Aon Advisor Solutions

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DOL Fiduciary Rule Revisited – DOL's Second Attempt to Regulate Advice to Retirement Investors

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Individual Retirement Accounts ("IRAs") are big business. According to the Investment Company Institute, nearly 48 million U.S. households hold $10.8 trillion in IRAs, and 60% of those IRAs were funded with rollovers from employer-sponsored retirement plans.[1] As a result, FINRA and the Securities and Exchange Commission (SEC), have treated rollover transactions as examination priorities. The Department of Labor ("DOL"), which oversees the Employee Retirement Income Security Act ("ERISA") and issued the ill-fated Fiduciary Rule and the Best Interest Contract ("BIC") Exemption, is again seeking to regulate rollover transactions and the advice to IRA owners.

On December 18, 2020, DOL issued the "Improving Investment Advice to Workers and Retirees" regulation ("Final Regulation"), which is a bit of a mixed bag. On one hand, it treats BDs, RIAs, banks, and insurance companies ("Firms") that provide certain kinds of advice about rollover transactions and to IRA owners, as ERISA fiduciaries. ERISA fiduciaries are held to an exacting fiduciary standard of care and may not receive variable compensation or compensation from third parties, unless they comply with the obligations of the Final Regulation or another available exemption. On the other hand, the Final Regulation allows more flexibility in compensation arrangements. On February 12, 2021, DOL confirmed that the Final Regulation will go into effect, as scheduled,[2] on February 16, 2021, but also stated that it will continue to work with various stakeholders to improve the Final Regulation. Thus, revisions remain possible. Further, DOL has allowed a transition period, which ends on December 20, 2021, to allow Firms to comply with the Final Regulation. This article summarizes the factors that determine when a Firm is acting as an ERISA fiduciary, and some of the important disclosure obligations of the Final Regulation.

I. The Final Regulation's Definition of ERISA Fiduciary

Pursuant to a 1975 DOL regulation, an ERISA fiduciary is either: (A) someone who provides investment advice and exercises control over assets; or (B) someone who provides (1) investment advice; (2) on a regular basis; (3) pursuant to a mutual understanding; and this advice (4) serves "a primary basis" for investment decisions; and (5) is individualized.[3] Under DOL's 2005 Deseret Letter, someone unconnected with an ERISA plan, who advised a participant to take a distribution and roll it into an IRA, was *not* an ERISA fiduciary, even when the rollover advice "was combined with a recommendation as to how to invest distributed funds." The Final Regulation retracts this guidance. Now, DOL will use the 1975 five-part test to determine if the "facts and circumstances" of a rollover transaction or an ongoing relationship with IRAs transforms the Firm into an ERISA fiduciary.

For rollovers, the key consideration is whether it is a one-time sales transaction or the beginning of a continuous relationship where both parties contemplate ongoing advice. A one-time transaction in which a distribution is rolled into an annuity or a self-directed brokerage account will not create ERISA fiduciary status, but a rollover that is followed by regular and ongoing investment advice will. Similarly, Firms that give regular advice to IRA owners that forms "a primary basis" for investment decisions will be treated as ERISA fiduciaries. Firms cannot avoid ERISA fiduciary status with written disclaimers. Thus, certain rollover transactions and ongoing relationships with IRA owners, may transform Firms into ERISA fiduciaries, who must satisfy ERISA's duty of care and comply with ERISA's prohibited transaction rules.

II. Important Obligations of the Final Regulation

As stated above, ERISA and the Internal Revenue Code prohibit fiduciaries from receiving certain kinds of compensation and from engaging in principal transactions, unless an exemption applies. The Final Regulation contains such an exemption and allows receipt of a wide variety of otherwise prohibited compensation, including commissions, 12b-1 fees, trailing commissions, sales loads, mark-ups, mark-downs, and revenue sharing payments from third parties. It allows ERISA investment fiduciaries to receive such compensation and engage in certain principle transactions if they: (1) adhere to Impartial Conduct standards, (2) provide written disclosures, (3) adopt procedures to ensure compliance with the exemption, (4) conduct an annual retrospective review, (5) self-correct any errors, and (6) meet eligibility requirements. These obligations are similar to requirements of the BIC Exemption, but there is no requirement of an enforceable contract with the customer.

The Final Regulation's Impartial Conduct standards, like Regulation Best Interest (Reg BI), require ERISA fiduciaries to: (1) act in the investor's best interest, (2) charge only reasonable compensation, and (3) make no materially misleading statements. However, the Final Regulation's disclosure requirements are more extensive than the disclosure requirements in Reg BI and Form CRS. In addition to requiring disclosures about the Firm's services and material conflicts of interest, the Final Regulation requires a Firm to disclose, in writing: (1) that it is an ERISA fiduciary, and (2) the reasons that any rollover transaction is in the investor's best interest. DOL provided guidance regarding the content of these disclosures, which may deter Firms from relying on the Final Regulation.

continued.

First, DOL provided a model fiduciary disclosure, which states: "When we provide investment advice regarding your retirement plan account or individual retirement account, we are fiduciaries within the meaning of Title I of (ERISA) and/or the Internal Revenue Code, as applicable, which are laws governing retirement accounts. The way we make money creates some conflicts with your interests, so we operate under a special rule that requires us to act in our best interest and not put our interest ahead of yours."[3] The model language is not mandatory, and it may create confusion among customers who have both IRA/ERISA accounts and non-qualified accounts. Similarly, it may expose Firms to breach of fiduciary duty claims, which would not otherwise be available.

Second, DOL provided a list of factors that Firms should consider and document when evaluating whether a rollover serves the best interest of the investors. These factors include: alternatives to rollovers and the advantages of staying in the current ERISA plan or IRA; the available account types, (commission v. fee-based); and a comparison of the fees, services, and investment options that would result from a rollover. DOL's analysis is consistent with FINRA Regulatory Notice 13-45 but requires Firms to review publicly available information when investors cannot provide information about the current plan. According to DOL, no one could make a "prudent recommendation" without this information. Finally, DOL requires firms to keep records relating to these disclosures for six years.

III. Conclusion

Not every Firm that executes rollover transactions or transactions for IRA owners will be required to comply with the Final Regulation. Rather, only Firms that provide ongoing and regular advice, which will form "a primary basis for investment decisions," are ERISA fiduciaries. Further, other exemptions, such as PTE 84-24 (which allows the receipt of certain commissions in connection with annuities and investment company securities) remain available, and may be less burdensome and more appropriate, depending upon a Firm's business practices. Given the brief compliance transition period, which ends on December 20, 2021, Firms should begin to evaluate their options for complying with the Final Regulation. Firms should review their practices to determine whether they will be viewed as ERISA fiduciaries, and if so, should identify the most appropriate exemption. In making this determination, Firms should weigh the litigation risks associated with a written acknowledgement of ERISA fiduciary status and other burdens, against the benefits of being able to receive a wider variety of compensation. Firms should also be aware that although DOL characterized the Final Regulation as being "aligned" with Reg BI and Form CRS, it refused to provide a safe harbor for Firms that complied with SEC and FINRA standards. Finally, the Final Regulation contains other requirements, beyond the scope of this article, that Firms must consider. Accordingly, Firms should monitor regulatory developments and may wish to consult counsel to determine the best course of action.

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[1]See *https://ici.org/pdf/per27-01.pdf*
[2]85 Fed. Reg. at 40593; 89 to be codified at 29 C.F.R. § 2510.3-21(c)(ii)(B).
[3]85 Fed. Reg. 82798, 82827 (December 18, 2020).