Welcome to the December issue of Investments & Wealth Institute’s Washington Insights. This month’s column reviews the Department of Labor’s (DOL or Department) recently released proposed definition of an ERISA fiduciary advisor and changes to related prohibited transaction exemptions (PTEs) for conflicted advice. Washington Insights also provides a brief wrap-up of other public policy topics of interest to wealth and institutional managers.

DOL ‘Retirement Security Rule’ Package Set for Hearings, Public Comments

On October 31, the DOL released the long-expected definition of an investment advice fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA). Despite the controversial nature of the proposal, the Halloween release date elicited at least one wry observation in a law firm’s legal update: “ERISA Déjà-Boo? New Halloween Fiduciary Proposal May Be a Real Scream.”

The headline wasn’t far off the mark. Opponents already were screaming—or at least raising an alarm—long before the ink was dry on the DOL’s third attempt in the past 13 years to corral thousands of commission-based insurance and securities brokers into fiduciary status. Following release of the agency’s rulemaking schedule last spring, Rep. Virginia Foxx (R-NC), chair of a House committee with ERISA oversight, and her Senate counterpart, Bill Cassidy (R-LA), in a strongly worded August 31 letter urged the Department to “cease further action on this rulemaking.”

The annuity sector is expected to be impacted the most by the DOL proposal. Although the DOL discussed Regulation Best Interest, which governs retail advice by securities brokers, and a beefed-up suitability rule for annuity transactions, the DOL said these rules fell short in extending protection to retirement investors.

Investment advisers also would be subject to some of the new conditions of PTE 2020-02 because the fiduciary standard under the Advisers Act is considered less stringent than the ERISA fiduciary standard.

The DOL’s rule package (officially entitled the “Retirement Security Rule”) comes in four parts:

- The updated (and greatly expanded) definition of a sec. 3(21) investment fiduciary;
- An expanded PTE 2020-02 capturing rollover advice and serving as the central exemption for other conflicted advice to retirement investors;
• A revamped and narrowly focused PTE 84-24 designed as an exemption solely for independent insurance agents; and
• PTEs 75-1, 77-4, 80-83, 83-1, and 86-128—revisions that basically retain an exemption for mutual funds, insurance companies, and brokerage firms executing product transactions but not when providing investment advice.

Changes to the five-part definition of “fiduciary.” The updated definition of an ERISA advice-fiduciary is designed to capture what the Department said in the preamble are changes needed to fill “an important gap in those advice relationships where advice is not currently required to be provided in the retirement investor’s best interest”—in other words, an indirect reference to the advisory activities of commission-based insurance producers and securities brokers.

Digging deeper into the new definition, the proposal essentially eliminates three prongs of the five-part test of fiduciary status from 1975 described below:

Under the current definition, an individual is a fiduciary under ERISA when, for compensation, the advisor:

• Advises on securities or other property;
• On a regular basis;
• Pursuant to a mutual understanding or agreement;
• The advice serves as the primary basis for the investment decision; and
• Is based on the needs of the plan or individual retirement account (IRA).

The streamlined and expanded definition. The three middle prongs of the five-part test basically were eliminated in the proposal and replaced with a facts-and-circumstances test—in which the investment recommendation is provided in one of three contexts below.

For compensation, and based on the particular needs of the retirement investor, the advisor:

• Has discretionary authority or control of the assets;
• Is in the business of making recommendations and in which the retirement investor relies on the advice as a basis for investment decisions made in the investor’s best interest; or
• Making the recommendation represents or acknowledges acting as a fiduciary when making investment recommendations.

Definition of “retirement investor.” The definition of a retirement investor covered by the rule is broad and can be any of the following:

• Plan
• Plan fiduciary
• Plan participant or beneficiary
• IRA fiduciary
• IRA, IRA owner, or beneficiary

Even if the new definition survives the anticipated lawsuits or congressional attempts to block the final rule, it represents a significant challenge to sales-oriented firms that, with the exception of traditional wholesale activity, would require service providers to a plan or an IRA to undertake a careful review of marketing practices, including the use of titles by agents that suggest an advisor-type relationship rather than an arms-length sales transaction.
Use of titles and marketing practices a new test? In fact, while not in the text of the proposed rule, the Department has invited comments regarding advice-providers “that adopt titles such as financial consultant, financial planner, and wealth manager, [and who] are holding themselves out as acting in positions of trust and confidence while simultaneously disclaiming status as an ERIA fiduciary.” However, the DOL offers a small caveat, adding that even if holding out under an advisor-like title “satisfies a portion of the definition, it is not fiduciary investment advice” unless the other prongs of the definition are satisfied, e.g., the person makes recommendations on a regular basis as part of their business.

PTE 2020-02. Given space limitations here, the other part of the DOL package covered in this column is PTE 2020-02—and the additions to it because it has been in effect for more than a year as separate relief for prohibited advice transactions.

For those ERISA advice fiduciaries already relying on PTE 2020-02, the additional disclosures are unlikely to add a significant compliance burden. The DOL said the additions are designed to “ensure that Retirement Investors have sufficient information to make informed decisions about the costs of the investment advice transaction and severity of the investment advice fiduciary’s Conflicts of Interest.”

One key disclosure added to PTE 2020-2 is a written statement describing the Best Interest standard of care.

Another amendment would require additional details on the compensation received by the firm/advisor such as clearly disclosing indirect commission payments.

The Department provides model language that firms can use to satisfy certain disclosure requirements regarding fiduciary acknowledgment, description of the Best Interest standard of care, and material conflicts of interest. This boilerplate doesn’t cover additional descriptions of services because these obviously vary between firms or basic information about the firm and advisor’s conflicts of interest:

*When we make investment recommendations to you regarding your retirement plan account or individual retirement account, we are fiduciaries within the meaning of Title I of the Employee Retirement Income Security Act and/or the Internal Revenue Code, as applicable, which are laws governing retirement accounts. The way we make money creates some conflicts with your interests, so we operate under a special rule that requires us to act in your best interest and not put our interest ahead of yours. Under this special rule’s provisions, we must:*

- Meet a professional standard of care when making investment recommendations (give prudent advice);
- Never put our financial interests ahead of yours when making recommendations (give loyal advice);
- Avoid misleading statements about conflicts of interest, fees, and investments;
- Follow policies and procedures designed to ensure that we give advice that is in your best interest;
- Charge no more than is reasonable for our services; and
- Give you basic information about conflicts of interest.

*You can ask us for more information explaining costs, fees, and compensation, so that you may make an informed judgment about the costs of the transaction and about the*
significance and severity of the Conflicts of Interest. We will provide you with this information at no cost to you.

It appears likely that many firms will adopt the boilerplate in order to avoid inadvertent compliance issues during Department investigations. The other major requirement of PTE 2020-02 that would remain in place is compliance with the Impartial Conduct Standards, i.e., fulfilling duties of loyalty and prudence and charging no more than reasonable fees, acknowledging fiduciary status, producing documentation for the basis of any rollover recommendation, and conducting annual retrospective compliance reviews.

The DOL asserts in the preamble to PTE 2020-02 that firms offering proprietary products or a limited menu of investments, including those that generate third-party compensation to the firm, still can meet the conditions of the exemption through enhanced disclosures and by ultimately determining that these limitations will not cause the firm or advisor “to receive compensation in excess of reasonable compensation.” Firms also must “reasonably conclude, among other factors, that it will not cause the firm or advisor to recommend imprudent investments ...”

No more BICE. Importantly, for those readers familiar with the previous Obama-era fiduciary rule, a controversial PTE known as the Best Interest Contract Exemption (BICE) was omitted from the current package. The BICE, or BIC Exemption, was designed to allow investors to sue for violations of a mandated contract when providing advice on IRA investments. Investors already have a private right of action under ERISA.

The Department received an especially stern legal thrashing from the Fifth Circuit Court of Appeals for exceeding its regulatory authority in including BICE in the 2016 rule. Although federal law allows the DOL to prescribe prohibited transaction relief for both ERISA plans and IRAs, enforcement authority for prohibited transactions involving IRAs comes under the jurisdiction of the U.S. Treasury Department with tax penalties imposed by the Internal Revenue Service (IRS).

Educational guidance. DOL guidance related to general educational advice, i.e., generic presentations to plan participants about investment options in the plan that did not include specific investment recommendations, was retained in the form of Interpretive Bulletin 96-1.

Current rule status. The Retirement Security Rule was published in the Federal Register on November 3, triggering the 60-day comment period that ends January 2, 2024. The Department also announced a two- to three-day series of online hearings in mid-December soliciting public comment in addition to the anticipated thousands of written comments to be filed before January 2.

Future hurdles. Given the propensity of trade groups and other special interest groups to increasingly challenge agency rulemakings in court—and the fact that six lawsuits were filed against the Obama fiduciary rule—most observers expect extensive litigation again next year after the rule officially is approved.

It is not expected that the DOL will make substantive changes to the current proposal, which is designed to avoid the legal roadblocks placed on the agency by the Fifth Circuit when it overturned the Obama rule in 2018.

Depending on when the rule is approved, it also could face congressional opposition in three forms:

1. Three “poison pill” amendments currently are attached to House legislation funding the Department in the 2024 fiscal year. These would bar the use of any funds for implementing
the rule—although the amendments are not expected to survive in the Democratic-controlled Senate.

2. If the rule is approved late in the current (118th) Congress, the Congressional Review Act (CRA) allows the next Congress (119th) in January 2025 to offer a streamlined legislative process. This process requires only a simple majority vote in each chamber to overturn the rule—but within 60 legislative days following agency approval [emphasis added]. The CRA was used by the GOP-controlled Congress in 2016 in an effort to overturn the Obama fiduciary rule, but it was unable to muster the two-thirds majority needed to override President Obama’s veto.

3. If Republicans control the White House and Congress in the 119th Congress, Congress could use the traditional legislative approach to restore the 1975 rule and the other PTEs although this same objective could be met by using the CRA process.

Administrative law challenges. Observers are confident that trade groups are likely to file lawsuits in the Fifth Circuit and perhaps other circuits seeking to overturn the rule package or, as happened previously, to target the most onerous provisions in more narrowly tailored lawsuits. Legal challenges to the 2016 fiduciary rule took nearly two years before the Fifth Circuit issued a controlling decision. AARP and three states attempted to intervene as defendants when the Trump administration chose not to appeal but were unsuccessful. It’s possible a similar or even longer time period would be needed to resolve any future challenge in court.

THE WRAP-UP

Congress

Federal retirement savings option legislation introduced in House, Senate. A bipartisan group of House and Senate members are once again introducing a measure that would establish retirement savings accounts for workers without access to an employer-sponsored plan.

The Retirement Savings for Americans Act (S. 3102), would automatically enroll participants at 3 percent of their income with the possibility of a matching contribution up to 4 percent via a federal tax credit for low- and moderate-income workers. A companion bipartisan bill was introduced in the House.

Neither proposal marks the first time Congress has entertained federally sponsored retirement savings programs. President Barack Obama unveiled an individual retirement account program available to the private sector in his 2014 State of the Union Address, but the proposal went nowhere.

Senator John Hickenlooper (D-CO), one of the Senate sponsors, told Bloomberg Law (subscription-only access) earlier this year, “Nobody’s really looked at this kind of an effort to provide a type of security for all those people that never had it.”

FINRA

U.S. Securities and Exchange Commission (SEC) reviewing FINRA projected returns rule. The Financial Industry Regulatory Authority (FINRA) has proposed amending Rule 2210 that generally prohibits projections of performance or targeted return strategies by brokerage firms or their reps. The proposed
amendments would, according to FINRA’s release, “create a new, narrowly tailored, exception to the general prohibition of projections.”

The rule would allow such projections to be provided to, among others, institutional investors and individual investors with more than $5 million in investments. According to an InvestmentNews article, Better Markets, a consumer-oriented organization, said FINRA is “really opening a can of worms.” Stephen Hall, legal director for Better Markets, said: “Using projections is one of the easiest ways to mislead people. It’s easy for people to think the result is guaranteed.”

Major industry trade groups are expected to support the rule change, which must be reviewed by the SEC in a process that could take eight months or longer.

**ERISA Excessive Fee Litigation**

**Class-action settlements in 2023 double; new complaints drop by half.** Class-action settlements involving excessive fee complaints in 401(k)-type plans have more than doubled this year through the end of November compared to the same period in 2022 (see figure 1). At the same time the number of new complaints in the pipeline has slowed by more than half, according to data compiled by Potomac Strategies, a consulting firm.

Monetary settlements pending or approved this year averaged $9.29 million, ranging from $200,000 to $61 million—and nearly double the average settlement amount of $4.8 million in 2022. The smallest monetary settlement in 2022 was $30,000 and the largest was $32.5 million. The majority of settlements were with so-called “jumbo plans”—those with more than $1 billion in assets.

Although the majority of 401(k)-type complaints typically survive the initial motion to dismiss, few go to trial. Most of the excessive fee lawsuits take several years to reach the settlement stage. The 2022 filings—which reached a near-record 85 complaints—could see another large wave of settlements starting in mid-2024 and into 2025.

**FIGURE 1: ERISA CLASS-ACTION ACTIVITY, 2022–2023 YTD**

Source: Potomac Strategies LLC

* Filings through November 29 for each year.
Excessive fee claims usually involve allegations of expensive recordkeeping fees, but also may include excessive investment fees and allegations of losses from imprudent, underperforming investment options in the plan.

IRS

New retirement plan and Social Security limits for 2024. The IRS announced November 1 the updated annual benefits and contribution limits on qualified plans for 2024. The limitation on the annual benefit under a defined benefit plan under section 415(b)(1)(A) of the Code is increased from $265,000 to $275,000. The elective deferral limit for 401(k)-type plans has increased $500 to $23,000 in 2024. A handy chart summarizing the annual changes can be found here. Social Security Administration cost-of-living adjustments for 2024 were announced on October 12, including a change in the taxable wage base.

Research

Vanguard: Retirement readiness outlook mixed across generations. An October 3 report by Vanguard, based on a sustainable 90-percent replacement rate of income throughout retirement, finds among late baby boomers (ages 61–65) that high-income workers are on track to meet spending needs in retirement while low- and middle-income workers are “off track.”

Vanguard found that across all three generations studied including mid-Generation Xers (ages 49–53), and early millennials (ages 37–41), the retirement outlook is “particularly challenging for lower-income workers.” Workers at the 25th percentile faced a projected retirement savings gap of 32 percent compared to high-income families with a savings surplus of 20 percent.

Inflation is top concern for workers across Fidelity’s retirement platform in Q3. Unsurprisingly, inflation continues to be a major concern among workers saving for retirement, according to Fidelity, the largest recordkeeper in the country. Seventy-four percent of respondents to a survey said inflation is causing them stress. Despite those concerns, Fidelity reports that workers and their employers continued to make steady contributions to participant accounts consistent with Q2 this year. The bad news is that while contributions remain consistent, individual account holders have been “tapping their retirement savings via hardship withdrawals or loans at an increasing rate,” according to the report.

Americans say money can buy happiness. The price? $1.2 million. New research by Empower, a Greenwood Village, Colorado-based recordkeeper, reports that six in 10 Americans believe money can buy happiness, with 17 percent of respondents holding a slightly different view, saying financial contentment is about reaching a certain net worth target.

Seventy-three percent of Americans find well-being is rooted “in a sense of security of a financial plan,” while those “with a more detailed financial plan are about three times as likely to report greater happiness in money matters,” according to the survey.
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