The Department of Labor Proposes Its New Fiduciary Rule

by William D. Jewett on November 2, 2023

On October 31, 2023, the Department of Labor published a new proposed regulation (the “Proposed Rule”) defining “investment advice” for purposes of determining when someone advising an ERISA plan or participant or an IRA owner is a fiduciary. The Department’s latest proposal is designed to avoid court precedents that have narrowed its regulatory authority in this area. The Proposed Rule, which most commentators will likely once again call the “fiduciary rule,” is now referred to by the Department as its “retirement security rule,” rather than, as previously, its “conflict of interest rule.”

The Proposed Rule is the Department’s third attempt to amend a 1975 regulation that set a hard-to-satisfy five-part test for determining when someone is giving investment advice as a fiduciary. A first attempt in 2010 to cast a wider net was abandoned in 2011 after much criticism, and a fundamental reworking of the rule proposed in 2015 was finalized in 2016 but struck down by the Fifth Circuit in 2018. The Department’s subsequent effort, in FAQs issued in 2020, to confer fiduciary status on advisers who give rollover advice was also struck down by a Florida district court earlier this year.

The most important changes made to the five-part test are that, to qualify as fiduciary advice, the advice no longer needs to be provided to the investor on a “regular basis” and there no longer has to be “a mutual agreement, arrangement, or understanding” that the advice will serve as “a primary basis for investment decisions.” Instead, it will be enough to trigger fiduciary status if the adviser makes investment recommendations “on a regular basis as part of their business,” and if the recommendation is provided “under circumstances indicating” that it is based on the needs of the investor and may be relied upon “as a basis” for investment decisions that are in the investor’s best interest. Persons with discretionary investment authority over retirement plan or IRA assets and advisers representing or acknowledging that they are fiduciaries will also be treated as investment advice fiduciaries. The Proposed Rule indicates that these phrasings are intended to capture situations where there is a legitimate expectation of trust and confidence, including situations involving one-off recommendations, while taking into consideration the Fifth Circuit’s criticism of the 2016 rule as being so broad that it covered situations not involving trust and confidence, the hallmarks of a fiduciary relationship.

In another significant change, the Proposed Rule defines investment recommendations to include recommendations "as to rolling over, transferring, or distributing assets from a plan or IRA." The Florida district court decision held that this position, articulated in the Department's FAQs on Prohibited Transaction Exemption 2020-02, could not be viewed as a reasonable interpretation of the 1975 regulation because a one-time recommendation could not satisfy the "regular basis" standard. To overcome this ruling, the Department is no longer re-interpreting the regulation in this regard, but instead is changing it.

In the years since the 2016 fiduciary rule, the Securities and Exchange Commission's Regulation Best Interest and the National Association of Insurance Commissioners' Model Regulation on Suitability in Annuity Transactions have taken up the mission of ensuring that advisers to retail investors act in the investor's best interest. However, Regulation Best Interest does not cover advice to workplace retirement plans or their representatives, the Model Regulation does not apply to contracts used to fund ERISA plans, and certain investment assets are not covered by either regulation. The Proposed Rule aims to fill these gaps and to ensure that all retirement investors are covered by the same fiduciary standard.

In connection with the release of the Proposed Rule, the Department is also proposing minor changes to Prohibited Transaction Exemption 2020-02 to enhance disclosure requirements and is proposing changes that would limit the availability of Prohibited Transaction Exemption 84-14 (covering certain insurance and mutual fund transactions) to advice provided by independent insurance agents. Other exemptions are being tweaked so that they will not cover investment advice transactions. To the extent an investment advice transaction involves a prohibited conflict of interest, it must satisfy the conditions of one of these two exemptions. The Department is leaving untouched Interpretive Bulletin 96-1, which addresses investment education.

Negative commentary on the Proposed Rule is already in circulation. Nevertheless, from a litigation perspective, the Proposed Rule seems to be carefully crafted to advance the Department's longstanding objective of enhancing protections for retirement investors while steering clear of relationships that are not meant to be fiduciary in nature. It seems unlikely to prompt a scramble to rework standard investment-related documents for fear of having ordinary communications treated as fiduciary advice.

It would be unsurprising to hear outcry from the annuity sales and distribution industry over the elaborate amendments to Prohibited Transaction Exemption 84-14, and we may well see an effort to overturn the inclusion of rollover and distribution recommendations as investment advice. Even so, stepping back to look at the regulatory package as a whole, and setting aside the troubled history of prior efforts, the Proposed Rule seems well-considered and, given its potentially vast reach, reasonable in its ambitions.

The Proposed Rule comes with a 60-day comment period and the promise of a public hearing approximately 45 days after publication. While we can expect widespread criticism of the Proposed Rule's significant broadening of the 1975 rule's five-part test, the Department has clearly learned from the reception given to its two prior attempts to update the nearly 50-year-old definition of investment advice, and there is reason to believe that the third time is the charm.

Please contact a member of Verrill's Employee Benefits & Executive Compensation Group if you have questions regarding the Proposed Rule.

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