is unlikely. A change in Presidential Administration might be the fastest way the Advice Regulation goes away.

Conclusion

In the event the Advice Regulation and the amendments to PTE 2020-02 and PE 84-24 become effective in their current form, they would have a substantial impact on how banks, broker-dealers, wealth managers, institutional assets managers, securities offering underwriters, insurance companies, insurance agents, plan recordkeepers, and other financial services companies do business. However, given the results of the industry's recent litigation efforts, most financial institutions will not make changes to their current compliance policies and procedures. That is, the status quo will prevail until the industry gets a better sense of how the litigation, legislative and political processes "shake out," except, possibly, to the extent financial institutions believe that their current policies and procedures are insufficient under current law. .

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