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3 Takeaways From DOL's New Fiduciary Proposal

By **Kellie Mejdrich**

Law360 (November 2, 2023, 8:16 PM EDT) -- The U.S. Department of Labor's new proposal to expand what constitutes fiduciary investment advice under the Employee Retirement Income Security Act isn't as sweeping as a previous fiduciary rule that failed in court, but it's still an ambitious package that benefits lawyers need to be aware of, experts say.

Stretching across **nearly 500 pages**, the DOL released a **proposed rule** on Tuesday along with three sets of amendments to prohibited transaction exemptions under ERISA. The public has 60 days to comment on the proposed changes after publication in the Federal Register, which is scheduled for Nov. 3, and the DOL's Employee Benefits Security Administration also plans a public hearing in the coming months.

The changes, if finalized, could sweep a much broader set of financial market participants under the purview of ERISA or force them to meet the conditions of an exemption to ERISA's rules to keep doing business, benefits attorneys said. But most attorneys agreed that the Biden administration proposal was **clearly less sweeping** than the DOL's previous attempt that the Fifth Circuit **invalidated in 2018**.

"This rule, while more ambitious than simply going after rollovers and investment menus, nevertheless does not have the overall breadth that the earlier proposal had," said Andrew Oringer, partner and general counsel at the Wagner Law Group.

Here are three things to keep an eye on now that the proposals have been unveiled.

Rollover Advice Targeted

One major takeaway from attorneys was that the proposal directly targets a much broader set of rollover recommendations given to retirement plan participants, despite the fact that the DOL's previous attempts to do so have been challenged repeatedly in court.

"Requiring that more rollover recommendations be in the retirement investor's best interest" was one of the most significant expected benefits of the proposal, the DOL said in the regulatory impact analysis of its proposed rule amending the ERISA fiduciary definition.

That was a key takeaway on the proposal for Jason Levy, of counsel at Covington & Burling LLP and an employee benefits and executive compensation attorney: "As expected, the rule is intending to capture nearly all rollover recommendations as fiduciary investment advice," he said.

"Whether in fact those rollover recommendations — whether that's going to stay, whether the recommendations are subject to the fiduciary standard — is a question that's been previously the subject of active litigation," Levy said, adding "It seems very likely that this aspect of the rule is going to be challenged in court."

Fred Reish, partner at Faegre Drinker Biddle & Reath LLP, agreed a major takeaway from the proposal was the focus on rollovers, as well as related changes to prohibited transaction exemptions allowing people making rollover recommendations to "keep their commission if they jump through a bunch of hoops."

Reish and others explained that if the rule is finalized and a broader set of rollover recommendations are now considered fiduciary investment advice covered by ERISA, more securities advisers,

insurance agents and others will have to seek out exemptions from being considered an ERISA fiduciary.

The DOL also proposed amendments to those exemptions Tuesday. Those include **changes to PTE 2020-02**, which is used by a wide swath of the financial industry when recommending rollovers, as well as **proposed changes to an exemption** tailored for use by insurance agents known as PTE 84-24. Attorneys also characterized a **third set of proposed amendments** to several prohibited transaction exemptions as generally pushing more exemption seekers into using either PTE 2020-02 or PTE 84-24.

Reish said he expects a legal challenge potentially directed at the insurance agent exemption in particular: "I think because that's so much more demanding than current practices, that the insurance industry may end up challenging the rule in court," he said.

Five-Part Test Rewritten

Another major focus for attorneys has to do with the specific amendments in the proposed rule to a five-part DOL test from 1975 for determining what constitutes investment advice that triggers fiduciary duties under ERISA.

The 1975 five-part test was essentially reinstated as the means for determining whether someone was an ERISA investment advice fiduciary after the Fifth Circuit's invalidation of the previous fiduciary rule in 2018, based on certain factors of the advice including the type, frequency and purpose. Overall, the changes to the test increase the likelihood that investment advice might be considered under the purview of ERISA, again forcing more individuals to seek exceptions from prohibited transaction rules or stop giving the advice, attorneys said.

John Schuch, a partner in Dechert LLP's employee benefits and executive compensation group, said amendments to the five-part test make the fiduciary definition "really broad," and "capture more financial professionals who provide any kind of recommendation to plan clients, IRAs and the like."

One of the most significant changes highlighted by attorneys to the five-part test was a change to what's called the regular basis prong of the test — which previously has excluded a lot of one-time recommendations such as rollovers from being considered subject to ERISA because the advice wasn't offered on a regular basis. Language in the proposed rule essentially changes what "regular basis" refers to, switching it from the number of interactions with a person receiving the advice to now instead referring to the type of business the adviser is engaging in with regard to a specific client, attorneys said.

Carol McClarnon, a partner in the employee benefits and executive compensation practice group at Eversheds Sutherland, was one of several management-side ERISA attorneys who were critical of changes to the so-called regular basis prong in interviews with Law360.

"DOL, I think, has viewed the regular basis prong as sort of a loophole that they need to close. That is not my view of regular basis," McClarnon said. "To me, regular basis is the essence of what makes an investment adviser a trusted fiduciary versus a salesperson."

Alex Ryan, partner at Willkie Farr & Gallagher LLP, also highlighted the changes, which he said essentially transform the five-part test into a three-part test. That test focuses on whom the advice is given to, whether there's fee-based compensation, and whether there's an expectation the advice is being given in a client's best interest, according to the proposed rule.

"The DOL is moving its focus from the regularity of interactions between financial professionals and particular retirement investors, to regularity in the ordinary course of an organization's or individual's business," Ryan said of changes to the regular basis prong in the test.

"So instead of focusing on interactions between an adviser and a particular investor, the three-part test now focuses in part on what the day-to-day business of a particular financial institution entails," Ryan said.

Exceptions an Expected Focus

Another major focus for attorneys was how the proposed rule doesn't contain an exception for independent fiduciaries managing at least $50 million in assets, whereas the rule finalized in 2016 and overturned in 2018 did.

Many attorneys now expect future debate on the potential inclusion of such an exception, given the wide-ranging fiduciary definitions contemplated in the proposal, which they warned might have unintended consequences.

Michael Hadley, a longtime benefits attorney and partner at Davis & Harman LLP, said he anticipates attorneys are going to be searching for ways the rule might loop in parties the DOL didn't intend to and subsequently make their case for an exception to the rules.

"I think what everyone is going to be doing in the next couple of weeks is going back and looking at all of the issues that were created by the prior Obama administration proposal. Because it set such a wide net, the Obama administration had to come up with all kinds of exclusions and exemptions — most of which are not included in this proposal," Hadley said.

Hadley says subsequently, he expects comments "explaining to the Department of Labor where their net has been cast too wide."

Several attorneys described scenarios where the rule's altered fiduciary definition, without an exception like the 2016 rule had, might potentially sweep up conversations the DOL didn't intend to regulate. Attorneys said the rule might sweep up talks between multibillion-dollar pension plans and their investment managers with private equity funds about potential investments, for example.

Jeff Ross, chair of the executive compensation and ERISA department at Fried Frank Harris Shriver & Jacobson LLP, said in an interview after the proposal's release that he was concerned that "this could be a lot worse, from the perspective of institutional asset managers, than the 2016 rule, if there's not an exception for advice to sophisticated fiduciaries."

"There really, really needs to be," Ross said.

Josh Lichtenstein, partner at Ropes & Gray, also highlighted concerns about large investors getting unintentionally pulled into certain aspects of the proposed rule as written.

"The main problem with the rule is it potentially makes a huge range of interactions with institutional plans fiduciary in nature. That isn't even just a problem for the service providers," Lichtenstein said.

--Editing by Bruce Goldman and Nick Petruncio.
