How Partial Invalidation Of ERISA Guidance Affects Advisers

By **Robert Daily and Sterling Perkinson** (February 17, 2023)

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On Feb. 13, the U.S. District Court for the Middle District of Florida invalidated the U.S. Department of Labor's policy on retirement plan rollovers.

Specifically, the court's ruling in American Securities Association v. Department of Labor addresses the DOL's policy on when advice provided by a financial institution or financial professional on a rollover from an Employee Retirement Income Security Act plan — including most 401(k), 403(b) and profit sharing plans — to an individual retirement account may be considered fiduciary investment advice under ERISA and the tax code.[1]

The district court's order struck down the agency's interpretation that rollover advice provided to a participant in an ERISA plan would satisfy the "regular basis" requirement of the DOL's fiduciary investment advice regulation merely because the adviser expects to provide investment advice, with respect to the assets on an ongoing basis after they are rolled over to an IRA.

The department's vacated interpretation to a large extent necessitated Prohibited Transaction Exemption 2020-02, which applied certain conditions and procedures in place for rollover transactions to mitigate the potential for conflicts of interest.[2]

Accordingly, the district court's invalidation of the policy significantly narrows the DOL's attempt to regulate the rollover area. But there are still a number of situations where an adviser may need to rely on PTE 2020-02, particularly when an adviser is a fiduciary with respect to the ERISA plan where the rollover originates or when the adviser has provided investment advice pertaining to a client's assets in the ERISA plan under an existing arrangement.

Background

There is a long saga between the DOL and courts as to whether a financial adviser provides investment advice as a fiduciary under ERISA and the tax code when the person provides a recommendation to a plan participant to roll money out of an ERISA plan and into an IRA.

Here is a quick timeline:

In 1975, the DOL issued regulations that stated a person is a fiduciary when giving investment advice (1) that is individualized, (2) provided on a regular basis, (3) provided under a mutual agreement or understanding, (4) that forms the primary basis for the investment decision and (5) is provided for a fee.

In 2005, the department released the so-called Deseret letter,[3] in which it interpreted the fiduciary definition in the 1975 regulations and concluded that advice regarding a rollover from an ERISA plan would generally not by itself be considered fiduciary investment advice. However, the DOL also said in the letter that rollover advice by a party that is already a

fiduciary with respect to the plan may be considered fiduciary investment advice.

The DOL in 2016 issued new regulations that updated the definition of when someone would be considered a fiduciary and revoked the Deseret letter. The department's 2016 rule provided that any recommendation to roll over or distribute plan assets would be fiduciary investment advice but that general information and education about rollovers would not be fiduciary advice — without a "recommendation" to a plan participant.

In 2018, the U.S. Court of Appeals for the Fifth Circuit vacated the 2016 rule, which reinstated the Deseret letter.

The DOL withdrew the Deseret letter in 2020, reinterpreted when an adviser would be a fiduciary with respect to rollover advice and proposed a new exemption in PTE 2020-02.[4] Most significantly, the agency accepted that the five-part test in the 1975 regulations applied, but it changed its interpretation of the regulations.

In the preamble to PTE 2020-02, the DOL said that even if the adviser has not provided investment advice before the rollover transaction, the investment advice may satisfy the regular basis requirement when the adviser "expects to regularly make investment recommendations regarding the IRA as part of an ongoing relationship."

In April 2021, the DOL issued a set of frequently asked questions[5] interpreting PTE 2020-02, with FAQ No. 7 addressing the department's new interpretation of the regular basis requirement that "the advice to roll assets out of an employee benefit plan into an IRA would be the start of an advice relationship that satisfies the regular basis requirement."

The agency announced in 2022[6] that it intends to issue regulations updating the term "fiduciary," as defined in its 1975 regulations, to reflect marketplace practices and the expectations of plan investors, as well as to address potential conflicts of interest.

American Securities Association Summary Judgment

In American Securities Association v. Department of Labor,[7] a trade association of regional financial services firms challenged the DOL's authority to issue PTE 2020-02. The plaintiff filed a motion for summary judgment that, among other things, sought to invalidate FAQ No. 7.

In the order partially granting the plaintiff's motion, the district court ruled that the plaintiff had standing to sue and that the FAQs concerning PTE 2020-02 were "interpretive rules" and not "legislative rules" that required notice and comment.

The court also concluded that the DOL's policy in FAQ No. 7 was not entitled to deference because it "impermissibly unmoors the focus of the inquiry into whether an individual is a fiduciary away from a specific ERISA plan, rendering it inconsistent with the statute and previous guidance."[8]

As the district court explained:

> Before a rollover occurs, a professional who gives rollover advice does so with respect to an ERISA-governed plan. However, after the rollover, any future advice will be with respect to a new non-ERISA plan, such as an IRA that contains new assets from the rollover. The professional's one-time rollover advice is thus the last advice that he or she makes to the specific plan. So, while an offer to provide future

> advice may, as the Department suggests, be the beginning of a relationship, that relationship is inherently divorced from the ERISA-governed plan. Because any provision of future advice occurs at a time when the assets are no longer plan assets, it is not captured by the "regular basis" analysis.[9]

Put differently, allowing rollover transactions "to satisfy the 'regular basis'" requirement, "even if infrequently, is incompatible with the 1975 Regulation."[10]

The court concluded that the DOL's interpretation of the regular basis requirement in FAQ No. 7 was arbitrary and capricious, vacating the policy referenced in FAQ No. 7 and remanding back to the agency for further proceedings consistent with its order.

The plaintiffs also challenged certain rollover documentation requirements in FAQ No. 15. The district court denied the plaintiff's motion for summary judgment on this issue, deciding that the rule was a legislative one that did not require notice and comment and that it is not arbitrary and capricious.

Considerations for Financial Advisers

Assuming this order stands and the DOL reconsiders FAQ No. 7 without amending the 1975 regulations, then it is likely that the agency will return to a position closer to its stance in the Deseret letter.

Under this interpretation, an adviser providing advice regarding a rollover, standing alone, would not provide investment advice as a fiduciary under ERISA and the tax code.

That said, even if the DOL returns to its position in the Deseret letter, a financial adviser may still be a fiduciary under ERISA and the tax code. As the DOL noted in the Deseret letter:

> The Department has stated on numerous occasions that directing the investment of a plan constitutes the exercise of authority and control over the management or disposition of plan assets and that the person directing the investments would be a fiduciary, even if the person is chosen by the participant and has no other connection to the plan.
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> …
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> Advice of this nature given by someone who is already a fiduciary of the plan would be subject to ERISA's fiduciary duties. Moreover, if the person exercised control over the participant's account in making the distribution and reinvestment outside the plan, the person would be a fiduciary and would be subject to the ERISA's fiduciary obligations.

This discussion in the Deseret letter may take on greater relevance in the future because these principles do not appear inconsistent with the order in American Securities Association.

If the DOL revives its interpretations in the Deseret letter, then an adviser potentially needs to rely on PTE 2020-02, in at least two types of circumstances:

1. If the adviser is engaged by an ERISA plan to provide advisory services with respect to the plan's investments.

2. If the adviser is engaged by an individual participant in an ERISA plan — even if the advisory is not engaged by the ERISA plan itself — and part of the advisory services include consulting on the participant's investment allocations in the ERISA plan.

In either of these circumstances, if an adviser provides advice to a participant to roll over assets to an IRA where the adviser or an affiliate may receive advisory fees, commissions or other compensation, the adviser may need to rely upon PTE 2020-02, even with the narrowing of the interpretation of fiduciary investment advice by the district court.

As noted above, the American Securities Association court has ordered the policy in FAQ No. 7 to be vacated and remanded back to the DOL for future consideration.

The agency had previously announced that it intends to update the definition of "fiduciary"; it is uncertain to what extent American Securities Association will have an impact on the DOL's plans for future regulations.

Regardless of whether the department appeals this order or reconsiders its policy as directed, PTE 2020-02 remains under challenge by another action, Federation of Americans for Consumer Choice Inc. v. United States Department of Labor,[11] which was filed around the same time as American Securities Association.

In the meantime, financial institutions or advisers that have policies in place to comply with PTE 2020-02 should consider whether any modifications to these policies are appropriate in view of the district court's decision.

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[1] American Securities Association v. Department of Labor, No. 8:22-cv-330, 2023 U.S. Dist. LEXIS 24076 (M.D. Fl. Feb 13, 2023).

[2] PTE 2020-02 is discussed in detail in our blog post here: https://kilpatricktownsend.com/en/insights/alert/2021/4/pte%202020-02%20for%20investment%20advice%20fiduciaries%20overview%20and%20checklist.

[3] https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/advisory-opinions/2005-23a.

[4] https://www.federalregister.gov/documents/2020/12/18/2020-27825/prohibited-transaction-exemption-2020-02-improving-investment-advice-for-workers-and-retirees.

[5] https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/faqs/new-fiduciary-advice-exemption.

[6] https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202204&RIN=1210-AC02.

[7] American Securities Association v. Department of Labor, No. 8:22-cv-330, 2023 U.S. Dist. LEXIS 24076 (M.D. Fl. Feb 13, 2023).

[8] Id. at *46.

[9] Id. at *51.

[10] Id. at *54.

[11] Federation of Americans for Consumer Choice Inc. v. United States Department of Labor, No. 3:22-cv-00243 (N.D. Tex. Feb 02, 2022).