

MEMO# 35053

March 1, 2023

Federal Court Invalidates DOL Interpretation of "Regular Basis" Prong of 5-Part Test Defining Fiduciary Investment Advice

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TO: ICI Members

Pension Committee

Pension Operations Advisory Committee SUBJECTS: Pension RE: Federal Court Invalidates DOL Interpretation of "Regular Basis" Prong of 5-Part Test Defining Fiduciary Investment Advice

On February 13, 2023, a US District Court in Florida issued a ruling vacating the Department of Labor's (DOL's) interpretation, articulated in FAQ guidance, regarding when in the context of a rollover recommendation, an advice provider meets the regulatory 5-part test and is therefore considered a fiduciary under ERISA.[\[1\]](#) The court disagreed with DOL's position that, for the "regular basis" prong of the test, a recommendation to roll over from a plan to an IRA can be the beginning of an intended future ongoing relationship.[\[2\]](#) The court's holding relies on the 5-part test's requirement that the advice is provided on a regular basis "to the plan" (i.e., the plan holding the assets at the time of the recommendation).

Background

Following the Fifth Circuit's vacatur of the Obama era fiduciary rulemaking package in 2018, DOL reinstated the 1975 regulation's 5-part test in 2020. Under DOL's 5-part test, a financial institution or investment professional who is not a fiduciary under another provision of ERISA will be considered to be acting as a fiduciary by virtue of providing "investment advice," if the person: (1) renders advice to a plan as to the value of securities or other property, or makes 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 understanding; (4) that such advice will be a primary basis for investment decisions; and that (5) the advice will be individualized to the plan.[\[3\]](#)

In the preamble to the prohibited transaction exemption (PTE 2020-02) finalized in

December 2020, DOL provided additional commentary regarding its interpretation of the 5-part test.[\[4\]](#) DOL provided additional guidance regarding the application of the 5-part test in the form of FAQs issued in April 2021.[\[5\]](#)

In the April 2021 FAQs:

- FAQ 7 discusses the regular basis prong of the 5-part test and confirms DOL's prior statements in the preamble to PTE 2020-02 that, in the context of a rollover recommendation, when an 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.
- FAQ 15 specifies that, in the context of documenting the reasons why a rollover would be in the investor's best interest, "[w]hen 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."

ASA Lawsuit (Citing the Carfora Lawsuit)

The American Securities Association (ASA)[\[6\]](#) filed the lawsuit against DOL on February 9, 2022 in the US District Court for the Middle District of Florida. ASA alleged that the policies referenced in FAQs 7 and 15 were imposed without observance of procedure required by law (i.e., notice and comment) and therefore violate the Administrative Procedure Act (APA), and that the interpretations are arbitrary, capricious, and an abuse of discretion. The court agreed in part, declaring the policy referenced in FAQ 7 to be arbitrary and capricious and vacating it. The court upheld the policy articulated in FAQ 15 and, with respect to both FAQs, found that notice and comment was not required.

In explaining how it came to its decision, the court explained that its analysis was "guided by" the analysis in another recent decision by the US District Court for the Southern District of New York—Carfora v. TIAA, decided on September 27, 2022.[\[7\]](#) The plaintiffs in that case alleged that TIAA breached its fiduciary duties in encouraging plan participants to roll over assets into a managed account service.

The court in Carfora granted the defendant's motion to dismiss based on the finding that TIAA was not an ERISA fiduciary during the relevant timeframe (years 2011 - 2017). In its analysis of whether TIAA became an ERISA fiduciary by providing investment advice, the court declined to apply PTE 2020-02 and associated guidance retroactively and instead engaged in its own interpretation of ERISA and the regulation (i.e., the 5-part test). The court determined that the two or three interactions alleged by plaintiffs "are clearly insufficient" to conclude that TIAA provided advice on a "regular basis."[\[8\]](#) On this point, it found that:

"regular basis" is meant to be understood in the context of the plan's investment decisions. The investment advice provision of ERISA states that "a person is a fiduciary with respect to a plan to the extent ... he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so" (emphasis in original). [\[9\]](#)

The court in Carfora determined that, when applying the 5-part test, it should consider only advice given while the assets at issue are, in fact, plan assets, and that "a promise of future

investment advice" is not itself an instance of advice-giving.^[10] Therefore, any actions taken following the rollover are outside the scope of the analysis.^[11]

The court in ASA agreed with the Carfora decision and appeared to rely on it heavily. DOL has 60 days to file a notice of appeal of the decision in the ASA lawsuit.

Next Steps

In addition to the two lawsuits described above, there is an ongoing suit in the US District Court for the Northern District of Texas. On February 2, 2022, the Federation of Americans for Consumer Choice (FACC) filed suit against DOL, challenging DOL's interpretation of the 5-part test articulated in the preamble to PTE 2020-02. Oral arguments in this case were heard on January 24, 2023.

In addition, as a reminder, DOL still indicates on its regulatory agenda that it intends to propose an amendment to the regulation defining who is a fiduciary as a result of rendering investment advice for a fee. In conjunction with this proposal, DOL also will propose amendments to existing exemptions or propose "new exemptions to ensure consistent protection of employee benefit plan and IRA investors."^[12]

We will continue to follow these lawsuits and the DOL activity.

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Notes

^[1] The decision, *American Securities Association v. DOL*, is available at https://ecf.flmd.uscourts.gov/cgi-bin/show_public_doc?2022-00330-55-8-cv.

^[2] ICI made similar comments in response to DOL's interpretation of the regular basis prong of the test in the preamble to the proposed version of PTE 2020-02. ICI also argued that DOL's interpretation is in opposition with the Fifth Circuit's 2018 decision to vacate the Obama era fiduciary rulemaking, which makes clear that ERISA and the Code require a relationship of trust and confidence to be present at the time a recommendation is made for the recommendation to constitute fiduciary investment advice. See pages 4 to 7 of ICI letter dated August 6, 2020, available at https://www.ici.org/system/files/attachments/20_ltr_doladvice.pdf.

^[3] For an overview of the fiduciary rulemaking package, including a technical amendment to reinstate the 5-part test and a proposed class exemption (PTE 2020-02, as proposed), see ICI Memorandum No. 32581, dated July 6, 2020, available at <https://www.ici.org/memo32581>.

^[4] For an overview of PTE 2020-02 (as finalized), see ICI Memorandum No. 32999, dated December 18, 2020, available at <https://www.ici.org/memo32999>. In October 2021, DOL extended its temporary enforcement policy relating to PTE 2020-02. DOL provided a longer extension—through June 30, 2022—of the enforcement relief for compliance with the

documentation and disclosure requirements for rollovers as set forth in the PTE. 2020-02. Under those requirements, an advice fiduciary must document the specific reasons that any rollover recommendation is in the best interest of the retirement investor and provide that documentation to the investor. See ICI Memorandum No. 33873, dated October 28, 2021, available at <https://www.ici.org/memo33873>.

[5] For a summary of the compliance FAQs, see ICI Memorandum No. 33485, dated April 19, 2021, available at <https://www.ici.org/memo33485>.

[6] ASA is a trade association of regional financial services firms whose mission is to "promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets." Two members of ASA purport to be injured by the policies set forth in FAQ 7 and 15: one asserts that the policies cause the firm to prohibit its investment advisors from recommending that an investor roll over assets out of an employee benefit plan, and the other asserts that the policies would require it to purchase expensive software and devote numerous hours for compliance.

[7] 2022 WL 4538213 (S.D.N.Y. Sept. 27, 2022) (opinion attached).

[8] Id. at page 16. The court also cites prior DOL interpretive guidance (e.g., the preambles to DOL's rulemakings on the definition of "fiduciary"/conflict of interest) in which DOL concludes that rollover recommendations do not constitute advice "on a regular basis" because they are "one-time" recommendations. Id. at pages 17-18.

[9] Id. at page 16.

[10] Id. at pages 20.

[11] Id. at page 21.

[12] For a description of DOL's Fall 2022 regulatory agenda, see ICI Memorandum No. 34825, dated January 23, 2023, available at <https://www.ici.org/memo34825>. The agenda lists the expected date for this package as December 2022.