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BLOG

IRAs, Investment Advice, and the Department of Labor—Important Takeaways

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On February 13, 2023, a Florida federal district court (the Court) partially invalidated the U.S. Department of Labor's Employee Benefit Security Administration's (the Department's) interpretation of its rule that described when a financial adviser who helps participants roll over some or all of their 401(k) assets into an individual retirement account (IRA) or an annuity is providing investment advice and acting as a fiduciary under the Employee Retirement Income Security Act of 1974, amended (ERISA). The ruling was issued pursuant to an action brought by the American Securities Association (ASA) against the Department. [https://si-interactive.s3.amazonaws.com/prod/plansponsor-com/wp-content/uploads/2023/02/14182814/DOL-Lawsuit-Verdict.pdf]

Background

In 2016, the Department finalized a new regulation intended to replace its 1975 Regulation that defined the term "Fiduciary" and addressed the conflict-of-interest rule associated with retirement investment advice [*see* 81 Fed. Reg. 20946 (Apr. 8, 2016)] (the Fiduciary Rule). The Fiduciary Rule provided, in relevant part, that an individual "renders investment advice for a fee" whenever they are compensated in connection with a "recommendation as to the advisability of" buying, selling, or managing "investment property."

In 2018, the Fifth Circuit vacated the Fiduciary Rule [*see Chamber of Com. v. U.S. Dep't of Lab.*, 885 F.3d 360, 379, 388 (5th Cir. Mar. 15, 2018)], holding that the Fiduciary Rule conflicted with the plain text of ERISA. After the Fifth Circuit's decision, the Department issued guidance confirming that the definition of "fiduciary" in the 1975 Regulation (found at 29 C.F.R. § 2510.3-21(c)) was the applicable definition.

In 2020, the Department proposed a new class exemption, Prohibited Transaction Exemption (PTE) 2020-02 (PTE 2020-02), to address the circumstances in which financial institutions and investment professionals who provide "fiduciary investment advice" to retirement investors can "receive otherwise prohibited compensation." During the notice-and-comment period, the American Securities Association (ASA) submitted comments requesting that the Department "make explicit that the ERISA 'five-part test' will be consistent with the Fifth Circuit's opinion regarding the 2016 Rule." The ASA further raised that requiring broker-dealers to disclose their fiduciary status to investors in the context of rollover recommendations was "unnecessary and could have adverse impacts," and that such "written affirmation requirements" would "add unnecessary subjectivity and complexity." The final PTE 2020-02 was published in December 2020. [*See* 85 Fed. Reg. 82798 (Dec. 18, 2020).]

In 2021, the Department issued a set of Frequently Asked Questions (FAQs) that were intended to provide the Department's interpretation of PTE 2020-02 as well as the five-part test under its 1975 Regulation. FAQ 6 addressed the five-part test. It asked, "How does ERISA define fiduciary investment advice?" The answer provided was,

> Under ERISA's statutory text, a firm or investment professional provides fiduciary investment advice to the extent she "renders investment advice for a fee or other compensation, direct or indirect, with respect to any money or other property of such plan, or has any authority or responsibility to do so."

In 1975, the Department issued a regulation that adopted a five-part test for determining when recommendations count as investment advice. Under this 1975 regulation, the person making the recommendation must:

1. render advice to the plan, plan fiduciary, or IRA owner 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, plan fiduciary, or IRA owner, that
4. the advice will serve as a primary basis for investment decisions with respect to plan or IRA assets, and that
5. the advice will be individualized based on the particular needs of the plan or IRA.

All parts of the 1975 test must be satisfied for a firm or investment professional to be an investment advice fiduciary when making a recommendation.

FAQ 7 addressed the second prong in the five-point test; it asked, "When is advice to rollover assets from an employee benefit plan to an IRA considered to be a on a 'regular basis'?" The answer provided was,

> A single, discrete instance of advice to roll[ ]over assets from an employee benefit plan to an IRA would not meet the regular basis prong of the 1975 test. However, advice to roll[ ]over plan assets can also occur as part of an ongoing relationship or as the beginning of an intended future ongoing relationship that an individual has with an investment advice provider. When the investment advice provider has been giving advice to the individual about investing in, purchasing, or selling securities or other financial instruments through tax-advantaged retirement vehicles subject to ERISA or the Code, the advice to roll assets out of the employee benefit plan is part of an ongoing advice relationship that satisfies the regular basis prong. Similarly, when the investment advice provider has not previously provided advice but expects to regularly make investment recommendations regarding the IRA as part of an ongoing relationship, 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 1975 test extends to the entire advice relationship and does not exclude the first instance of advice, such as a recommendation to roll plan assets to an IRA, in an ongoing advice relationship.

The ASA took issue with FAQ 7's expansive view of the phrase "regular basis" in connection with advice related to rollovers and with FAQ 15, which addressed, "What factors should financial institutions and investment professionals consider and document in their disclosure of the reasons that a rollover recommendation is in a retirement investor's best interest?"

Court's Analysis of FAQ 7

The Court grappled with whether the guidance provided in FAQ 7 improperly amended the Department's rules without notice and comment. The Department took the position that the FAQ provided guidance solely with respect to the definition of "regular basis" and was not offering a new legislative rule; however, the Court disagreed.

The Court's decision heavily relied on the *Carfora* case. [*See Carfora v. Teachers Ins. Annuity Ass'n of Am.*, --- F. Supp. 3d ---, 2022 WL 4538213 (S.D.N.Y. Sept. 27, 2022).] In that case plaintiffs brought suit against TIAA, which provided the plaintiffs with employer-sponsored plans with various administrative and investment-related services, based on alleged breaches of fiduciary duties regarding advice to roll over assets into a managed-account service. Here, the court declined to retroactively apply PTE 2020-02 and associated guidance. Thus, the court examined whether TIAA provided "investment advice" on a "regular basis" under the statutory and regulatory framework only when it offered advice to roll over a participant's account balance. The court bifurcated the transactions. First, where TIAA provided advice to the employer-sponsored plan and, second, where TIAA advised participants on whether to roll over their assets. The court, "[f]ocusing the analysis on only the timeframe when the assets in question were plan assets," found that the actions taken following the rollover were not subject to ERISA's fiduciary guidance.

The Court based its reasoning as follows:

> 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 … . FAQ 7 … sweeps conduct into its purview that would not otherwise trigger fiduciary obligations.

Thus, the Court held that FAQ 7 does not provide guidance as to the term "regular basis"; it instead expands the circumstances in which an investment advisor is subject to fiduciary duties under ERISA. The Court declared unlawful, and vacated the guidance referenced in, FAQ 7 and remanded it to the Department for further proceedings consistent with its order.

Court's Analysis of FAQ 15

Although the Court examined a similar issue with respect to FAQ 15, the Court held that the text of FAQ 15 did not improperly amend the Department's rules without notice and comment but rather did further interpret an existing regulation and provide guidance to market participants.

Winston Takeaway

Based on this Court's decision, when advice is offered to a participant in regard to rolling over the participant's account balance, such advice is not necessarily ongoing advice that satisfies the regular-basis prong of the Department's 1975 Regulation, which is contrary to the Department's interpretation in its FAQs. We will wait and see whether the Department amends its FAQs or appeals this decision.

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