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DOL Releases Highly Anticipated "Fiduciary Rule" Proposal

On October 31, 2023, the Department of Labor ("DOL") published its long-awaited proposal to amend a 1970s regulation to broaden who is considered an ERISA fiduciary by reason of providing investment advice for a fee. In many ways, the proposal is very similar to a 2016 regulation from DOL that was struck down by a court.

Background

ERISA provides that a person is a fiduciary with respect to a plan if, among other things, they render investment advice with respect to "plan assets" for a fee or other compensation. A 1975 DOL Interpretive Bulletin created a five-part test that must be satisfied in order for a person to be treated as a fiduciary by reason of providing investment advice. Under that test, a person is a fiduciary only if they meet a set of criteria, including that they render investment advice on a regular basis.

In 2016, DOL released a rule amending the 1975 regulation in a way that significantly broadened who is considered a fiduciary under ERISA – the so-called "fiduciary rule." Under the 2016 fiduciary rule, fiduciaries included advisers who made recommendations to roll over assets from a retirement plan to an IRA, and an adviser could be considered a fiduciary even on a first-time interaction with a plan participant.

Following a flurry of lawsuits contesting this expanded definition, the Fifth Circuit Court of Appeals struck down the rule in 2018 and reinstated the five-part test. Of particular concern in that case was that the 2016 rule got rid of the "regular basis" prong of the five-part test, such that nearly *all* financial professionals who do business with ERISA plans and IRA holders could qualify as ERISA fiduciaries – and therefore be subject to ERISA's stringent fiduciary duties – even if they did not have a relationship of trust and confidence with the client.

In 2020, DOL published Prohibited Transaction Exemption ("PTE") 2020-02, followed by an accompanying set of FAQs in 2021, which addressed fiduciary investment advice to retirement investors. In the FAQs, DOL stated that the "regular basis" test could be satisfied for a recommendation to roll plan assets to an IRA, even when it is the first instance of advice by an adviser. Thus, PTE 2020-02 and the FAQs reignited concerns that DOL was trying to significantly broaden the definition of an ERISA fiduciary. DOL currently faces multiple lawsuits alleging that PTE 2020-02 and the FAQs are improperly attempting to improperly revive the 2016 rule. Separately, DOL indicated for much of 2023 that it intended to issue a new proposal amending the 1975 regulation.

Proposed Fiduciary Rule

On October 31, 2023, DOL announced its proposed "retirement security" rule to update the 1975 regulation. Like the 2016 regulation, this fiduciary rule proposal casts a wide net on who – and what type of investment advice – can make an adviser an ERISA fiduciary. The proposed regulation would replace the five-part test with one that would make a person a fiduciary if:

1. The person makes a recommendation regarding an investment transaction or investment strategy to a plan, plan fiduciary, plan participant or beneficiary, IRA, IRA fiduciary, or IRA owner or beneficiary (called a "retirement investor").
2. The person meets any one of the following three criteria:

a. Directly or indirectly (e.g., through an affiliate) has discretionary authority or control with respect to purchasing or selling investments for retirement investors.
b. Directly or indirectly makes investment recommendations to investors on a regular basis as part of their business, and the recommendation is provided under circumstances indicating that the recommendation is based on the particular needs or individual circumstances of the retirement investor and may be relied upon by the retirement investor as a basis for investment decisions that are in the retirement investor's best interest.
c. Represents or acknowledges that they are acting as a fiduciary when making investment recommendations.

3. The person receives a fee or other compensation in connection with the investment recommendation.

In effect, the proposed test is very similar to the test under the 2016 rule, as it treats financial professionals who regularly provide investment recommendations as fiduciaries in cases where the recommendation is based on the investor's particular circumstances and may be relied upon by the investor. The proposed test would also encompass one-time advice, rollover recommendations, and advice to take or not take a distribution. Assuming all of the elements of the test are met, it would also include advisers making a recommendation to an individual to hire that adviser for investment management services.

The lengthy proposal would also amend PTE 2020-02 to, among other things, require new disclosures to retirement investors. In addition, the proposal would amend other, older PTEs that allow fiduciaries to provide recommendations for particular products or transactions and very generally bring them in line with the new proposed regulations.

Outlook

The new fiduciary rule proposal would have far-reaching effects for investment advisers, including in some instances where they merely offer one-time advice. If the proposal is eventually finalized, it will almost surely be subject to lawsuits, just as the 2016 rule was. In the meantime, however, public comments on the proposal are due by January 2, 2024.

IRS Releases Package of Updated Guidance on Defined Benefit Plan Mortality Table Rules

In late October the Internal Revenue Service ("IRS") issued three pieces of guidance – final regulations, an IRS Notice, and new proposed regulations – affecting the mortality table rules that defined benefit ("DB") pension plans use to calculate minimum funding standards and related obligations.

Background

Single-employer DB plans must use the mortality tables under Internal Revenue Code ("Code") section 430 for purposes of many pension rules, including calculating the plan's minimum funding obligations, the minimum value of lump sum distributions, and Pension Guaranty Benefit Corporation premiums. The Code requires the IRS to revise the mortality tables at least every decade to reflect the actual mortality experience of DB plans and to project updated trends. As an alternative to the generally applicable mortality tables, certain employers may use plan-specific substitute mortality tables, subject to approval from the IRS.

The last time that the IRS updated the mortality tables was in final regulations released in October 2017. These mortality tables were criticized because they use a higher rate of future mortality improvement than was used by the Social Security Administration ("SSA") and other federal agencies. This could cause the tables to incorrectly overstate pension obligations, because as assumed future mortality improvements increase, DB plans have increased funding obligations.

Section 335 of the SECURE 2.0 Act of 2022 ("SECURE 2.0") requires the IRS to amend the 2017 final regulations so that for valuation dates occurring during or after 2024, mortality improvement rates may not assume for years beyond the valuation date future mortality improvements at any age that are greater than 0.78% (i.e., the weighted average previously used by the SSA). SECURE 2.0 also requires the IRS to, as necessary, modify the 0.78% figure to reflect material changes in the overall rate of improvement projected by the SSA.

Mortality Table Guidance Updates

In October 2023, the IRS released three guidance updates relating to the mortality tables:

Final regulations. On October 20, 2023, the IRS released final regulations regarding the required updated mortality tables. The final regulations generally follow 2022 proposed regulations, but with some changes. Most importantly, the final regulations incorporate 0.78% annual cap on mortality improvement rates as required by SECURE 2.0. In addition, the final regulations modify the mortality improvement rates to reflect the impact of COVID–19 on mortality rates. The final regulations also retain the rule from the proposed regulations that large plans, but not small plans, must use generational mortality tables (i.e., a series of tables, one for each year of birth) and may no longer use static mortality tables (i.e., a single mortality assumption for all years of birth). The final rules will apply to valuation dates occurring on or after January 1, 2024.

Notice 2023-73. On October 19, 2023, the IRS released Notice 2023-73, which provides the mortality table that will apply to lump sum payments beginning in the 2024 calendar year. Under Code section 417(e)(3), when a DB plan offers a lump sum distribution option to a participant, the lump sum may not be less than an amount based on specified interest rates and the applicable mortality assumptions issued by the IRS. This Notice was issued in conjunction with the final regulations described above and provides the mortality table that may be used for determining the required minimum lump sum value. The Notice applies to distributions with annuity starting dates during stability periods beginning in 2024.

Proposed regulations. On October 20, 2023, the IRS also released separate proposed regulations that would update the requirements that apply when a plan sponsor seeks approval from the IRS to use substitute mortality tables. The proposed regulations would generally retain the methodology for the development of substitute mortality tables in the 2017 final regulations, as well as the procedures outlined in Revenue Procedure 2017-55 by which a plan sponsor can request and obtain approval for substitute mortality tables. However, the proposal would provide additional rules regarding the use of mortality experience data due to the COVID-19 pandemic. These new rules are proposed to apply for plan years beginning on or after January 1, 2025.

Pension De-Risking Remains A Hot Topic as DOL Develops Report to Congress on Standards for Selecting an Annuity Provider

A popular pension de-risking strategy, which involves shifting certain benefit liabilities from the plan to an insurer by purchasing annuities, has been criticized by some policymakers for potentially putting those benefits at risk if the insurer defaults. In response, SECURE 2.0 includes a provision requiring the Department of Labor ("DOL") to prepare a report to Congress on whether changes to Interpretive Bulletin 95-1 (IB 95-1), the current guidance on the fiduciary standards associated with selecting an annuity provider, are needed to better protect plan participants. Pension plan sponsors, fiduciaries, and other interested parties are anxiously awaiting the DOL report, which is due by December 29, 2023.

Background

When a defined benefit pension plan is terminated, the plan typically purchases annuities as part of its obligation to distribute all vested benefits as part of the plan termination process. (The rest of the benefits typically are settled by lump-sum distributions.) As noted, annuity purchases also occur in the context of certain pension de-risking strategies that involve annuitizing the benefits of certain groups of retirees and other terminated vested participants. In either case, the insurance company replaces the role of the plan and the Pension Benefit Guaranty Corporation (PBGC) with respect to paying and guaranteeing affected participants' benefits. However, there are state guarantees in place in the event an insurer defaults on its obligations.

In the case of an ERISA plan, the decision to terminate the plan or undertake a de-risking strategy is a settlor function that is not subject to ERISA's fiduciary standards. But choosing an annuity provider is a fiduciary function, and the basic fiduciary requirements of acting "solely in the interest" of the plan's participants and beneficiaries and for the "exclusive purpose" of providing benefits are applicable. According to DOL IB 95-1, a fiduciary must choose the "safest annuity available" in order to meet these standards. This includes conducting a thorough evaluation of several factors related to the insurance company's claims-paying ability and creditworthiness, including the quality of the annuity provider's investment portfolio and the level of its capital and surplus.

SECURE 2.0 Requires DOL to Review Existing De-Risking Guidance

In spite of this very high standard, the use of annuity purchases for pension de-risking has led some to question whether the "safest available annuity" standard is sufficient to protect participants.

As noted, section 321 of the SECURE 2.0 Act of 2022 ("SECURE 2.0") directs the Secretary of Labor, in consultation with the ERISA Advisory Council ("EAC"), to review IB 95-1 and determine whether amendments are warranted. The EAC is a 15-member body that advises DOL on certain ERISA-related matters and, after studying selected topics, submits recommendations on those topics to the agency.

As part of its efforts to study IB 95-1 pursuant to SECURE 2.0, the EAC heard testimony from witnesses regarding what, if anything, about IB 95-1 should be changed. Subsequently, the EAC voted to recommend to DOL one change to IB 95-1. In an 8-7 vote, the council recommended that DOL update IB 95-1 to expand on its existing language addressing how a fiduciary should consider an annuity provider's administrative capabilities and experience when determining if the provider can meet the safest annuity available standard. A series of other recommendations that were put forward at the EAC's meeting – e.g., a recommendation to clarify that a fiduciary should consider the ownership structure and control of an annuity provider, and a recommendation that IB 95-1 should incorporate reinsurance as a factor in evaluating an annuity provider's abilities to pay claims – were not approved by a majority.

The EAC filed its report regarding IB 95-1, which contains the one recommended change to the guidance, on September 1, 2023. During EAC meetings in mid-September, multiple EAC members asked Lisa Gomez, the Assistant Secretary of DOL's Employee Benefits Security Administration, to provide an update on DOL's study of IB 95-1. Gomez indicated that DOL is working hard to meet the statutory deadline to deliver its report to Congress by the end of the year, and DOL is currently analyzing information obtained through stakeholder engagement in addition to the EAC's report. While DOL is required by SECURE 2.0 to consult with the EAC on recommendations for changes to IB 95-1, the council has no binding authority over the agency, and DOL may or may not follow the recommendation that the EAC described in its report.

While the saga continues over whether DOL will ultimately recommend changes to IB 95-1 in its report to Congress, employers that are considering pension de-risking options should be mindful of these developments. Some stakeholders believe that DOL will propose to Congress a wide array of changes to IB 95-1. However, it isn't clear if any recommended changes could be accomplished just by regulatory action, or if statutory changes would be required.

Whatever the DOL recommends, the standards outlined in IB 95-1 will remain in place until statutory and/or regulatory changes are made and implemented.

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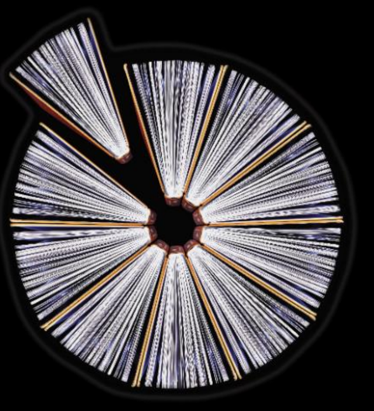

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