The Department of Labor's New Fiduciary Rule

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The Department of Labor (DOL) has issued its package of new fiduciary rules. The package includes a new and expanded definition of fiduciary advice and exceptions (called "exemptions") from the rules that prohibit fiduciary recommendations that are conflicted—for example, where the fiduciary adviser will make money if the recommendation is accepted.

This article discusses the impact on plan sponsors and participants, as well as plan committee members and individual retirement investors.

As background, the existing fiduciary definition requires, among other things, that for a recommendation to be fiduciary advice, the recommendations must be given on a "regular basis", meaning that one-time advice would not result in creating fiduciary status. As a result, advisors, brokers and insurance agents making rollover recommendations to an IRA for example, have not been held to a fiduciary standard, even though it might be the single most important financial decision in the lives of most participants. That requirement has created an imbalance where benefits are accumulated over a working life in fiduciary-protected retirement plans, but then taken out of the plans and rolled into IRAs with retail expenses and conflicts of interest. The DOL's goal is to require that rollovers, IRA investing, and other retirement investments be subject to a fiduciary standard where the interests of the participants and IRA owners must be made in their best interest.

A few definitions will make this easier to read:
The current fiduciary definition applies to any "person" who makes an investment recommendation to a "retirement investor". In most cases, that person would be an investment adviser, a financial planner, broker-dealer, or an insurance agent. This article refers to them all as "advisors". Another definition is that the term "investment" recommendation broadly refers to investments, annuities, investment managers, other investment-related products and services, and even rollovers. A third is that "the retirement investor" definition will include a private sector retirement plan, participants in those plans, and IRA owners.

The new fiduciary definition—effective September 23, 2024—expands who will be considered a fiduciary for recommendations made to retirement investors. The new definition describes that a fiduciary advisor is someone who:

- *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*

In other words, if an advisor makes an investment recommendation to a retirement investor, and the circumstances indicate that it is an individualized, professional, and best interest recommendation, the advisor will be a fiduciary, subject to a "Care Obligation"—the prudent person rule and to a Loyalty Obligation"—a duty to act in the best interest of the retirement investor.

Human Resource Professionals

That definition could, at first blush, mean that human resources personnel could become fiduciaries. However, the DOL makes clear that, absent extraordinary circumstances, they are not.

The Department did revise [the fiduciary definition] in the final rule to refer to "professional" investment recommendations. This change is designed to provide additional certainty that the provision would not be satisfied by the ordinary communications of a human resources employee, who is not an investment professional, in communications with plan participants. Similarly, this language is intended to make clear that the provision would not pick up other employees of the plan sponsor, who are not investment professionals, interacting with plan participants, including in the context of a merger or acquisition.

As a result, the employees of plan sponsors are protected for becoming inadvertent fiduciaries if they happen to make an investment recommendation (e.g., "If you don't know what to do, invest in the target date fund").

Consultants and Advisors to Retirement Plans

If a plan hires a consultant for a limited, one-time engagement—for example to advise on a single plan transaction or investment, the consultant likely would not be a fiduciary under current rules. However, on September 23, when the new rule is effective, the consultant would be a fiduciary and therefor would be subject to the same standard of care as the plan committee members.

Selection and Monitoring of Service Providers

Plan committees should know which of their service providers are fiduciaries—and the services for which they are fiduciaries, and which providers are not fiduciaries. The service providers who act as fiduciaries are held to the same standard of care as the plan committee members—ERISA's fiduciary standards. In addition, fiduciary service providers are subject to stringent rules about conflicts of interest and cannot allow their conflicts to override their duty to make recommendations in the best interest of the plan and the participants.

On the other hand, the service providers who are not acting as fiduciaries are subject to standards that are lower than the fiduciary standard and their conflicts of interest are not prohibited.

Since the new rules will cause more service providers to be fiduciaries, at least for some of their services, the effect will be that more of the services offered to plans will be subject to the high standards of ERISA's fiduciary responsibility rules.

Participants

Under the new definition, one-time advice—for example, responses from a call center—will be considered fiduciary advice. For example, if participants can call the plan's recordkeeper or investment adviser for one-time recommendations about how to invest their 401(k) accounts, those recommendations may not have been held to a fiduciary standard in the past, but they will be under the new rules.

Also, when a rollover recommendation is made to a terminating or retiring participant, that recommendation is not fiduciary advice under the current rules. But, beginning on September 23, it will be. As a result, the advisor will be held to the ERISA prudent person standard, requiring a thoughtful, professional, individualized recommendation in the best interest of the participant, taking into account the needs and circumstances of the participant.

Conflicts of Interest

When a fiduciary advisor has a conflict of interest (for example, the advisor will earn money if the recommendation is accepted), that conflict is prohibited under ERISA and the Internal Revenue Code.

That can happen where the advisory firm or an affiliate has proprietary investments, or where an adviser recommends a third-party investment or service provider that pays compensation to the advisor or the advisor's firm. A few decades ago, that was common and, to a lesser degree, still occurs today.

A more common conflict of interest is a rollover recommendation to a participant. The conflict is created because the advisor will earn compensation from the rollover IRA.

A third example of a prohibited conflict is where a fiduciary advisor to an IRA recommends investments (e.g., mutual funds) that pay a commission or revenue sharing to the advisor or the advisor's firm. This could happen where a participant rolls their assets over to an IRA or if a person—for example, a committee member, has a personal IRA and receives investment recommendations from the advisor for those assets and the advisor receives a commission from the recommended investments.

In all of those cases, the advisor and the firm will need to satisfy the requirements of a "prohibited transaction exemption", or PTE for the recommendations to be allowable. The DOL has issued an exemption for this purpose, PTE 2020-02.

That PTE has four categories of requirements, some of which apply on September 23 of this year and the others a year later. The requirements are:

- Impartial Conduct Standards, which are similar to ERISA's fiduciary rule must be met.
- Disclosures of important information for the retirement investor, including information about conflicts involved in the recommendation must be delivered.
- Policies and procedures of the firm to ensure compliance with these rules must be complied with.
- An annual review and report, where the firm has to review its compliance in the preceding year must be completed.

The concept is that these requirements will protect retirement investors from an advisor's conflicts of interest.

As explained earlier, the a major reason for the new rules is to protect participants as they retire and/or take a distribution and roll it over to an IRA. The rules require that a rollover recommendation be in the best interest of the investor and be developed through a thoughtful and informed process, with conflicts of interest being disclosed and managed.

Concluding thoughts

The new rules impose demanding standards on advisors who make recommendations about qualified retirement investments. The Department of Labor's objective is to provide greater protection from conflicts of interest and to require that investment recommendations for retirement money be in the best interest of retirement investors, including plan committees, participants, and IRA owners

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