4 Takeaways From DOL's Final ERISA Investment Advice Regs

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Law360 (April 25, 2024, 6:57 PM EDT) -- The U.S. Department of Labor's finalized regulations broadening who qualifies as a fiduciary under the Employee Retirement Income Security Act will bring more investment advisers under the purview of federal benefits law, but the final version contains some important differences from what the DOL initially proposed.

The package of final regulations **published Tuesday** from the DOL's Employee Benefits Security Administration — contained in a **final rule** and three sets of amendments to ERISA prohibited transaction exemptions — stretches across nearly 800 pages of regulations. The DOL's final rule amending the definition of an investment advice fiduciary under ERISA takes up more than half of that.

The final package backs off some requirements **from an Oct. 31 proposal**, including certain items that triggered significant criticism during the public comment process. Still, insurance and securities industry trade groups, which opposed the regulations because many of their members will be newly subject to ERISA's fiduciary duties or have to seek exemptions, have already threatened to sue over the final regulations.

"It's a huge shift in what the definition of a fiduciary is," said Carol McClarnon, a partner in the employee benefits and executive compensation practice group at Eversheds Sutherland.

Here are four key takeaways from the finalized regulatory package.

No One-Time Advice Loophole

The rule for determining when someone is an investment advice fiduciary under ERISA no longer contains an explicit exemption for one-time advice, including advice related to rollover transactions.

The rule accomplishes this by eliminating what's called the regular basis prong from the five-part test dating back to 1975 that had been used to determine ERISA fiduciary status when giving investment advice.

Looping in one-time advice and rollovers has been a clear goal of the DOL since the rule was proposed in October, but it's among the most significant impacts of the final rule, attorneys said.

Fred Reish, a partner at Faegre Drinker Biddle & Reath LLP said the "biggest single change will be that a one-time recommendation makes you go into those exemptions."

Reish said in the case of someone recommending a rollover out of a 401(k) plan into an IRA or an annuity, "the agent or the adviser will have to put in writing why a rollover is in the best interest of the participant and will have to give that to the participant."

"That's going to create some tension, where people have to be careful about making recommendations, because they're going to have to document them," Reish added.

The DOL also significantly amended many ERISA transaction exemptions in the final package, contained in the three sets of amendments. One set of final amendments **modifies a 2020 exemption** used by many financial firms when recommending rollovers for a fee, called PTE 2020-02.

The DOL also modified an exemption tailored **for use by insurance agents** known as PTE 84-24. Another set of amendments **affected several other ERISA-prohibited transaction exemptions** used by financial professionals in different investment advice situations.

"There's new fiduciary interactions, and more fiduciaries," said Robert Sichel, partner with K&L Gates.

Sichel said that the practical effect of the new regulation was that "rollovers are interpreted more broadly by the DOL and also include a wealth manager trying to get a new client and have them move over from the competitor down the street."

"Now the light bulb moment is, 'Oh, I might be a fiduciary sooner than once the client signs the contract and I'm managing the assets. I'm actually a fiduciary at the cocktail party, when I'm telling the person, I think you should roll that money out of your workplace retirement plan,'" he said.

"Or I'm actually a fiduciary when I'm saying, 'My firm's better than the firm you're with down the road, and you should hire me.' So those one-time interactions, [before] signing a contract, can be fiduciary interactions," Sichel said.

Erica Rozow, partner with Simpson Thacher & Bartlett LLP, highlighted how the rule also makes clear that one-time advice goes beyond rollovers.

"It's really focused on any type of investment advice that's provided one time to a retirement investor. … That one-time piece of investment advice can make you an investment advice fiduciary," she said.

More Time to Comply

A stretched-out timetable for compliance with the final rule and amendments was another major takeaway from attorneys.

Whereas the initial proposal provided just 60 days for compliance, most provisions in the final package generally take effect in September, with an extra year for meeting certain conditions in PTE 2020-02 and PTE 84-24.

The DOL said in its final rule that it shifted from 60 to 150 days for compliance in response to comments requesting more time.

Jeffrey Lieberman, counsel in the executive compensation and benefits group at Skadden Arps Slate Meagher & Flom LLP, said the change was "a good thing."

"Initially, the DOL said 60 days, and that seemed, I think to a lot of people, an awfully short time to evaluate your business, figure out what you have to do — and especially meet [conditions of] the exemptions," Lieberman said.

The DOL also said in the final rule that the agency wouldn't be focused on taking enforcement action for noncompliance in the early days after it becomes effective.

"The department also confirms that, rather than take an enforcement-oriented approach in the initial period following applicability, its primary focus will be on promoting compliance and providing assistance to parties working in good faith to comply with the law's obligations," the final rule said.

Some Major Proposal Items Axed

Several attorneys said a major development in the final regulations had to do with what the DOL dropped from its proposal, including abandoning a contemplated requirement that financial institutions, insurers and others taking advantage of certain ERISA prohibited transaction exemptions disclose compensation arrangements on a public website.

That was something the agency said it wanted public comments on in its proposed exemption amendments to PTE 2020-02 as well as PTE 84-24. The requirement also appeared in the DOL's last attempt to amend the definition of fiduciary investment advice under ERISA that was proposed in 2015 and finalized in 2016, which the Fifth Circuit invalidated as beyond the agency's authority in 2018.

"It would have been very expensive, for one thing, to put these public websites together, and that was something that was brought up in 2015. And there were a ton of comments on just how expensive and unworkable that was," said McClarnon of Eversheds Sutherland.

In the October proposal, the DOL had requested estimates of how much such a website might cost. But in the Tuesday final rule, the DOL actually highlighted the lack of this website requirement as a development that distinguished its final rule from a previous attempt to amend the fiduciary definition that the **Fifth Circuit invalidated in 2018**.

"Both the final rule and the regulatory context are far different than the 2016 final rule considered by the Fifth Circuit in the Chamber opinion," the DOL said, referring to the name of the case**, U.S. Chamber of Commerce et al. v. U.S. Department of Labor et al.** "In addition, there are other important ways in which the final rule is different than the 2016 rulemaking, above and beyond this final rule's clear focus on relationships of trust and confidence."

Another major change from the proposal to the final rule that was mentioned by several attorneys — and highlighted Tuesday as a major shift by DOL senior officials — was to change the design of its new test outlining recommendation-for-a-fee contexts that would trigger ERISA's fiduciary duties that replaces the 1975 five-part test.

The proposal would have included as one of its three context-related prongs whether the advice provider, directly or indirectly, had discretion or control over retirement investor assets. That prong had rankled much of the financial industry and triggered a stream of comments on how the requirement might be unworkable, particularly in situations involving large financial conglomerates with many affiliates.

The DOL also said in the final rule that removing the discretion-focused prong was a response to critical comments.

"The narrowing of the circumstances under which an investment recommendation would be considered fiduciary advice was not something I expected," said David Olstein, partner with Hogan Lovells. Olstein added that provision dates back to the 1975 rule.

Andrew Oringer, partner and general counsel at the Wagner Law Group, said the change "shows that the department seriously considered these comments," because the change "restructured a foundational part of the regulation."

HR Education, Sales Pitches Not Covered

Attorneys also took heed of new clarifying language in Tuesday's final rule that made clear that HR education to employees and sales pitches weren't considered fiduciary investment advice, though attorneys said many plan sponsors were hoping for a broader sophisticated institutional exemption such as what was included in 2016 final rule.

In response to comments that raised concern about whether HR education or sales pitches might newly be subject to the fiduciary investment advice definition under ERISA, the DOL explained that the final rule contained a new paragraph confirming those situations can occur "without ERISA fiduciary status attaching."

Elizabeth Dyer, partner at Cleary Gottlieb Steen & Hamilton LLP, said the clarifications were "helpful," even though plan sponsors were "really looking for an independent sophisticated fiduciary exception much like what was in the 2016 rule."

The DOL also touched on its reason for not including that carve-out in its final rule, noting how the need for broad carve-outs was one of the criticisms from the Fifth Circuit when it invalidated the previous regulation in 2018.

"The department believes this facts and circumstances approach based on the parties' relationship is fully consistent with the Chamber opinion's emphasis on relationships of trust and confidence, as opposed to an artificial carve-out from fiduciary status that does not reflect the parties' reasonable understandings," the DOL's final rule said.

Dyer said the final rule showed how the DOL "really did try to address" comments and comparisons to the rule invalidated in 2018.

"I think there is general cognizance by the DOL about the 2016 rule and wanting to avoid the same fate," Dyer said.

--Editing by Bruce Goldman and Roy LeBlanc.