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District Court Vacates Department of Labor's Plan-to-IRA Rollover Guidance; Other Challenges to Agency's Rulemaking under ERISA Loom

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On February 13, 2023, a judge from the U.S. District Court for the Middle District of Florida struck down the U.S. Department of Labor's (DOL) most recent guidance on when rollover advice is viewed as fiduciary under ERISA. The guidance at issue is part of the DOL's 2021 FAQs that interpreted its Prohibited Transaction Exemption 2020-02 (PTE 2020-02) on how financial institutions and investment professionals who provide fiduciary investment advice to ERISA plan participants can receive otherwise prohibited compensation. (See our Alert describing PTE 2020-02 here and our subsequent Alert addressing the 2021 guidance here). In *American Securities Association v. U.S. Department of Labor*, 22-cv-00330-VMC (*ASA*), the court found the DOL's interpretation of when rollover recommendations can satisfy the "regular basis" prong of the five-part test set forth in the existing fiduciary regulation (the 1975 Regulation), was an arbitrary and capricious interpretation of the 1975 Regulation, which violates the Administrative Procedure Act (APA). Importantly, the judge did not vacate PTE 2020-02 or any other policies the DOL articulated in its preamble to PTE 2020-02 as well as in its 2021 guidance regarding being an investment advice fiduciary under ERISA. **Given the continued application of PTE 2020-02 and the likelihood that the DOL will appeal this decision and/or revise its guidance to treat rollover advice as fiduciary, we recommend that institutions and advisors continue to comply with PTE 2020-02 in connection with rollovers at this time.**

The *ASA* decision represents the latest setback for an agency that is facing multiple challenges to its recent guidance interpreting ERISA's statutory requirements as well as efforts to weaken its ability to assert its regulatory authority, including:

- **PTE 2020-02's Preamble Discussion of the Five-Part Test** – In *Federation of Americans for Consumer Choice Inc. et al. v. United States Department of Labor et al.* (3:22-cv-00243, N.D. Tex.), a group of annuity providers filed a lawsuit in 2022 challenging the DOL's reinterpretation of its five-part test for determining whether a person is an advice fiduciary under ERISA, which the DOL stated in the preamble to PTE 2020-02. The plaintiffs asked the court to vacate the new interpretation of the law, saying the rule allows the DOL to rewrite and expand the definition of a fiduciary in the same way the Fifth Circuit had ruled against in 2018 with respect to the prior fiduciary rule. Briefing in the case is ongoing, and in their most recent filing on February 17, 2023, the plaintiffs cite *ASA* as supplemental authority in connection with its motion for summary judgment.

- **CAR 2022-01: 401(k) Plan Investments in Cryptocurrencies** – In *ForUsAll Inc. v. U.S. Department of Labor et al.* 1:22-cv-01551, D.D.C., a retirement plan service provider that was the first company to announce that it would make cryptocurrency available to 401(k) plan participants through a self-directed window, sued the DOL in June 2022, claiming that the agency's cryptocurrency guidance set forth in a sub-regulatory guidance document (Compliance Assistance Release 2022-01) amounted to an arbitrary and capricious attempt to restrict the use of cryptocurrency in 401(k) and other defined contribution retirement plans, in excess of its authority under ERISA and without following the notice and comment process required under the APA. The DOL moved to dismiss the lawsuit on the basis that it represented to the court that CAR 2022-01 is not binding, would not be the basis of any enforcement action, does not prohibit investments in cryptocurrency, does not impose a heightened standard of care, and does not require plans to monitor investments in brokerage windows. In its last brief filed in November, ForUsAll asked the court to bind the DOL to its own representations regarding CAR 2022-01.

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- **2022 Investment Duties Rule**
  - **State AG Lawsuit** – As discussed in our previous Alert (see here), in *Utah v. Walsh*, 23-cv-00016 (N.D. Tex. Jan. 26, 2023), attorneys general from 25 states filed a lawsuit in the Northern District of Texas last month, attempting to prevent the DOL's 2022 final rule that addresses fiduciary duties for ERISA retirement plans with respect to investment selection and consideration of ESG factors as well as exercises of shareholder rights from taking effect, asserting that the rule undermines key protections for retirement plan participants, oversteps the DOL's authority under ERISA and is arbitrary and capricious in violation of the APA.
  - **Congressional Efforts to Repeal 2022 Investment Duties Regulation** – There is a Congressional Review Act resolution (S.J. Res. 8) to nullify the 2022 rule currently under consideration, which has the support of every Republican Senator (49), along with Sen. Manchin (D-WV). News reports indicate that Sens. King (I-ME) and Tester (D-MT) haven't decided on how they will vote and are still weighing their options. Rep. Barr (R-KY) has introduced companion legislation (H.J. Res. 30) in the House. Assuming the resolution passes both the House and Senate, it will likely be vetoed by President Biden.
  - **Second Lawsuit Seeking to Enjoin 2022 Rule** – Most recently, in *Braun et al v. Walsh*, 2:23-cv-00234 (E.D. Wis. Feb 21, 2023), two individual plaintiffs filed a lawsuit claiming that the 2022 investment duties rule violates ERISA and exceeds the authority granted to the Secretary of Labor, and therefore, a preliminary and permanent injunction enjoining the rule should be granted. Among other things, the complaint claims that the rule fundamentally alters the focus on investment returns for plan participants and beneficiaries by "injecting consideration of ESG factors—but without requiring that fiduciaries quantify the benefits of any such factors, or even document the reasoning behind their consideration."

ASA: Case Background

In *ASA*, a trade association comprising regional financial services firms, sued the DOL in 2022, asserting that two of the questions in the agency's 2021 guidance—FAQ #7 and FAQ #15[1]—were unlawful and should be vacated, and that the DOL should be enjoined from implementing or enforcing them in any manner.

FAQ #7 addresses how advice to roll over assets from an employee benefit plan to an IRA could be considered to occur on a "regular basis" for purposes of the 1975 Regulation's five-part test for defining an investment advice fiduciary.[2] The FAQ acknowledges that a single, discrete instance of advice to roll over assets would not meet the regular basis prong of the 1975 test, but it also takes the view that advice to roll over plan assets can be provided 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. FAQ #15 fleshes out PTE 2020-02's express requirement for enhanced documentation of the specific reasons why a recommendation to roll over assets from an ERISA plan to an IRA is in "the Best Interest of the Retirement Investor" (as such terms are defined in PTE 2020-02). FAQ #15 identifies relevant factors that financial institutions and investment professionals must consider and document as part of this prudent analysis.

According to the plaintiffs, in FAQ #7, the DOL "rewrote its regulations concerning when a financial professional serves as a fiduciary under ERISA and the Internal Revenue Code" by stating that the first instance of advice to roll over assets from a retirement plan to an IRA can be a fiduciary act despite the 1975 Regulation providing that a person is not a fiduciary unless he provides advice "on a regular basis to the plan." In FAQ 15, the plaintiffs asserted that the DOL "imposes a host of burdensome documentation and investigation requirements on financial institutions when making rollover recommendations, despite the fact that the exemption the DOL promulgated contains no such requirements." On May 20, 2022, ASA filed a motion for summary judgment, and the DOL responded on June 30, 2022, and filed a motion to dismiss, or, in the alternative, for summary judgment.

Court Findings

The key question for the court was whether FAQ #7's interpretation of the future provision of advice pertaining to an IRA as rendering investment advice to an employee benefit plan constituted a reasonable interpretation under ERISA and the 1975 Regulation. The court's analysis was guided by the principles set forth in *Carfora v. Teachers Insurance Annuity Association of America*, --- F. Supp. 3d ---, 2022 WL 4538213 (S.D.N.Y. Sept. 27, 2022), which noted how the phrase "regular basis" in the 1975 Regulation is "understood in the context of the plan's investment decisions." As *Carfora* explained, an ERISA fiduciary is a fiduciary of a plan, and the regular basis inquiry ought to focus on "only the timeframe when the assets in question were plan assets." Before a rollover occurs, a professional who gives rollover advice does so with respect to an ERISA plan, but after the rollover, any future advice will be with respect to a new non-ERISA plan, such as an IRA that contains the rollover assets. As a result, the court concluded here that "[w]hile an offer to provide future advice may, as the DOL suggests, be the beginning of a relationship, that relationship is inherently divorced from the ERISA-governed plan" because the future advice occurs at a time when the assets are no longer plan assets. Since the court found that the policy referenced in FAQ #7 abandoned this plan-specific focus in the context of rollovers, it determined that it conflicts with the 1975 Regulation and is an arbitrary and capricious interpretation in violation of the APA.

With respect to FAQ #15, the court's inquiry focused on whether the policy set forth in the question was unreasonable and inconsistent with a plain reading of PTE 2020-02. According to the plaintiff, PTE 2020-02 provides that financial institutions need only document the specific reasons that any recommendation to roll over assets is in the "Best Interest of the Retirement Investor," and while a financial institution could document the items required in FAQ #15, nothing in PTE 2020-02 requires it to do so. After engaging in a close, textual analysis, the court concluded that the policy articulated in FAQ #15 was not at odds with PTE 2020-02, and nothing in that frequently asked question contradicted PTE 2020-02's requirement to make a record of the reasons why a rollover recommendation is in a retirement investor's best interest. The court ruled that the policy referenced in FAQ #15 neither contradicts PTE 2020-02 nor goes beyond it, and therefore, it is not arbitrary and capricious.

Implications

It is not clear how or when the issue of identifying fiduciary or non-fiduciary rollover recommendations will be resolved. Despite the district court's holding, as of the date of this publication, FAQ #7 still appears in its entirety in the 2021 guidance document posted on the DOL's website (see here). At this time, it is unclear what impact (if any) this decision will have on financial institutions and advisors for the following reasons:

1. The DOL has 60 days to file an appeal of the order, and it is expected to do so. There is no way to predict whether the circuit court would find for the DOL or plaintiffs on appeal.

2. It is widely expected that the DOL will re-propose amendments to the 1975 Regulation's definition of "fiduciary" at some point this year, and while that rule will likely cover multiple topics, it could allow the DOL to make rollover recommendations fiduciary advice without regard to this decision or any future circuit court decision.

3. Many investment firms have already committed significant time and resources to revamping their processes and procedures to comply with PTE 2020-02 and the 2021 guidance, including, with respect to rollover recommendations, and it is not clear whether these firms would move to change practices while this high level of uncertainty persists.

If you would like to discuss the details and implications of the *ASA* decision, please contact any of the below Ropes & Gray attorneys.

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1. The text of FAQs #7 and #15 from the DOL's 2021 guidance on PTE 2020-02 are copied below:

   Q7. When is advice to roll over assets from an employee benefit plan to an IRA considered to be a on a "regular basis"?

   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.

   Q15. 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?

   Financial institutions and investment professionals must consider and document their prudent analysis of why a rollover recommendation is in a retirement investor's best interest. For recommendations to roll over assets from an employee benefit plan to an IRA, the relevant factors include but are not limited to:

   - the alternatives to a rollover, including leaving the money in the investor's employer's plan, if permitted;
   - the fees and expenses associated with both the plan and the IRA;
   - whether the employer pays for some or all of the plan's administrative expenses; and
   - the different levels of services and investments available under the plan and the IRA.

   When considering the alternatives to a rollover, the financial institution and investment professional generally should not focus solely on the retirement investor's existing investment allocation, without any consideration of other investment options in the plan. For rollovers from another IRA or from a commission-based account to a fee-based arrangement, a prudent recommendation would include consideration and documentation of the services under the new arrangement. As relevant, the analysis should include consideration of factors such as the long-term impact of any increased costs; why the rollover is appropriate notwithstanding any additional costs; and the impact of economically significant investment features such as surrender schedules and index annuity cap and participation rates.

   To satisfy the documentation requirement for rollovers from an employee benefit plan to an IRA, investment professionals and financial institutions should make diligent and prudent efforts to obtain information about the existing employee benefit plan and the participant's interests in it. In general, such information should be readily available as a result of Department regulations mandating disclosure of plan-related information to the plan's participants (see 29 CFR 2550.404a-5). If the retirement investor won't provide the information, even after a full explanation of its significance, and the information is not otherwise readily available, the financial institution and investment professional should make a reasonable estimation of expenses, asset values, risk, and returns based on publicly available information. The financial institution and investment professional should document and explain the assumptions used and their limitations. In such cases, the financial institution and investment professional could rely on alternative data sources, such as the most recent Form 5500 or reliable benchmarks on typical fees and expenses for the type and size of plan at issue.

2. Under the five-part test, for advice to constitute "investment advice," a financial institution or investment professional who is not a fiduciary under another provision of ERISA must (1) render advice to the plan 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.

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