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Federal District Court Narrows Interpretation of Fiduciary Rollover Advice

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On February 13, 2023, a federal district court in the Middle District of Florida invalidated the Department of Labor's ("DOL") policy as to when advice provided by a financial institution or financial professional ("adviser") on a rollover from an ERISA Plan (including most 401(k) plans, 403(b) plans and profit sharing plans) to an IRA may be considered fiduciary investment advice under ERISA and the Tax Code. The district court's order strikes down the DOL'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 DOL's vacated interpretation to a large extent necessitated PTE 2020-02, which applied certain conditions and procedures in place for rollover transactions to mitigate the potential for conflicts of interest. (PTE 2020-02 is discussed in detail in our prior blog post). 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 with respect to a client's assets in the ERISA Plan under an existing arrangement.

Background

There is 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 a IRA. Here is a quick timeline:

- In 1975, the DOL issued regulations that stated a person is a fiduciary when providing investment advice (i) that is individualized, (ii) provided on a regular basis, (iii) provided under a mutual agreement or understanding, (iv) that forms the primary basis for the investment decision, and (v) that is provided for a fee.
- In 2005, the DOL released the so-called "Deseret Letter," where 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 Deseret Letter that rollover advice by a party that is already a fiduciary with respect to the Plan may be considered fiduciary investment advice.
- In 2016, the DOL issued new regulations that updated the definition of when someone would be considered a fiduciary and revoked the Deseret Letter. The DOL'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 a fiduciary advice (without a "recommendation" to a plan participant). In 2018, the Fifth Circuit vacated the 2016 rule, which reinstated the Deseret Letter.

- In 2020, the DOL withdrew the Deseret Letter, reinterpreted when an adviser would be a fiduciary with respect to rollover advice, and proposed a new exemption in PTE 2020-02. Most significantly, the DOL accepted that the five-part test in the 1975 regulations applied, but changed its interpretation of the regulations. In the preamble to PTE 2020-02, the DOL said 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 IRS as part of an ongoing relationship."
- In April 2021, the DOL issued a set of FAQs interpreting PTE 2020-02. As relevant here, FAQ #7 addressed the DOL'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."

American Securities Association Summary Judgment

In *American Securities Association v. Department of Labor*, 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 #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 about PTE 2020-02 were "interpretive rules" and not "legislative rules" that required notice and comment. The district court also concluded that the DOL's policy in FAQ #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." *Id*. at *46. 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.

Id. at *51. Put differently, allowing rollover transactions "to satisfy the 'regular basis'" requirement, "even if infrequently, is incompatible with the 1975 Regulation." *Id*. at *54. The district court concluded that the DOL's interpretation of the regular basis requirement in FAQ #7 was arbitrary and capricious. The district court then vacated the policy referenced in FAQ #7 and remanded back to the DOL for further proceedings consistent with its order.

Considerations for Financial Advisers

Assuming this order stands and the DOL reconsiders FAQ #7, then it is likely that the DOL will return to a position closer to its position 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 a financial adviser potentially need 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 advisor 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 #7 to be vacated and remanded back to the DOL for future consideration. Regardless of whether the DOL 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*, Docket No. 3:22-cv-00243 (N.D. Tex. Feb 02, 2022), 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.