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U.S. Department of Labor Issues a New ERISA Fiduciary Rule

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On April 23, the U.S. Department of Labor (DOL) finalized its latest effort to change the rules for determining who a fiduciary is under the Employee Retirement Income Security Act of 1974, as amended (ERISA). Called the final Retirement Security Rule (the Final Rule), this marks the latest effort by the DOL to redefine who a fiduciary is for purposes of ERISA. The Final Rule is slated to become effective on September 23, 2024.

The Final Rule will replace long-standing DOL regulations that have governed the determination of fiduciary status since 1975 (the 1975 Fiduciary Rule). The Final Rule expands the definition of “investment advice fiduciary” and therefore those who will be considered fiduciaries under ERISA. According to the DOL, the Final Rule is a more accurate reflection of the purposes of ERISA and will better protect the interests of retirement investors by filling a gap where certain advice relationships are not treated as fiduciary advice under the 1975 Fiduciary Rule. As of the date of this alert, at least one lawsuit has been filed challenging the Final Rule.

1. The 1975 Fiduciary Rule

The 1975 Fiduciary Rule applied a “five-part test” to determine fiduciary status. Under that test, an adviser is considered a fiduciary if (1) the adviser makes investment recommendations (2) on a regular basis (3) pursuant to a mutual understanding with a plan fiduciary that (4) the advice will serve as a primary basis for investment decisions and (5) the advice will be individualized to the particular needs of the plan.

2. The Final Rule

The Final Rule focuses on the relationship between an adviser and an investor in determining who is an “investment advice fiduciary.” Under the Final Rule, an adviser will be considered an investment advice fiduciary under ERISA if they provide a recommendation to a retirement investor for a fee or other compensation and either (A) represent or acknowledge that they are acting as a fiduciary under ERISA or (B) directly or indirectly “makes professional investment recommendations to investors on a regular basis as part of their business and the recommendation is made under circumstances that would indicate to a reasonable investor in like circumstances that the recommendation:

- is based on a review of the retirement investor’s particular needs or individual circumstances,
- reflects the application of professional or expert judgment to the retirement investor’s particular needs or individual circumstances, and
- may be relied upon by the retirement investor as intended to advance the retirement investor’s best interest.”

A “retirement investor” includes a plan, a plan participant or beneficiary, an IRA, or an IRA owner or beneficiary.

As under the 1975 Fiduciary Rule, if the recommendation is not made for a fee or other compensation, the adviser will not be an investment advice fiduciary with respect to that specific recommendation (unless the adviser acknowledges or represents that they are acting as a fiduciary).

Unlike the 1975 Fiduciary Rule, however, even an adviser who provides one-time advice can be a fiduciary. Thus, for example, a financial services provider will be a fiduciary with respect to a recommendation to roll over assets from a workplace retirement plan to an IRA if the other elements of the test above are satisfied.

3. What Is a Recommendation?

A threshold question in determining whether an adviser is a fiduciary investment adviser is whether a “recommendation” is made. Under the Final Rule, the determination of whether a recommendation is made will be based on individual facts and circumstances and determined on an objective basis. Factors that will be looked at in determining whether a recommendation has occurred will be construed consistent with the Securities and Exchange Commission’s Regulation Best Interest, which includes factors such as whether the communication is individually tailored, could be viewed as a “call to action,” and/or “reasonably would influence an investor to trade a particular security or group of securities.” Whether the communication is a call to action is a key indicator of whether it is a recommendation.

The Final Rule covers “recommendations of any securities transaction or other investment transaction or any investment strategy involving securities or other investment property,” which is defined as:

- the advisability of acquiring, holding, disposing of, or exchanging, securities or other investment property, investment strategy, or 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;
- 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;
- 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.

The Final Rule addresses an area of concern for the DOL by precluding investment advisers from avoiding fiduciary responsibility solely by focusing on the investment of assets after a rollover. Under the Final Rule, a recommendation as to how to invest after a rollover involves an implicit rollover recommendation. Similarly, the DOL makes clear in the Final Rule that it attaches fiduciary status to any recommendation to make or not make a distribution or rollover.

The Final Rule also clarifies that recommendations are not limited to recommendations to buy, sell, or hold securities or investment property and extends to recommendations as to the “voting of proxies appurtenant to securities.” While not exhaustive, the Final Rule includes some clear examples of what is a recommendation, such as a recommendation to move from a commission-based account to an advisory fee account (or vice versa).

4. What Is Not Considered a Recommendation?

The preamble to the Final Rule and the Final Rule itself provide some helpful guidance on actions or communications that are not considered recommendations. A salesperson’s recommendation to purchase a particular product or explore a particular investment strategy will not satisfy the objective test to be treated as fiduciary advice. However, caution should be used if the communication goes beyond a sales pitch and could be viewed as assuming a position of trust/confidence. Similarly, simply providing investment information or education, absent making a recommendation, is not considered advice under the Final Rule. The key here is that the communication is education and not a call to action, in which case it would be considered a recommendation.

The DOL provided that a recommendation to purchase health, disability, life, or another insurance product without an investment component is not investment advice. A few other examples of actions that are not recommendations are normal marketing unaccompanied by a recommendation of a securities or other investment transaction or for any investment strategy; offering a preset list of investments or offering a menu of investment options without additional facts; offering valuation services, appraisal services, or fairness opinions; and identifying investment alternatives using third-party criteria to assist in selecting/monitoring investments without additional screening or recommendation.

5. Additional Fiduciary Indicators

The Final Rule also focuses on a few other factors that are worth highlighting in considering whether someone is providing investment fiduciary advice. Holding oneself out as a “trusted adviser”; using certain titles, credentials, or slogans; or being in

the business of making recommendations to investors, even if not to a particular investor, are all factors that may be indicative of a fiduciary relationship. While it can be helpful for both the adviser and the retirement investor to clarify the terms of the relationship, disclaiming fiduciary status is not dispositive and will not defeat fiduciary status if inconsistent with communications or other interactions with a retirement investor.

As noted above, one of the elements for an action to result in investment fiduciary advice is whether the recommendation is for compensation. Some examples of compensation that would satisfy this component of the test include brokerage commissions, mutual fund sales commissions, insurance sales commissions, fees based on assets under management, and fees received in connection with an investment transaction.

6. Conclusion

Investment advisers should review the components of the Final Rule and determine whether any services they perform will be considered investment fiduciary advice and, if so, what they will need to do to comply with ERISA. The authors and other members of our ERISA team regularly advise investment managers on the implications of being a fiduciary under ERISA. Please contact the authors or any other Lowenstein Sandler lawyer with whom you regularly work if you have any questions or for assistance in complying with the Final Rule.

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