EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION
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Are You a Fiduciary? The New Definition of an Investment Advice Fiduciary

On April 25, 2024, the United States Department of Labor (USDOL) issued a final rule, the "Retirement Security Rule," that significantly alters the definition of a "fiduciary" under the Employee Retirement Income Security Act of 1974 (ERISA). Specifically, the Retirement Security Rule expands the scope of "investment advice fiduciaries" from individuals rendering investment advice on a regular basis pursuant to a mutual agreement to any individual recommending investments in such a manner that reasonably establishes trust and confidence by a retirement investor in said recommendation. As a result, the Retirement Security Rule imposes fiduciary duties on many more individuals than under the prior rule. The Retirement Security Rule is effective Sept. 23, 2024.

This memorandum addresses the definition of an "investment advice fiduciary" under ERISA, the USDOL's official interpretation of the definition from 1975 through 2024, the policies underlying the USDOL's transition to the new Retirement Security Rule, the requirements of the rule, and the impact thereof on businesses, investors, and plan sponsors. The memorandum also examines the Retirement Security Rule's chance of survival in the face of current legal challenges.

ERISA Sets the Stage: The Definition of an Investment Advice Fiduciary from 1975-2024

Nearly 50 years ago, on Sept. 2, 1974, Congress and President Ford enacted ERISA to protect employees' welfare and retirement benefits. Generally, Tile I of ERISA charges "fiduciaries" to administer welfare and retirement plans in the best interest of participants pursuant to a duty of loyalty and prudence owed to plan participants. There are several types of "fiduciaries" bound by these ERISA fiduciary duties. One such fiduciary is the "investment advice fiduciary." Under section 3(21)(A)(ii) of ERISA, this type of fiduciary is defined as an individual who "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such [retirement or welfare] plan, or has any authority or responsibility to do so."

In the wake of ERISA's enactment, the USDOL, on October 10, 1975, promulgated a regulation to expound upon ERISA's definition of an investment advice fiduciary (1975 Rule). This 1975 Rule established the following five-part test for determining whether an individual is an investment advice fiduciary bound by ERISA's fiduciary duties:

1. renders advice as to the value of securities or other property, or make recommendations 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, arrangement or understanding with the plan or a plan fiduciary;
4. the advice will serve as a primary basis for investment decisions with respect to plan assets; and
5. the advice will be individualized based on the particular needs of the plan.

This understanding of an investment advice fiduciary prevailed for almost 50 years before the USDOL changed that understanding with the Retirement Security Rule.

Why the Change? Policies Driving the Transition from the 1975 Rule to the 2024 Rule

At the time of ERISA's enactment and the promulgation of the 1975 Rule, defined benefit plans, such as pension plans, held 71% of all retirement assets. Consequently, most retirement assets were controlled by relatively sophisticated pension plan administrators and fiduciaries. Therefore, the 1975 Rule and ERISA focus on investment advisors that have a recurring relationship with a retirement plan or plan fiduciary.

Today, however, retirement assets are increasingly managed by individuals with no ERISA fiduciary overseeing such assets. For example, in 2022, Americans rolled over approximately $779 billion from defined contribution plans, such as 401(k) plans, into individual retirement accounts (IRAs). These IRAs are often self-directed by individuals who may not have the same investment experience as an ERISA fiduciary.

In this present investment context, the Biden Administration and the USDOL identified "blind spots" in the 1975 Rule. Specifically, the Biden Administration wanted to increase protections for retirement investors by imposing fiduciary duties in contexts outside scope of the 1975 Rule, such as one-time financial advice over transactions like a 401(k) plan rollover, transactions involving non-securities and certain annuities, such as fixed index annuities, and advice to plan sponsors concerning which investments to include in a 401(k) plan investment lineup. To do so, the Biden Administration and the USDOL needed to change the 1975 Rule.

Change is Here: The New Rule Defining Investment Advice Fiduciary Under ERISA

After a notice and comment period concerning modifications to the 1975 Rule, the USDOL issued the final Retirement Security Rule to replace the 1975 Rule.

The Retirement Security Rule replaces the five-factor test of the 1975 Rule with a test that involves analyzing the totality of the circumstances surrounding an investment "recommendation." Specifically, the Retirement Security Rule imposes fiduciary obligations on a person if the person:

1. makes an investment recommendation of any securities transaction or other investment transaction or any investment strategy involving securities or other investment property;
2. to a retirement investor;
3. for a fee or other compensation; and
4. The person either:
    a. directly or indirectly (e.g., through or together with any affiliate) makes professional investment recommendations to investors on a regular basis as part of their business and made the recommendation in such a manner that would indicate to a reasonable investor that it was particularized to that investor based on the person's professional experience permitting reasonable reliance on the recommendation; or
    b. represents or acknowledges that the person is acting as a fiduciary under ERISA with respect to the recommendation.

For purposes of this new test, the USDOL defines an investment recommendation as any recommendation

concerning the acquiring, managing, rolling over, transferring or distributing of investment property, which includes securities, annuities and any other similar investment property. The Retirement Security Rule defines retirement investor as an "ERISA plan, plan participant or beneficiary, IRA, IRA owner or beneficiary, and any fiduciary that exercises discretionary authority or control with respect to the management of a plan or the investment of its assets."

Based on the foregoing, the Retirement Security Rule imposes fiduciary duty any time an individual recommends an investment strategy to any type of retirement investor in any context where the investor reasonably placed trust and confidence in the recommendation based on either (i) the individual's professional affiliation and particularized pitch, or (ii) the individual represents that he/she is an ERISA fiduciary. The Retirement Security Rule eliminates the conditions of the 1975 Rule that investment advice be *regularly* rendered and that it be pursuant to a *mutual agreement*. As a result, fiduciary status could apply without an understanding among the parties that a fiduciary relationship was intended to be established and based on a one-time investment recommendation.

In addition to issuing a new test for investment advice fiduciary under ERISA, the Retirement Security Rule prohibits written disclaimers of fiduciary status. Any such writings are deemed a nullity under the Retirement Security Rule. The new test is applied notwithstanding such written disclaimers.

Dealing with Change: Modifying Business Practices, Investor Expectations and Plan Administration

For financial services businesses, the Retirement Security Rule creates greater exposure to liability for breach of fiduciary duty than that under the 1975 Rule because the Retirement Security Rule imposes fiduciary duties on a much broader range of services that financial services businesses provide for their clients. For example, salespeople affiliated with an insurance company that offers investment services, such as annuities, could be investment advice fiduciaries under the Retirement Security Rule based on one sales pitch, provided the pitch is sufficiently particularized to the prospective investor. Thus, financial services businesses should train their staff to ensure that the requisite "trust and confidence" is not inadvertently established. Moreover, such businesses should review their written marketing material to ensure that such material does not contain representations that could potentially establish a fiduciary relationship with prospective customers under the Retirement Security Rule.

For investors, the Retirement Security Rule provides new expanded protections, such as the enhancement and expansion of fiduciary duties to a broader set of retirement investors. However, for the investment advice fiduciary status to apply, the investor needs to "reasonably" rely on the recommendations. As a result, investors are still expected to review recommendations as a "reasonable" investor would.

For plan sponsors, the Retirement Security Rule invalidates any disclaimer of fiduciary status by an investment advisor in an investment service agreement with a plan sponsor. Additionally, in conjunction with the Retirement Security Rule, the USDOL amended USDOL Prohibited Transaction Exemptions 84-24 (PTE 84-24) and 2020-02 (PTE 2020-02). These amendments affect the compensation arrangement between plan sponsors and investment advisors. Under the amended PTE 2020-02, investment advisors can only receive "reasonable compensation" from an ERISA plan pursuant to this prohibited transaction exemption if they satisfy enhanced duty of loyalty obligations owed to plan sponsors, including additional disclosures. The amended PTE 2020-02 also applies to more transactions than under the original PTO 2020-02 such that the amended PTE 2020-02's applicability is virtually coextensive with that of the Retirement Security Rule. Pursuant to the amended PTE 84-24, independent insurance agents or brokers serving as investment

advisors to ERISA plans who sell annuities or other insurance products that are not "securities" under the federal securities laws may receive reasonable sales and commission compensation from the plan provided they satisfy the duty of loyalty requirements similar to those under PTE 2020-02 and are licensed to sell insurance under State law. Thus, plan sponsors should review their service agreements and compensation arrangements with investment advisors to ensure that they comply with the Retirement Security Rule and the related USDOL Prohibited Transaction Exemptions, as amended.

Preparation for the implementation of the Retirement Security Rule should start now, as the Retirement Security Rule is effective Sept. 23, 2024.

Is Change Here to Stay? Legal Challenges to the Retirement Security Rule

On May 2, 2024, a group of insurers filed a lawsuit in the United States Eastern District of Texas to prevent the implementation of the Retirement Security Rule on grounds that it exceeds the USDOL's authority to promulgate regulations under the Administrative Procedures Act. This lawsuit is styled as *Federation of Americans for Consumer Choice, Inc., et al. v. U.S. Dep't of Labor*, 6:24-cv-0163 (Dist. Ea. Tex. 2024).

This lawsuit is not the first action to vacate a USDOL Rule concerning investment fiduciary status. For example, in 2016, the USDOL issued regulations that would have expanded the scope of the 1975 Rule's definition of an investment advice fiduciary. However, in *Chamber of Com. of United States of Am. v. United States Dep't of Lab.*, the Fifth Circuit vacated that regulation on the grounds that, among other reasons, the USDOL's regulations did not incorporate the common law requirement of "trust and confidence" for the imposition of fiduciary status and that the 2016 regulation infringed on the jurisdiction of the Securities and Exchange Commission (SEC) pursuant to the Dodd-Frank Act.

Since then, the USDOL drafted the Retirement Security Rule to incorporate the "trust and confidence" common law standard and highlighted the Retirement Security Rule's alignment with recent SEC rulemaking, specifically the SEC's Regulation Best Interest.

Thus, the United States District Court for the Eastern District of Texas in the action, *Federation of Americans for Consumer Choice, Inc., et al. v. U.S. Dep't of Labor*, will have to determine whether the USDOL resolved the issues identified by the Fifth Circuit with the Retirement Security Rule. At present, plaintiffs in that action have filed their Complaint and are actively seeking an injunction to stay the enforcement of the Retirement Security Rule while the action is pending. Stay tuned.

If you have any questions related to the information presented in this memo, please do not hesitate to contact John M. Harras, any attorney in Bond's employee benefits and executive compensation practice or the Bond attorney with whom you are regularly in contact.

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