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New Final Department of Labor Rules on Investment Advice are Immediately Challenged in Court

Article By:

Henry Talavera

Meredith A. VanderWilt

The U.S. Department of Labor ("DOL") recently issued final, new regulations (the "rules") regarding who is considered an investment advice fiduciary that are slated to become generally effective on September 23, 2024, as well as some additional changes to prohibited transaction exemptions applicable to investment advisors. The new rules were immediately challenged on May 2nd by the Federation of Americans for Consumer Choice, Inc., among others, in a lawsuit against the DOL and the Secretary of Labor filed in the Northern District of Texas.

The plaintiffs essentially allege, among other allegations, that the DOL exceeded its authority in issuing the rules in contravention to a Fifth Circuit case that invalidated a prior iteration of these rules.

The DOL has asserted that it merely is "closing loopholes and making relatively minor updates to existing exemptions." In fact, the DOL spent a considerable amount of time in the preamble to the rules emphasizing how the rules comply with the Fifth Circuit precedent. Regardless of how the District Court rules, the decision will likely be appealed. The fate of the rules may eventually hinge on the Presidential election that is set to take place later this year.

Regardless, we encourage fiduciaries and employers to assess service contracts relating to investment advice provided to retirement plans and Individual Retirement Accounts ("IRAs") in light of this new guidance to determine how they might be potentially impacted. Retirement plan sponsors and other fiduciaries may also need to reconsider whether a relationship between a service provider might create a fiduciary relationship under the rules that did not exist previously. Polsinelli's Employee Benefits team is ready and available to assist in this analysis and provide practical advice as requested.

With that background, below is a high level summary of some of the more important aspects of the rules. The portion of the rules regarding who is considered an investment advice fiduciary is only two pages long in a PDF, but such rules are preceded by a lengthy discussion of, among other things, the state of the law and the reasoning behind the rules.

Who Can Be Considered a Fiduciary under the New Rules?

Under the new DOL rules, a person is an investment advice fiduciary if, for a fee or other compensation, they:

1. Make a recommendation regarding any securities transaction, any other investment transaction or any investment strategy involving securities or other investment, property;
2. To a retirement investor (which includes a plan, plan participant or beneficiary, IRA, IRA owner or beneficiary, plan fiduciary or IRA fiduciary); and
3. The person making the recommendation either:
    1. 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 upon a review of, and reflects the application of professional judgment to, an investor's particular needs or individual circumstances and which may be relied upon as intended to advance the retirement investor's best interest; or
    2. Acknowledges or represents that they are acting as a fiduciary under ERISA or the Code with respect to the recommendation.

The assessment of fiduciary status is based on the facts and circumstances and may prove difficult to implement and apply. Nevertheless, this approach could potentially offer flexibility to plan sponsors and third-party service providers in determining whether someone providing investment advice meets the criteria for fiduciary status. The new rules should be considered when assessing how updates should be reflected in new or revised service contracts as appropriate.

What Counts as Investment Advice?

Advice about investments means recommendations to certain retirement investors generally held in a tax-qualified retirement plan, IRA or certain health savings accounts (collectively a "plan") regarding amounts relating to the following:

- *What to do with the money, like buying, holding, or selling investments*. This includes acquiring, holding, disposing of, or exchanging securities or other investment property, including strategies, both before and after rolling over, transferring, or distributing from a plan.
- *How to manage the investments*. This involves managing securities or other investment property, such as investment policies, portfolio composition, selecting advisors, account arrangements, and voting proxies.
- *Moving money from one retirement account to another*. This encompasses rolling over, transferring, or distributing assets from a plan, including advice about whether to engage in such a transaction.
    - NOTE: One of the significant implications of the rules is that they cover advice to plan participants when recommending tax-free rollovers to an IRA.

The new rules are intended to exclude certain communications, such as general investment education, investment information, or recommendations made during sales pitches, from being classified as "investment advice." However, this exclusion depends on the specific facts and circumstances surrounding the communication.

What is Different under the New Fiduciary Rules?

The new rules are broader than the existing versions from 1975, which required that advice be given

regularly under a mutual understanding that the advice would be the primary basis for investment decisions and be individualized to the needs of the plan.

In contrast, under the new rules, it is possible for a single investment recommendation to be considered an action that creates a fiduciary obligation. Further, the new rules do not necessarily require that the parties agree to the fiduciary status or that the investment advice will be considered as the primary basis for investment decisions. In fact, the DOL indicated in the preamble to the rules that an advisor may be a fiduciary even if the parties try to create a contractual agreement that the advisor does not have such status. On the other hand, the DOL does recognize the possibility that certain "sophisticated advice recipients" may not need the protections provided to less sophisticated recipients, including most participants. However, it declined to provide a carve-out in the rules for this type of investor (i.e., a "sophisticated" investor), stating that it was preferable to retain the facts and circumstances test for all recommendations.

Besides the Definition of "Fiduciary" What Else Do the New Rules Change?

The DOL also generally consolidated several prohibited transaction exemptions ("PTEs") into an amended Prohibited Transaction Exemption 2020-02 ("PTE 2020-02") and PTE 84-24. *See generally existing* PTEs 77-4, 75-1, 80-83, 83-1, and 86-128, which have now been amended. Generally, PTE 2020-02 allows parties providing fiduciary investment advice to retirement investors to receive reasonable compensation for their services, which would otherwise be prohibited absent an exemption. In order for such otherwise prohibited variable compensation to be permitted, certain enumerated requirements must be satisfied.

The recent updates to the rules include (among other things) a requirement to acknowledge fiduciary status in writing and fulfill a new "Care Obligation" and "Loyalty Obligation" in an attempt to align the PTE with SEC standards. In light of this, advisors and financial institutions relying on PTE 2020-02 should review their policies, procedures, and incentive practices comprehensively to identify and eliminate any elements that may incentivize recommendations or actions that do not prioritize the best interests of clients over the interests of the advisors or institutions themselves.

PTE 84-24 provides a prohibited transaction exemption for certain transactions relating to the purchase, with plan assets, of insurance contracts, annuities, and securities issued by an investment company, and the payment of related commissions to insurance agents or brokers and certain other parties, and it has been amended to limit its availability to only those who are licensed and sell insurance contracts, including annuities, of multiple unaffiliated insurance companies who are not employees of the insurance company ("Independent Producers"); investment advice fiduciaries who are not Independent Producers, should look to PTE 2020-02 (see above) to find relief.

Looking Forward

We also await further guidance from the DOL and the courts as to the anticipated date of compliance with the rules and various PTEs approaches. Additionally, with an expected Supreme Court ruling relating to the deference owed by courts to agency guidance (called the "*Chevron*" doctrine), there is uncertainty regarding how the court in the pending litigation against the DOL will review the new rules. Following the oral arguments before the Supreme Court this past January in *Relentless, Inc. v. Department of Commerce* and *Loper Bright Enterprises v. Raimondo*, there is speculation that the justices may choose to limit or discard this doctrine.

Polsinelli's Employee Benefits team is prepared to offer further guidance on these developments,

including the new rules and the amended PTEs, as there are nuanced applications to any set of facts and circumstances.

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