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The Retirement Security Rule: Only Fiduciaries Need Apply

A new proposed rule seeks to expand the definition of a fiduciary in the context of an investment advisor. Here's what financial planners need to know.

In November 2023, the United States Department of Labor (DOL) issued a new set of pronouncements on the role of an investment advisor when working with a “retirement investor,” which would include an Employee Retirement Income Security Act of 1974 (ERISA) plan participant or an owner of an individual retirement account (IRA), health savings account, medical savings account, or educational savings account covered under Internal Revenue Code (IRC) Section 4975, including their beneficiaries and fiduciaries. One of these directives is in the form of a proposed regulation, known as the Retirement Security Rule.

The proposed rule meaningfully expands the definition of a fiduciary in the context of an investment advisor. Additionally, the proposed rule removes several exemptions from prohibited transaction status, which advisors might otherwise rely on to collect fees from retirement accounts.

Having already passed a period for written comments and public hearings, the proposed rule is currently making its way through the federal rulemaking process and is expected to take effect in summer 2024.

THE NUTS AND BOLTS OF THE RULE

Under the proposed rule, a greater number of activities performed by advisors will be considered fiduciary investment advice.

In summarizing the DOL's proposal, an advisor would be considered an investment advice fiduciary if they (1) provide investment advice or make an investment recommendation to a retirement investor; (2) the advice or recommendation is provided for a fee or other compensation, direct or indirectly; and (3) the advice or recommendation is made within one of the following contexts:

- The advisor either directly or indirectly has discretionary authority or control—whether pursuant to an agreement, arrangement, or understanding—with respect to purchasing or selling securities or other investment property for the retirement investor.
- The advisor either directly or indirectly makes investment recommendations to investors on a regular basis as part of their business, and the recommendations are provided under circumstances indicating that the recommendations are based on the particular

needs or individual circumstances of the retirement investor and may be relied upon for making investment decisions that are in the retirement investor's best interest.

- The advisor making the recommendation represents or acknowledges that they're acting as a fiduciary when making investment recommendations.

Notably, there are three types of recommendations advisors should be cautious of making if they don't intend to act as a fiduciary:

1. Advice on the purchase, sale or holding of investment securities, or investment strategy related to said securities.
2. Advice on the management of a securities portfolio, including portfolio composition, and utilizing managers and submanagers. Most forms of "consultative selling," often done to persuade a consumer to engage the investment advisor, appear to meet this definition.
3. Advice on the decision to roll over an account balance to an IRA.

Fees and other compensation should also be carefully considered, as these could include an explicit fee or compensation (to the advisor or any affiliate) for the advice and any fee or compensation (to the advisor or any affiliate) that wouldn't have been paid except for the recommended transaction or the provision of advice. Other forms of compensation may include commissions, loads, finder's fees, revenue sharing payments, shareholder servicing fees, marketing or distribution fees, markups or markdowns, underwriting compensation, payments to brokerage firms in return for shelf space, recruitment compensation paid in connection with transfers of accounts to a registered representative's new broker-dealer firm, expense reimbursements, gifts, gratuities, or other non-cash compensation.

PROHIBITED TRANSACTION EXEMPTIONS

Both the ERISA and IRC deem the collection of compensation for investment advisor fiduciaries from retirement accounts as a prohibited transaction unless the advisor meets a statutory exemption. In 2020, ERISA issued PTE 2020-02, a prohibited transaction exemption that identified activities that advisors must undertake when providing advice on IRA rollovers from qualified plans or other IRAs to collect compensation from clients. The rule would amend several other exemptions issued as far back as the 1970s. Of course, this means fiduciary investment advisors could only rely on the provisions of PTE 2020-02 to claim exemption from prohibited transaction status.

LEGISLATIVE EFFORTS, GOALS

The proposed Retirement Security Rule represents the DOL's latest effort in expanding the definition of a fiduciary to cover any financial services professional who advises consumers on their investments. Notably, we've been down this road before. The current investment advice fiduciary definition has been around since 1975, despite efforts to make changes on the matter. For example, in 2010, the DOL issued a proposal to broaden the definition and released final regulations in 2016. However, due to legal challenges that were ultimately upheld in 2018 with the U.S. Court of Appeals, advisors were no longer mandated to follow the practices contemplated by the 2016 regulations.

In my opinion, it's quite ironic that opponents of the rule tend to be the largest brokerage firms. Had brokerage firms refrained from

marketing all of their brokers as "financial advisors" or "investment advisors" and instead plainly referred to them as brokers when soliciting and/or serving customers, there would be less confusion over the limitations of the liability of their brokers. In other words, customers likely wouldn't infer any sort of fiduciary duty in the relationship. In essence, these firms and their brokers have become regulatory targets largely because of their success in marketing themselves to consumers as trusted advisors.

Ultimately, the proposed Retirement Security Rule increases the likelihood that any professional who provides advice on retirement account investments will be deemed a fiduciary. The bottom line? If you're unwilling to operate your practice or provide a service related to retirement account investing as a fiduciary, you may be better off leaving that kind of work—and those fees—to another advisor. ☹

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