What next for rollover regulation?

By Kerry Pechter *Mon, Nov 25, 2024*

The Trump election is bound to have some obvious, fundamental and high-profile consequences for various federal agencies. One particular potential area of impact relates to the recently adopted Retirement Security Rule under ERISA (i.e., the Employee Retirement Income Security Act of 1974). In this regard, some in the market have been wondering if and when... Read more »

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In this regard, some in the market have been wondering if and when financial institutions will move to dismantle ERISA-related compliance efforts regarding rollover solicitations in response to years of ebbing and flowing regulatory activity that has been undertaken by the U.S. Department of Labor (often referred to as the "DOL") with respect to the definition of "investment advice" under ERISA's fiduciary rules.

The 1975 rule

To understand where we might now be in this saga, it's important to know how we got here. One place to start is shortly after ERISA's enactment in 1974.

ERISA was enacted against a backdrop of significant concerns about the integrity of the private-sector retirement system, together with a desire for national uniformity in the area. The regulatory balances that have been struck over the years in pursuit of these goals have sometimes overshot the mark and have sometimes undershot the mark.

In 1975, the DOL promulgated a seminal regulation that contained a five-part test under which the provision of non-discretionary advice would rise to the level of "investment advice" such that the provider would be a fiduciary under ERISA. The test struck a balance between bringing advisors under ERISA's fiduciary tent, on the one hand, and leaving advisors outside the tent, on the other.

Arguably, the regulation could have been motivated, at least in part, by a concern that overinclusiveness could have caused any number of desirable providers not to want to service ERISA plans, or to provide those services at increased costs.

Over the years, however, the DOL may have become frustrated that fiduciary status under the five-part test was too easy to avoid, particularly given the migration of American retirement policy from being centered on defined benefit plans to being centered on defined contributions plans.

Eventually, back in 2010, the DOL made its first real attempt to revamp the 1975 rule. The controversy was so intense that the DOL withdrew that proposal. It started to look as if the tale of the DOL's attempt to modernize the 1975 rule would be an extremely short story.

The 2016 rule

Fast forward to 2015. President Obama, in a speech to the AARP, focused on the question of what a fiduciary is when providing non-discretionary investment advice. An ERISA practitioner could well have taken some self-satisfaction in observing that the President of the United States himself had specifically addressed an ERISA defined term in a major policy speech.

A key aspect of the rulemaking that would follow was an attempted comprehensive modification of the 1975 rule to reflect the movement of American retirement policy from traditional defined benefit pension plans to participant-directed "401(k)" and other individual-account defined contribution plans.

But the effort to revise the 1975 rule went through controversial fits and starts, resulting in the withdrawal of a 2010 proposal together with a re-proposal in 2015 and then a finalized amended fiduciary rule in 2016. This initiative was a key one for the Obama administration.

One aspect of the stunningly expansive 2016 rule involved a recasting of the rule to reach solicitations by a financial professional to plan participants of rollovers of their retirement plan assets to IRAs managed or otherwise sponsored by the professional's financial institution.

There are clear indications that the DOL has significant concerns about these solicitations in light of the financial incentives surrounding rollovers and the possibility that as a result professionals might not be sufficiently attentive to the best interests of plan participants.

In crafting the amended rule, the DOL rejected prior authority under the 1975 rule (often referred to as the "Deseret letter") under which rollover solicitations generally would not be viewed as being fiduciary in nature. The DOL had concluded that the text of the rule itself had to be changed in order to reach rollover solicitations.

A feature of the DOL's rulemaking was the issuance of related amended and new prohibited transaction class exemptions (often referred to as "PTCEs"). The approach could be characterized as one under which the DOL brought numerous providers newly under ERISA's fiduciary tent, only to allow them out of the tent if they satisfied the new, unprecedented and quite extensive conditions of one of the exemptions.

In *Chamber of Commerce of the United States of America v. U.S. Department of Labor*, 885 F.3d 360 (2018), the U.S. Court of Appeals for the Fifth Circuit, following the lead of a Texas District Court, vacated the 2016 rule as an arbitrary and capricious overreach by the DOL.

One of the focuses of *Chamber of Commerce* was on the concept that the 2016 rule reached not only intuitively fiduciary relationships, but also extended to relationships that did not have the fiduciary-type characteristic of trust and confidence between the provider and the consumer. Among the casualties of *Chamber of Commerce* were the amended and new exemptions that were issued along with the 2016 rule.

In particular, the so-called "best interest contract" (or "BIC") exemption was also vacated. The BIC exemption would have allowed a broad range of compensation arrangements for those who would be "investment advice" fiduciaries under the broadened 2016 amended fiduciary rule if, among other things, the institution satisfied certain "impartial conduct standards." (While there were other new and amended exemptions, for the sake of convenience the applicable references herein will be only to the BIC exemption.)

The elimination of the BIC exemption had a somewhat perverse effect. The exemption was a positive thing for institutions that might be fiduciaries notwithstanding the vacating of the amended fiduciary rule. For example, maybe an institution believed that the DOL might pursue more aggressive interpretations of the 1975 rule; maybe institutions were concerned they've always been fiduciaries; maybe institutions affirmatively wanted to assert fiduciary status as a differentiator in an effort to get a market advantage over other providers.

Regardless of the reasons that an institution may have wanted to utilize the BIC exemption, the lack of an exemption like the BIC exemption could have caused providers to seek to avoid fiduciary status, a result the DOL would presumably not want.

Thus, in 2018, in the wake of *Chamber of Commerce*, the DOL issued Field Assistance

Bulletin 2018-02 (May 7, 2018), which stated that, pending final regulatory action, the DOL at a transitional matter would not pursue prohibited transaction claims against "investment advice" fiduciaries if they were working "diligently and in good faith" to comply with the BIC exemption's impartial conduct standards.

Reinterpretation of the 1975 rule

Eventually, in 2020, the DOL proposed a replacement for the BIC exemption, which was finalized later in the same year as PTCE 2020-02. While the exemption was proposed and finalized ostensibly to help those who might be "investment advice" fiduciaries, the preambles to the proposed and final exemptions set forth a major reinterpretation of the 1975 rule that (depending on the facts) could cause a range of otherwise non-fiduciary rollover solicitations essentially to be viewed as fiduciary advice under ERISA, thus subjecting a whole new class of solicitations and providers to ERISA's fiduciary rules.

The basis of this reinterpretation was arguably suspect. While in 2016 the DOL indicated the need to change the 1975 rule in order to change the result in the Deseret letter, now faced with a return to the 1975 rule by virtue of *Chamber of Commerce*, the DOL reinterpreted the 1975 rule contrary to its prior interpretation in the Deseret letter and went so far as to withdraw the Deseret letter.

Interestingly, the DOL's reinterpretation occurred under the Trump administration – the very same administration that allowed *Chamber of Commerce* to stand without appeal. The reinterpretation was not surprisingly embraced and even broadened by the Biden administration; and the preamble's reinterpretation was later set forth in a DOL Frequently Asked Question (or "FAQ").

The courts were hostile to the DOL's reinterpretation, first in a still-ongoing TIAA case not involving the DOL (*Carfora v. Teachers Insurance Annuity Association of America*, 631 F. Supp. 3d 125 (S.D.N.Y. 2022)), and then in other cases, notably *American Securities Association v. U.S. Department of Labor*, No. 8:22-cv-330-VMC-CPT (M.D. Fla. Feb. 13, 2023), which did involve the DOL.

ASA invalidated the DOL's FAQ; the DOL, after first indicating its desire to appeal, later abandoned its appeal and let *ASA* stand. Some viewed this abandonment of the appeal as an indication that the DOL might prefer to focus on making another actual amendment to the 1975 rule, rather than trying to pursue its agenda through sub-regulatory advice that would repeatedly come before hostile courts.

The Retirement Security Rule

And so DOL did amend the 1975 rule. Again to significant controversy, the DOL in 2023 proposed to amend the 1975 rule, and, in 2024, an amended rule, now christened the Retirement Security Rule, was finalized. While on the whole the effort was less ambitious than the 2016 rule, the Retirement Security Rule continued to be expansive in some ways, for example, regarding the expansion of the general application of the impartial conduct standards to the insurance industry.

The 2024 attempt to revise the 1975 rule was once again broad, even if not as broad as the extremely comprehensive effort made in 2016. At a minimum, the Retirement Security Rule was by no means a laser-shot aimed only at rollover solicitations. Arguably, though, addressing rollover solicitations in a way that brought them within the ambit of ERISA remained at the forefront of the DOL's efforts.

Not surprisingly, litigation ensued and yet again did not go well for the DOL. Back in the State (Country?) of Texas, one District Court (in *Federation of Americans for Consumer Choice Inc. v. U.S. Department of Labor*, No. 6:24-cv-163-JDK (E.D. Tex. July 25, 2024)) invalidated certain aspects of the 2024 rulemaking, and a second (in *American Council of Life Insurers v. U.S. Department of Labor,* No. 4:24-cv-00482-O (N.D. Tex. July 26, 2024)) finished the job with broader invalidation.

Now in 2024, in a striking replay of the 2020 situation, there is (i) a new version of the fiduciary rule, (ii) judicial invalidation of the amended rule, (iii) an impending change in administrations, including of the party in power (with the same individual, President-elect Trump, to lead the charge) and (iv) a decision that will have to be made about whether (A) to continue the appeal of the judicial decision-making that threatens the efficacy of the amended rule or (B) to allow the amended rule to die on the vine. It really does bring to mind the Yogi-ism of Déjà Vu All Over Again (although my own personal favorite is, in reference to some particular restaurant: "No one ever goes there anymore, it's too crowded.").

Neither a re-interpreter nor an amend-er be? (apologies to Mr. Shakespeare)

What are some of the dynamics surrounding the current state of play? We have a confluence of the judicial (but not final) rejection of the DOL's reinterpretation of the 1975 rule, the judicial rejection of the Retirement Security Rule, and the re-ascension of former President (and now President-elect) Trump to the presidency.

This confluence of events could have important practical ramifications for the financial services industry. To use election-type vernacular, what now is the path to survival of the DOL's efforts to regulate rollover solicitations as ERISA fiduciary advice?

So, with all that said, if in fact the second Trump DOL withdraws the DOL's appeal of the Texas cases, it may well be worth asking the question: is it now time to consider dismantling any machines that have been built to effectuate PTCE 2020-02 compliance for rollover solicitations?

It wouldn't be the first time in the world of ERISA that extensive compliance efforts were completely scuttled by the evolution of the underlying legal rules. For example, back in the late 1980s, an entire treatise was written about compliance by welfare plans with a new Section 89 of the federal tax code, and then – poof – no more Section 89 and no more need to comply therewith.

At the time of various of the setbacks experienced by the DOL over the course of this long and winding road, one could imagine (i) any given institution that has already ramped its rollover-related compliance efforts around PTCE 2020-02 asking whether the time has come to consider dismantling those efforts and (ii) any given institution that has not yet ramped up its compliance efforts (e.g., an insurance company) asking whether, given the uncertainty about the validity of the DOL's regulatory efforts, it is time to start preparing to ramp up compliance efforts, just in case the rule changes survive.

Until the election, however, one could further imagine that (i) it might have been premature to start dismantling existing compliance procedures, for fear that the DOL's rulemaking would ultimately be left in place, and (ii) for institutions that have not yet built out their compliance procedures, it might have been premature to expend the resources to construct compliance procedures, given all the surrounding uncertainty.

Paths forward

Now, though, after the elections, let's surmise for the moment that the incoming Trump administration once again, as was the case in 2020, does not appeal the pending rejection of the DOL's amended regulation by the Texas courts and lets the amended regulation die on the vine.

At that point, to use election vernacular, it may well become hard to see a continuing path forward for the initiative broadly to regulate rollover solicitations under ERISA. To wit, one would have (i) the 1975 rule in place, by hypothesis, (ii) no effective reinterpretation of the

1975 rule that would cause rollover solicitations to be subject to it, and (iii) presumably, no other obvious remnants in place of the DOL's rollover-related initiative.

There is, however, still some room for caution. Even assuming that the pending Texas cases are not appealed, the final chapter will not necessarily have been written. For example:

- One possible path is that the DOL indeed goes back to the well yet again, notwithstanding failure to get over the goal line in 2010, 2016 and 2024; maybe with a far more laser-shot effort to nuance the 1975 rule so as to reach rollover solicitations but without additional expansion of the underlying reach of the 1975 rule.
- It should be emphasized that the Supreme Court has not yet spoken on the matter, so the DOL's efforts have not definitively failed from an analytical perspective as a matter of law. In considering whether to be concerned that the DOL might continue to try to revise ERISA's fiduciary rules, however, one might consider that we're arguably entering a different legal, practical and political world. For example,
- There's the rejection by *Loper Bright Enterprises v. Raimondo,*144 S. Ct. 2244 (2024), of the deference to administrative rulemaking previously established by *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U. S. 837 (1984), presenting yet another potential impediment to the effectuation of anything the DOL might want to do.
- The DOL would need to be willing to go back to the well after what might be considered Strike Three (or Four or Five).
- With the resounding nature of the recent Trump victory, is this the fight that a later Democratic administration would really want to pick, even assuming some kind of political reversal in 2028 or thereafter?

When all is said and done, if and when it becomes clear that the DOL will neither continue to pursue reinterpretation of the 1975 rule nor appeal the elimination of the Retirement Security Rule, the time may at some point arrive for financial institutions to start considering the dismantling of efforts to shoehorn rollover solicitations into the construct of PTCE 2020-02.

However, a financial institution might not necessarily dismantle its compliance procedures just because it can. For example, a provider might, as indicated above, affirmatively use a fiduciary approach as a differentiator to others in the market, or could take such a fiduciary approach in order to harmonize its approaches under multiple sets of regulatory requirements (for example, the Securities and Exchange Commission's Regulation Best Interest, state-law fiduciary-type rules, etc.), or may otherwise view a "best interest" approach as the right approach whether or not it is legally required. Thus, the mere possibility that ERISA compliance may soon become unnecessary, even if that eventuality in fact comes to pass, would not necessarily be the final chapter in this NeverEnding Story.

Conclusion

Could this NeverEnding Story possibly be coming to an end? For the first time in a long time, it's not impossible. We may be closer than ever to a final answer regarding the fate of efforts to revise ERISA's fiduciary rules.

If all of the efforts to amend the rule are scuttled, along with efforts by the DOL to reinterpret the existing 1975 rule, we may in effect be back to the status quo ante of the Deseret letter. And maybe, just maybe, it will be time for financial institutions to consider whether to dismantle the compliance procedures they have constructed, if they have not done so already. We at The Wagner Law Group will be watching for continued developments, and stand ready to advise regarding the matters discussed in this Client Alert or any other matters arising under the fiduciary provisions of ERISA.