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New DOL Fiduciary Rule Proposal: Still the Same Old Act…

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On November 3, 2023, the Department of Labor proposed yet another fiduciary rule, the latest in more than a decade of DOL efforts to ensure that every financial professional who sells an investment product to a retirement investor is held to a fiduciary standard of care. This proposal, should it become law, will significantly impact insurance agents, independent marketing organizations, and insurance providers. After ERISA was enacted in 1974, the DOL enacted implementing regulations in 1975 that defined “an investment advice fiduciary” for purposes of ERISA. Under a conjunctive five-part test, an investment advice fiduciary is a person who (1) “renders advice … or makes recommendation[s] as to the advisability of investing in, purchasing, or selling securities or other property”; (2) “on a regular basis”; (3) “pursuant to a mutual agreement … between such person and the plan”; and the advice (4) “serve[s] as a primary basis for investment decisions with respect to plan assets”; and (5) is “individualized … based on the particular needs of the plan.” ERISA fiduciaries were generally prohibited from receiving compensation for such investment advice from third parties dealing with a plan, absent a specific exemption. Also, DOL guidance issued in 2005 established that recommendations to take a distribution from a plan and roll over to an IRA were not investment advice for purposes of ERISA. **DOL Enters the Center Ring …** In 2016, the DOL enacted a new fiduciary rule revising the 1975 five-part test, most notably dispensing with the “regular basis” and “primary basis” criteria used for 40 years. The new rule encompassed virtually all financial and insurance professionals who did business with ERISA plans and IRA holders, including stockbrokers and insurance agents engaged in single transactions. They were barred, if they did not qualify for an exemption, from being paid whatever transaction-based commissions and brokerage fees were standard in their industries because those types of compensation were deemed a conflict of interest. In 2018, the Fifth Circuit Court of Appeals vacated the new rule in Chamber of Commerce v. Department of Labor and upheld the 1975 five-part test, stating that the “1975 regulation captured the essence of a fiduciary relationship known to the common law as a special relationship of trust and confidence between the fiduciary and his client.” The court explained: “For the past forty years, DOL has considered the hallmarks of an ‘investment advice’ fiduciary’s business to be its ‘regular’ work on behalf of a client and the client’s reliance on that advice as the ‘primary basis’ for her investment decisions.” Under the new rule, however, a single transaction recommended by a stockbroker or insurance agent would be sufficient to trigger fiduciary status. The Fifth Circuit held that the language of ERISA did not support such an expansion of DOL authority and vacated the rule. Shortly thereafter, the DOL re-implemented the 1975 five-part test. Donning some new costumes in December 2020, the DOL adopted a revised prohibited transaction exemption for fiduciary investment advice (PTE 2020-02). While the operative text provided broad exemptive relief, the preamble to the exemption provided a new interpretation of the reinstated 1975 five-part test and withdrew the 2005 guidance regarding rollover advice. Essentially, the preamble indicated that a single instance of rollover advice could now mark the beginning of an ongoing fiduciary relationship that would subject any financial or insurance professional to fiduciary status for a single transaction. This, again, was contrary to the language of the 1975 five-part test requiring a "regular basis" to hold someone accountable as an ERISA fiduciary. Litigation ensued. In February 2023, in American Securities Association v. Department of Labor, the district court vacated the DOL policy holding that advice to roll over from a plan may be part of an ongoing advice relationship that satisfies the regular basis prong. Another federal lawsuit, Federation of Americans for Consumer Choice Inc. v. Department of Labor, remains pending. **… Still the Old Act** The DOL did not appeal American Securities Association. Instead, in November 2023, the department proposed another fiduciary rule that would expand investment advice fiduciary status. Most notably, the proposal again attempts to nullify the "regular basis" prong of the five-part test, this time by revising it from persons who provide investment advice to a particular client on a regular basis to persons who provide investment advice "on a regular basis as part of their business," which is quite different. This change alone would make one-time advice, such as rollover advice, subject to the ERISA fiduciary standard provided the financial or insurance professional provides such advice regularly to others. Other changes in the proposal to the "mutual agreement" and "primary basis" prongs would serve to expand fiduciary status to any recommendation, notwithstanding the absence of an agreement or a primary basis, where "the recommendation is based on the particular needs or individual circumstances of the retirement investor and may be relied upon by the retirement investor as a basis for investment decisions that are in the retirement investor's best interest." The proposal also includes significant restrictions to another exemption, PTE 84-24. For example, investment advice fiduciaries who are not independent producers would not be able to rely on the exemption for relief. Thus, insurance agents who have relied on PTE 84-24, and its predecessor PTE 77-9, in order to receive commissions in connection with any of the covered transactions, but who are not independent producers, would have to rely on PTE 2020-02 to do so. Further, PTE 84-24 would be available only for investment advice that is provided by independent producers who work with two or more unrelated insurers to sell fixed annuities or other insurance products not regulated by the SEC (investment advice regarding any other investment products would require compliance with PTE 2020-02). An independent producer is defined as a person or entity licensed under the laws of a state to sell, solicit, or negotiate insurance contracts, including annuities, and who sells to retirement investors products of multiple unaffiliated insurance companies, but who is not an employee of an insurance company (including a statutory employee under Internal Revenue Code section 3121). Finally, PTE 84–24 would provide relief from the prohibited transaction rules only for the receipt of fully disclosed commissions or fees in connection with annuity recommendations or other insurance products not regulated by the SEC. Overall, the pending DOL rule proposal would have a profound impact on financial and insurance professionals who may provide a single instance of advice regarding a fixed annuity to an investor only to find themselves subject to the ERISA fiduciary standard. In particular, insurance agents would then need policies, procedures, and training to ensure compliance with the ERISA fiduciary standard, which burden will likely fall on insurance companies or independent marketing organizations. And most errors and omissions insurance policies held by agents won't cover claims for breach of fiduciary duty. In short, this proposal would have a huge impact on the insurance industry and independent producers. But even if the newly proposed rule is finally adopted, it will be challenged in the courts, notwithstanding its revised script, new cast, and makeup. And for largely the same reasons that the courts vacated the DOL's 2016 rule and partially vacated PTE 2020-02, it appears likely that the new rule will be vacated as well. After all, "the touchstone of common law fiduciary status" is "the parties' underlying relationship of trust and confidence." Such a relationship is not likely to arise in a single transaction, no matter how much a government agency wants it so.

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