INSURED RETIREMENT INSTITUTE

2024 DOL Fiduciary Rule

Overview and Analysis of Final Rule Package

What is this all about?

Since 1974, the Employee Retirement Income Security Act (ERISA) has imposed fiduciary status on anyone who provides investment advice for compensation to an employer-based retirement plan like a 401(k) or to any participant or beneficiary of such a plan. In 1975, the Department of Labor (DOL) adopted a five-part test to clearly define when a person or entity would trigger this fiduciary status. The federal tax code imposes a similar but not identical fiduciary standard on providers of investment advice to individual retirement accounts (IRAs) and IRA owners, and the same five-part test also applies in the IRA context.

In brief: DOL's 2024 fiduciary rule broadens the definition for who is classified as a fiduciary and imposes more stringent requirements on fiduciaries.

Nearly all firms and financial professionals will be treated as fiduciaries under this new rule.

The five-part test was designed to ensure that fiduciary status under ERISA and the federal tax code would only be imposed when there is a special relationship of trust and confidence between the advice provider and the advice recipient. Since 2010, the DOL has been trying to change its rules to treat more people as fiduciaries and to impose more stringent requirements on their conduct.

On April 23, 2024, the DOL issued final amendments to the five-part test and the rules fiduciaries must follow in order to receive compensation for their services. These amendments will take effect on September 23, 2024, though certain elements will not become applicable and enforceable until one year later.

Will this rule have a negative effect on consumers?

Millions of consumers are likely to suffer harm under this regulation.

For the second time in less than a decade, DOL has adopted a regulation that treats all financial professionals who sell retirement planning products and services as fiduciaries. An attempt at a similar rule in 2016 was invalidated as arbitrary and capricious rulemaking by the U.S. Court of Appeals for the Fifth Circuit in 2018.

DOL has unreasonably dismissed the extensive research and real-world experience decisively demonstrating the 2016 DOL fiduciary rule significantly harmed lower- and middle-income workers before being vacated in federal court.

- A study of the 2016 fiduciary rule found that more than 10 million smaller retirement account owners lost the ability to work with financial professionals.
- A more recent analysis found that if DOL adopts a new rule similar to the 2016 rule, the retirement savings of 2.7 million individuals with incomes below $100,000 would plummet by $140 billion over ten years.
- The analysis also found that people of color, particularly Black and Latino retirement account owners, would be among the hardest hit, increasing the racial wealth gap by 20 percent.

What does it mean to be an investment advice fiduciary under ERISA?

The fiduciary standard imposed by ERISA is often referred to as the "highest standard known under the law" and for good reason. Fiduciaries to employer-based plans are held to statutory duties of prudence and loyalty and are subject to strict prohibited transaction rules. This means fiduciaries cannot make recommendations if their compensation would vary depending on what they recommend unless they qualify for an exemption from the prohibited transaction rules. Plan participants and beneficiaries have the right to sue in private litigation if they think a fiduciary has violated those duties or rules.

Fiduciary Standard Summary

Under ERISA

- Duty of prudence and loyalty
- Prohibited transaction rules
- Private right of action

For IRA Advice

- Prohibited transaction rules
- No private right of action
- Fines for violations

How is the fiduciary standard different in the IRA context?

The federal tax code imposes the same prohibited transaction rules on fiduciaries who provide investment advice to IRAs, but in the IRA context, the duties of prudence and loyalty do not apply and there is no private right of action. If a fiduciary to an IRA violates the prohibited transaction rules, they can be fined by the Internal Revenue Service (IRS), but they cannot be sued by the IRA or the IRA owner.

Who will become a fiduciary under this new rule?

Just like the 2016 rule, nearly all firms and financial professionals will become fiduciaries under this new rule. Generally speaking, a person or entity will be a fiduciary if they or any of their affiliates regularly make investment recommendations as part of their business and if they make a recommendation to a particular client that a reasonable investor would view as personalized and in the client's best interest. This would include recommendations not only to plan participants and IRA owners but also to plans and IRAs themselves. This could even impact call center representatives or other employees who might suggest particular courses of action. This would be a significant departure from and expansion of the five-part test.

A person or entity making a recommendation to a retirement saver for compensation will be a fiduciary under the new rule if:

- They or an affiliate make professional investment recommendations on a regular basis as part of their business;
- The recommendation is based on the client's particular needs or circumstances; and
- The recommendation reflects the application of professional or expert judgment and may be relied upon by the retirement investor as intended to advance the retirement investor's best interest.

Will this new rule have an impact on the treatment of rollover recommendations?

Yes. Prior to the 2016 rule, a firm or financial professional who was not already a fiduciary to a plan could make a recommendation to a plan participant to roll their account balance over to an IRA without becoming a fiduciary to the plan, even if the recommendation also included advice about how to invest those funds after the rollover. The DOL has been trying to reverse this position since 2016 by changing the test for fiduciary status. This new rule expressly treats rollover recommendations as fiduciary advice to a plan, and as a result, providers of rollover advice will become exposed to the risk of private litigation.

What are prohibited transaction exemptions and how does the new rule impact them?

The DOL can issue exemptions from the prohibited transaction rules to allow fiduciaries to engage in otherwise prohibited conduct that would be in the interests of plans, participants, and beneficiaries. Prohibited transaction exemptions (PTEs) typically require compliance with prescribed conditions designed to protect the rights of plan participants and beneficiaries. Over the past 48 years, the DOL has issued numerous PTEs for use by investment advice fiduciaries.

Currently, two primary exemptions, PTE 2020-02 and PTE 84-24, can be used in connection with annuity recommendations. Both of these exemptions have been significantly altered as part of this new rule.

How has PTE 2020-02 changed?

PTE 2020-02 was adopted by the DOL in 2022 to serve as the primary source of exemptive relief for all providers of fiduciary investment advice. To qualify for this relief, a fiduciary was required to do the following:

- ✓ Comply with impartial conduct standards
  - Best interest standard
  - Reasonable compensation standard
  - Prohibition on misleading statements
- ✓ Acknowledge fiduciary status
- ✓ Provide clients with information about services provided and material conflicts of interest

In addition, a broker-dealer, investment adviser, bank, or insurance company must serve as a co-fiduciary for the recommendations for which the PTE is needed.

Key changes to PTE 2020-02

> Near-ban on incentive compensation programs
> Burdensome new disclosure requirements
> Draconian disqualification provisions
> Only PTE for most investment advice fiduciaries

Currently, many firms and financial professionals — but not all — operate under the existing version of PTE 2020-02 in connection with annuity recommendations as well as many other types of transactions.

The new rule makes significant and problematic changes to PTE 2020-02, including a near-ban on almost all forms of incentive compensation programs, burdensome new disclosure requirements, and draconian disqualification provisions that could result in entire enterprises losing eligibility to use the PTE for ten years based on completely unrelated foreign or domestic criminal convictions. The amended version of PTE 2020-02 also replaces the “best interest standard” with explicit care and loyalty obligations that may be incompatible with some compensation structures.

In addition, given that DOL believes all fiduciary investment advice should be provided under PTE 2020-02, the final rule makes such advice ineligible for relief under several other PTEs that have been used widely and without any reported problems for many years. These other PTEs were specifically designed to be used for very particular circumstances, but the DOL has now determined that the need for a so-called “level playing field” outweighs the value of tailoring exemptive relief to the situations in which they are used.

How has PTE 84-24 changed?

This PTE was specifically designed to be used for annuity recommendations. Prior to the adoption of these new rules, relief under this PTE was available as long as certain disclosure requirements were satisfied and the transaction was approved by an independent third party. In practice, this PTE was often used as a preventive measure by insurance producers who did not believe they were fiduciaries but wanted to avoid violating the prohibited transaction rules in case they were later found to have inadvertently triggered fiduciary status.

Key changes to PTE 84-24

- Available only to independent producers
- Cannot be used for variable annuities
- Problematic insurer supervision requirements

As modified, PTE 84-24 will only be available for independent insurance producers recommending fixed and fixed indexed annuities. To qualify for this relief, independent producers will have to satisfy stringent and burdensome conditions similar to those required under PTE 2020-02, including the impartial conduct standards and the problematic changes described above.

The revised version of PTE 84-24 will require that insurers supervise recommendations of their products by independent producers, but unlike PTE 2020-02, insurers will not be required to acknowledge co-fiduciary status. These supervisory requirements are inconsistent with applicable state laws and rules, and will be unworkable for many insurers.

How does the final rule compare to the proposal?

Very few substantive changes were made to the proposal. The DOL has asserted that the final rule provides a more objective test for fiduciary status, but any firm or financial professional operating in compliance with Reg BI and/or the NAIC best interest model will be a fiduciary under the new test.

The final rule purports to provide a carve-out for sales pitches and to allow parties to define the nature of their relationship through disclaimers, but these provisions are not available when the new test has been met.

PTE 84-24 reflects modest improvements as compared to the proposal, but these changes are not sufficient to make the exemption broadly workable in the real world. Most notably, the extremely narrow definition of "insurance sales commission" has been removed, making relief potentially available for more than just commissions.

Comparison to Proposal

Similarities

- Bring nearly all interactions with clients, including rollover advice, under the fiduciary umbrella
- Give retirement savers expanded private right of action
- Prohibition on incentive compensation programs

Differences

- Potentially less restrictions on types of compensation eligible for PTE 84-24
- Moderate improvements to insurer supervision, disclosure, and disqualification provisions
- Slightly longer implementation period

The insurer supervision requirements are also slightly improved. Insurers will be able to make limited use of sampling when conducting retrospective reviews, but they will still have to review every transaction for compliance with the exemption requirements.

The disclosure requirements regarding compensation are also somewhat more manageable, and the draconian disqualification provisions were made slightly less troubling by excluding convictions in countries designated as "foreign adversaries." These changes are also reflected in the final version of PTE 2020-02.

Lastly, the final rules extend the implementation timeline to 150 days for the new test for fiduciary status, the impartial conduct standards, and the fiduciary acknowledgment, with an additional year for the remaining conditions in PTE 84-24 and PTE 2020-02.

How is this allowed after the court struck down the 2016 rule?

While the DOL has gone to great lengths to create the appearance that this new rule is consistent with the ruling in that case, IRI's view is that nothing could be further from the truth. The vast majority of the rule is entirely incompatible with the court's decision. There are also serious questions about whether the DOL even has the authority to do everything contemplated by this rule.

This final rule will likely face one or more legal challenges, and we believe those cases have a high likelihood of success.

Why did the DOL rush through this rulemaking process?

With the 2024 presidential elections rapidly approaching, the DOL was concerned that an extended rulemaking process could expose this effort to possible reversal if Republicans win the White House and/or control of Congress. By finalizing this new rule so far in advance of the election, the DOL has attempted to make it much more difficult to unwind.

What happens next?

As noted above, we do believe the final rule will face one or more legal challenges, although the timing, parties, venue, and strategic approach all remain to be determined. IRI has not yet made a formal decision about whether to participate in any litigation. Our Board of Directors will be presented with all the information they will need to make that decision at the appropriate time. IRI will share information and updates regarding litigation through the appropriate committees and working groups.

In addition, IRI is launching a new program to assist and support members' efforts to determine how they will handle it. While some members will undertake the necessary steps to prepare for implementation and compliance, others may be forced to consider significant changes to their business models to protect their enterprises from the significant risks and burdens created by the new rules. IRI will provide assistance for all members, regardless of their approach.

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