Wealth Management

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# What the DOL Retirement Security Rule means for retirement plan sponsors

On April 25, 2024, the Department of Labor (DOL) published final regulations on who is an "investment advice fiduciary" when making an investment recommendation to a retirement investor. With the new rule, the DOL has tried to create an objective standard to protect investors from advisors with potential conflicts of interest—while also helping to ensure that any new requirements will not limit the access that investors have to competent advisors.

## A brief history of the fiduciary rule

The Employee Retirement Income Security Act of 1974 (ERISA) has defined the term "fiduciary" for nearly 50 years. But the retirement world has changed radically since then. Defined benefit pension plans were much more common then. Now, 401(k) plans are the predominant plan type, especially in the private sector. Participant direction of plan investments is routine. And account balances have ballooned in many cases, making the eventual decision to roll over assets to an IRA—or not—especially important. The DOL believes the old approach no longer adequately addressed many of the situations that retirement plans, participants and IRA owners now face.

In 2016, after considerable effort and after years of proposals, the DOL released a final fiduciary rule. This 2016 rule imposed much more stringent requirements on investment advisors and gave retirement investors additional remedies that ERISA provisions did not expressly authorize. Without recounting all the details, in 2018, a federal appeals court invalidated the 2016 final rule, essentially sending the DOL back to square one. In response, the DOL took several actions in 2020, including reinserting the 1975 regulations into the Code of Federal Regulations and releasing Prohibited Transaction Exemption (PTE) 2020-02.

## Who's an investment advice fiduciary under the new rule?

The DOL's final rule defines an investment advice fiduciary as a person who provides a recommendation for a fee or other compensation (direct or indirect) in either one of the following contexts:

- The person makes professional investment recommendations to investors regularly as part of their business and the recommendation is made under circumstances that would indicate to a reasonable investor in like circumstances that the recommendation:
  - Is based on a review of the retirement investor's particular needs or individual circumstances
  - Reflects the application of professional or expert judgment to the retirement investor's particular needs or individual circumstances

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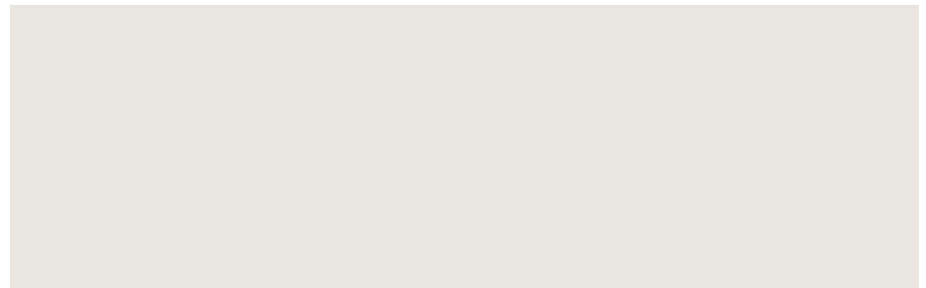

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- — May be relied upon by the retirement investor as intended to advance the retirement investor's best interest
- The person represents or acknowledges that they are acting as a fiduciary with respect to the recommendation

## Other provisions in the final rule

Although the definition of "investment advice" and its attendant fiduciary duty is the key provision in the final fiduciary rule, other items in the rule are worth noting:

- Written disclaimers about a person's fiduciary status will not control to the extent that they are inconsistent with that person's other representations.
- Investment advice provided "for a fee or other compensation, direct or indirect" is defined expansively and includes even expense reimbursements, gifts and non-cash payments.
- The mere presentation of investment information or education, without an investment recommendation, is not considered advice.
- The rule includes IRA owners and beneficiaries as "retirement investors"—and a rollover recommendation is a transaction potentially covered by the final rule.

## What does the new rule mean for plan sponsors?

### HR professionals are not fiduciaries.

The DOL clarified that the rule is only intended to make professional investment advisors fiduciaries. The original proposal caused concern that HR professionals and plan sponsors who provide information to their employees may be classified as fiduciaries but including the word "professional" in the definition of fiduciary has eased that concern.

### A distribution or rollover recommendation is fiduciary advice.

One of the DOL's primary concerns is to make sure distributions to roll out of an employer-sponsored plan meet the duties of care and loyalty under ERISA. The rule expands the situations that would be considered investment advice to include many situations and investment professionals that would previously have not been covered.

### Service providers will need to decide whether to embrace fiduciary status.

The new rule is likely to make more investment professionals fiduciaries to their retirement clients as now even one-time investment advice will trigger fiduciary status. The rule is likely to require service providers to evaluate whether their services will make them plan fiduciaries, even in the cases of one-time advice such as a call center representative giving distribution recommendations to a plan participant. This may expand or diminish service levels, depending on the provider.

Plan sponsors should expect to see additional disclosures about when a service provider is a fiduciary later in 2024.

## What's next?

This final rule will become effective on September 23, 2024, however the DOL has granted a transition relief period of one year, making most of the provisions effective on September 23, 2025. The rule is already facing legal challenges and the results of the 2024 presidential election could have ramifications on whether the rule withstands these challenges. Despite this uncertainty, financial service providers are preparing to comply with the new standards in advance of the upcoming deadlines.

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# In-Plan Roth Conversion Opportunity

The SECURE 2.0 Act of 2022 authorized several new Roth contribution options for employer-sponsored retirement plans. One of these provisions allows plan sponsors to give participants the choice to receive employer-matching and profit-sharing contributions as Roth contributions rather than as pre-tax contributions. Although this option was available immediately upon the SECURE 2.0 Act's enactment date (December 29, 2022), very few plan sponsors have yet adopted this provision.

There are many benefits to giving participants flexibility in how they choose to characterize employer contributions but implementing these changes can be challenging. Perhaps topping the list of hurdles is the IRS's guidance—in Notice 2024-02—that such contributions must be reported on IRS Form 1099-R. This form normally reports plan distributions and not taxable contributions; therefore, payroll service providers will have to create new processes and coordinate them with plan sponsors before they can effectively administer this new option.

Another possible barrier for plan sponsors adding this feature is that participants must be 100% vested in a contribution source (i.e., matching contributions) before they can elect to take it as a Roth contribution. This added layer of complexity may also dampen enthusiasm for this provision.

There is good news for plan sponsors who want to allow their plan participants to bolster their Roth accounts without having to wait for service providers to catch up. For years, plans that authorize designated Roth accounts are also permitted to allow "in-plan Roth rollovers" (IRRs). This provision involves moving non-Roth assets into a participant's designated Roth account and taxing any pre-tax assets that are involved. According to IRS Retirement Plans FAQs on Designated Roth Accounts, participants can make an in-plan Roth rollover of:

- Elective deferrals
- Matching contributions
- Nonelective (profit-sharing) contributions
- Rollovers
- After-tax employee contributions
- Earnings on all these contributions

Even though plan sponsors may not be able to offer their workers a direct path to placing employer contributions into their Roth accounts, they may be able to use IRRs to achieve the same result. This may be a perfect time for sponsors to review their plan provisions to see whether IRRs are currently allowed and under what conditions (for example, at any time or only with a distribution trigger). Even if plan participants cannot yet elect to take employer contributions as Roth contributions, in-plan Roth rollovers may provide an effective alternative.

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