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The DOL's New Fiduciary Proposal and the Continued Focus on Rollover Recommendations

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*This article focuses on rollover recommendations from
ERISA plans to IRAs and the resulting compliance*

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Rollovers are once again a focal point of a regulation proposed by the Department of Labor (DOL) which would expand the definition of fiduciary advice that applies to private sector retirement plans and individual retirement accounts (IRAs) (the Proposed Rule), as well as accompanying amendments proposed by the DOL to several existing prohibited transaction exemptions for conflicts of interest relating to fiduciary recommendations. While the Proposed Rule and proposed prohibited transaction exemption amendments cover a wide range of recommendations and financial transactions by advisors and insurance agents, this article focuses on rollover recommendations from plans subject to the Employee Retirement Income Security Act of 1974, as amended (ERISA), to IRAs and annuities and the resulting compliance issues for broker-dealers and registered investment advisers.

The Fiduciary Advice Definition

Background

The DOL has been focused on changing its fiduciary advice definition, which was originally issued in 1975, for some time. The DOL’s 2016 attempt to overhaul the fiduciary advice regime in the form of an expansive regulatory package was vacated by the Fifth Circuit Court of Appeals in 2018. Then, in 2021, the DOL expanded its interpretation of fiduciary advice in a manner that would make broker-dealers, registered investment advisers and their representatives (collectively, advisors) fiduciaries under ERISA and/or the Internal Revenue Code (Code) for their rollover recommendations to retirement investors. However, in February 2023, a Federal District Court in Florida set aside certain key portions of the DOL’s expanded interpretation as it applies to plan-to-IRA rollovers, again creating uncertainty about its exact scope and reach. In response to this ruling and other factors, the DOL has now issued the Proposed Rule.

Covered Persons

Under the Proposed Rule, a person is an advice fiduciary if (1) the person makes investment recommendations to retirement investors and either acknowledges that he/she is an advice fiduciary, or has investment discretion over any investment property of the retirement investor; or (2) if . . .

(ii) The person either directly or indirectly (e.g., through or together with any affiliate) makes investment recommendations to investors on a regular basis as part of their business and the recommendation is provided under circumstances indicating that 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; . . . [Prop. DOL Reg. 2510.3-21(c)]

This proposed definition is comprised of three parts:

1. Investment recommendations to investors, regardless of whether or not the investor is a retirement investor, must be a regular part of the business;
2. Circumstances indicate that the recommendation is based on the particular needs or individual circumstances of the investor; and
3. Circumstances indicate that the recommendation may be relied on by the investor as a basis for an

investment decision that is in the investor's best interest.

Advisors regularly provide investment recommendations to investors. Further, the Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) require that advisors obtain information about individuals and other retail investors (including plan participants and IRA owners) and use that information to make a recommendation personalized for that investor in order to satisfy a best interest standard of care under SEC guidance. Even further, the Proposed Rule would make it more difficult for advisors to avoid fiduciary status by using "fine print" disclaimers, under circumstances where the above three requirements would otherwise appear to be met:

Written statements by a person disclaiming status as a fiduciary under [ERISA], the Code, or this section, or disclaiming the conditions set forth in [the fiduciary advice definition]...will not control to the extent they are inconsistent with the person's oral communications, marketing materials, applicable State or Federal law, or other interactions with the retirement investor. [Prop. DOL Reg. 2510.3-21(c)(1)(v)]

As a result, advisors providing rollover recommendations to individual clients and customers almost certainly would be fiduciaries under the Proposed Rule.

Covered Advice

The Proposed Rule defines covered recommendations broadly as follows:

(10) The phrase "recommendation of any securities transaction or other investment transaction or any investment strategy involving securities or other investment property" means recommendations:

- (i) As to the advisability of acquiring, holding, disposing of, or exchanging, securities or other investment property, as to investment strategy, or as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred, or distributed from the plan or IRA;
- (ii) As to the management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, selection of

other persons to provide investment advice or investment management services, selection of investment account arrangements (e.g., account types such as brokerage versus advisory) or voting of proxies appurtenant to securities; and

- (iii) **As to rolling over, transferring, or distributing assets from a plan or IRA, including recommendations as to whether to engage in the transaction, the amount, the form, and the destination of such a rollover, transfer, or distribution.**

[Prop. DOL. Reg.2510.3-21(f)(10) (Emphasis added)]

As indicated in the bolded text, the Proposed Rule directly addresses rollovers and clearly states that recommending a rollover from an ERISA plan to an IRA is a covered recommendation. While this article focuses only on ERISA plan to IRA rollovers, it should be noted that rollover is broadly defined to also include plan to plan rollovers, IRA to IRA transfers, IRA to plan rollovers and recommending a change of investment account (for example, commission-based to advisory fee-based account within an IRA or a participant's account). Also, recommending how assets should be invested after they are rolled over is covered advice under the Proposed Rule. This means that if an advisor provides an investment proposal to an ERISA plan participant indicating how IRA assets will be invested once they are rolled over, the proposal would be considered a covered recommendation.

Because a recommendation to rollover ERISA plan assets to an IRA would be considered a fiduciary act under the Proposed Rule, the advisor would be subject to the ERISA fiduciary duties of prudence and loyalty. And, if the rollover recommendation results in compensation that the advisor would not have otherwise received (for example, the fee for managing the rollover IRA), the advisor would be engaging in a prohibited self-dealing transaction and would need to rely, in most cases, on Prohibited Transaction Exemption (PTE) 2020-02.

PTE 2020-02

PTE 2020-02 is a broad-based exemption from the prohibited transaction rules of ERISA and the Code that allows advisors to receive conflicted compensation resulting from non-discretionary fiduciary investment advice to ERISA plans, plan participants, and IRA owners. PTE 2020-02 is the primary exemption available for "conflicted" rollover recommendations.

PTE 2020-02, in its current form, imposes four (4) sets of fundamental requirements that apply to “conflicted” recommendations, including plan-to-IRA rollover recommendations:

1. Compliance with the exemption’s “Impartial Conduct Standards,” which requires: (a) adherence to a best interest standard (which mirrors the ERISA duties of prudence and loyalty); (b) reasonable compensation; (c) best execution standards; and (d) no materially misleading statements;
2. Pre-transaction disclosures consisting of: (a) acknowledgement of fiduciary status under ERISA and/or the Code; (b) description of services and material conflicts of interest; and (c) in the case of a rollover, a statement of the specific reasons as to why the rollover is in the investor’s best interest (the rollover disclosure);
3. Adoption and implementation of policies and procedures to ensure compliance; and
4. An annual retrospective review reduced to a written report certified by a senior executive officer.

PTE 2020-02 also contains a self-correction process if there is a failure to satisfy any of these conditions. If the self-correction procedure needs to be undertaken, the failure and the correction must be described in the written report of the annual retrospective review.

The DOL’s proposed amendments to PTE 2020-02 focus on (i) the pre-disclosure requirements, and (ii) the self-correction process. The DOL proposes that the disclosure also include a written statement of the best interest standard owed to the investor, additional fee description language, and changes to the rollover disclosure. This article focuses on the amendments to the rollover disclosure requirements. The other PTE conditions remain much the same.

The proposed rollover disclosure is as follows:

(5) Rollover disclosure. Before engaging in a rollover, or making a recommendation to a Plan participant as to the post-rollover investment of assets currently held in a Plan, the Financial Institution and Investment Professional **must consider and document the basis for their conclusions as to whether a rollover is in the Retirement Investor’s Best Interest**, and must provide that documentation to the Retirement Investor. Relevant factors to consider must include but are not limited to:

- (A) the alternatives to a rollover, including leaving the money in the Plan or account type, as applicable;

- (B) the fees and expenses associated with the Plan and the recommended investment or account;
- (C) whether an employer or other party pays for some or all of the Plan’s administrative expenses; and
- (D) the different levels of services and investments available under the Plan and the recommended investment or account.

[PTE 2020-02, Section II, (b)(5) (Emphasis added)]

The proposed disclosure requirement is worded differently from the parallel provision in the current PTE. While it may be intended to be the same, that is, to require that the participant be given, in writing, the specific reasons why the rollover recommendation is in the best interest of the participant—the proposal could be interpreted as being more expansive and require that additional information be provided. Stated differently, it is not clear what “document the basis for their conclusions” fully contemplates. Hopefully, this will be clarified when the final exemption is issued by the DOL.

The proposed amendment is consistent with guidance issued by the DOL in the form of frequently asked questions (FAQs) issued in connection with the current PTE 2020-02. In the FAQs, the DOL describes the process for satisfying the best interest standard for rollover advice and this process is again explained by the DOL in the Preamble to the proposed amendments to PTE 2020-02. The DOL points out that the participant’s options need to be considered, for example, leaving the money in the plan, taking a taxable distribution, rolling over to an IRA, and, if applicable, transferring the money to the plan of a successor employer. The DOL emphasizes that the services, fees and investments under the plan and the IRA (or successor plan) should be compared. And, this comparison should take into account factors, such as:

- the different levels of services and investments;
- whether the employer pays for some or all of the plan expenses; and
- all plan investment options on the plan’s investment line-up and not just those allocated within the participant’s account.

The DOL explains that this process is intended to address an important concern it has that investment advice providers avoid focusing solely on investment of assets after they are rolled out of the plan:

This proposed provision addresses an important concern of the Department that investment advice providers should not be able to avoid fiduciary responsibility for a rollover recommendation by focusing solely on the investment of assets after they are rolled over from the plan. In many or most cases, a recommendation to a plan participant or beneficiary regarding the investment of securities or other investment property after a rollover, transfer, or distribution involves an implicit recommendation to the participant or beneficiary to engage in the rollover, transfer, or distribution. Certainly, a prudent and loyal fiduciary generally could not make a recommendation on how to invest assets currently held in a plan after a rollover, without even considering the logical alternative of leaving the assets in the plan or evaluating how that option compares with the retirement investor's likely investment experience post rollover. A fiduciary would violate ERISA's 404 obligations if it recommended that a retirement investor roll the money out of the plan without proper consideration of how the money might be invested after the rollover.

[Preamble to Proposed Definition of Investment Advice Fiduciary, 88 Federal Register 75890 at page 75905 (November 3, 2023) (Emphasis added)]

The prudent analysis drawn from consideration of all relevant factors should then be documented to establish why the rollover recommendation is in the plan participant's best interest. The DOL explains that in order to satisfy the documentation requirement, the adviser should make diligent and prudent efforts to obtain information about the participant's existing plan. The DOL notes that that this information is available on the 404a-5 participant disclosure statement for the participant's plan.

Where a participant will not provide the information even after a full explanation of its significance and the information is not otherwise readily available, the DOL says that the firm can make a reasonable estimation of expenses, asset values, risk and returns based on publicly available information and document the assumptions used and their limitations. Examples of

publicly available information identified by the DOL are the recent Form 5500 and reliable benchmarks on typical fees and expenses for the type and size of plan at issue. The DOL is inviting comments on reliable benchmarks that can be used for this purpose.

Once an advisor has the actual plan data, or the alternative information, the advisor and the firm is required to engage in a best interest process to determine which alternative is in the best interest of the participant. That process involves a comparative analysis of the plan expenses, services and investments with the investments, services and expenses in the rollover IRA, in light of the participant's profile, for example, the needs and circumstances of the particular participant.

Conclusion

Under the Proposed Rule, an advisor who recommends that an investor roll over ERISA plan assets to an IRA would be considered a fiduciary under ERISA subject to the ERISA duties of prudence and loyalty. And, because a rollover recommendation inevitably results in compensation that the advisor would not have received absent the rollover (that is, the IRA management fee, commissions, etc.), the advisor and the advisor's firm would need to comply with PTE 2020-02. It is possible that advisors already are complying with the current iteration of PTE 2020-02 for their rollover recommendations. Even so, advisors and their firms should review their rollover policies and procedures to ensure they reflect a best interest process and take into account the factors and considerations identified by the DOL in its earlier guidance and now emphasized again in this Proposed Rule.

The proposed regulation and amendments to PTE 2020-02 will likely be finalized in the next few months and, in all likelihood, the final versions will be similar to the proposals. At that time, advisors and their firms will need to modify their current practices, policies, and disclosures to take into account the final rules. ■

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