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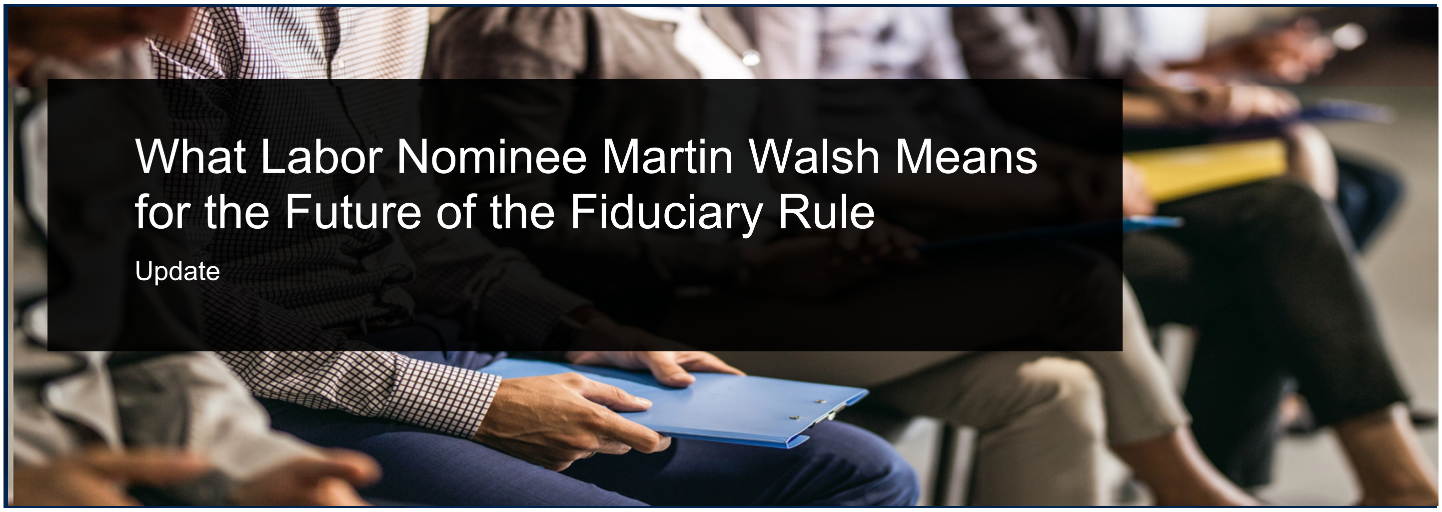

What Labor Nominee Martin Walsh Means for the Future of the Fiduciary Rule

January 19, 2021 | 4 minute read

On January 7, 2021, President-elect Joe Biden named Boston Mayor Martin Walsh as his nominee for Secretary of Labor. Walsh's nomination raises questions for the future of the Labor Department's ("DOL's") "fiduciary rule," which regulates "investment advice fiduciaries" under the Employee Retirement Income Security Act of 1974 ("ERISA"). In particular, the new fiduciary rule guidelines promulgated by the DOL in December 2020 appear to be in jeopardy under a Biden administration with Walsh as Labor Secretary.

Background

Under ERISA, an investment advisor is considered a fiduciary with respect to a retirement plan or IRA if the advisor renders "investment advice" for a fee or other compensation.[1] The scope of the fiduciary rule has been the subject of extensive policy debate since at least April 2016, when the Obama administration issued new guidelines that replaced the longstanding five-part test established in 1975 for determining who qualifies as an "investment advice fiduciary."[2] The 2016 rule significantly expanded the definition of "investment advice" as it applies to retirement plans and IRAs, extending fiduciary status to a wider range of advisors.

On March 15, 2018, however, the U.S. Court of Appeals for the Fifth Circuit vacated the Obama-era fiduciary rule.[3] The Court held, in a split decision, that the DOL's redefinition of the term "fiduciary" conflicted with the statutory text of ERISA and was an unreasonable exercise of administrative power.

In June 2020, President Trump's DOL proposed a revised version of the fiduciary rule, which would re-establish the 1975 five-part test for determining what constitutes "investment advice" under ERISA.[4] Under that five-part test,

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advice constitutes “investment advice,” and confers fiduciary status on the person or institution providing it, if that person or institution:

1. Render[s] advice to the plan as to the value of securities or other property, or make[s] 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.[5]

A determination that an investment advisor is a fiduciary carries significant implications, since it subjects the advisor to ERISA’s prohibited transaction rules, in addition to the regulatory burdens of demonstrating compliance with the prudence and loyalty standards set forth in ERISA.

Recent Developments and Implications for IRA Rollover Advice

On December 18, 2020, the DOL published the final version of its proposed revision to the fiduciary rule, called the Prohibited Transaction Exemption.[6] The final rule affirms the reinstatement of the five-part test for determining when investment advice triggers a fiduciary duty under ERISA.

The Prohibited Transaction Exemption also contains notable guidance relating to advice that an investor roll over assets from an employee retirement plan to an IRA; namely, that such advice is subject to the five-part test. As a practical matter, the DOL’s guidance indicates that whether such investment advice falls under ERISA’s fiduciary standards is likely to turn on whether the advice is provided “on a regular basis.” A single, isolated recommendation to roll over assets into an IRA would not meet the “regular basis” prong. By contrast, any rollover advice that is provided as part of an ongoing investment advice relationship is likely to meet the five-part test and subject the advisor to fiduciary status.

This guidance has enormous implications for the financial industry since such IRA rollovers accounted for nearly $2.4 trillion cumulatively from 2016 through 2020.[7]

The timing of the DOL’s issuance of the new fiduciary rule, however, calls into question whether it will ever become effective. Since the Administrative Procedures Act and Congressional Review Act require the DOL to allow 60 days from publication before major rules becomes effective, the new fiduciary rule and its guidance for advice related to rollovers will not go into effect until February 16, 2021—after Biden's inauguration.

Labor Nominee Martin Walsh

Martin J. Walsh, President-elect Joe Biden's nominee, is currently the mayor of Boston, a position he has held since 2014. Previously, Walsh served as a member of the Massachusetts House of Representatives from 1997 to 2014.

Walsh is also the former head of both Laborers' Union Local 223 and the Boston Metropolitan District Building Trades Council. As President-elect Biden has noted, if confirmed as Labor Secretary, Walsh "would be the first union member to serve in this role in nearly half a century." As a result, much speculation has focused on Walsh's potential impact on workers' rights issues such as overtime rules and the status of "gig economy" workers.

Yet, Walsh also has the potential to alter DOL rules and guidance for investment advice professionals. In fact, the Democratic Party has already laid down its marker: in its official platform—adopted in July 2020, shortly after Trump's DOL announced its new fiduciary rule—the party promised to "take immediate action to reverse the Trump Administration's regulations allowing financial advisors to prioritize their self-interest over their clients' financial wellbeing."

Congressional Democrats have criticized the new fiduciary rule because it subjects fewer transactions to fiduciary standards, as compared with the vacated Obama-era fiduciary rule. In particular, Democrats have characterized the DOL's guidance allowing one-time investment advice related to rollovers without invoking fiduciary obligations as a "loophole[] . . . that unscrupulous advisors can exploit."

Since the Prohibited Transaction Exemption does not become effective until after January 20, it is likely that Walsh, at the very least, will suspend its implementation. But such an action does not mean financial professionals should let their guard down: most commentators expect Walsh and the Biden administration to take a stricter approach to regulation of investment advice, including advice to roll over assets into an IRA.

Conclusion

The DOL under the Biden administration will have until February 16, 2021 to decide whether to suspend the Prohibited Transaction Exemption before it goes into effect. Bracewell attorneys are experienced with financial regulatory issues, and are ready and available to provide further information and discuss particular circumstances.

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[1] 29 C.F.R. § 2510.3-21(c).

[2] Definition of the Term "Fiduciary"; Conflict of Interest Rule-Retirement Investment Advice, 81 Fed. Reg. 20945 (April 8, 2016). Available at https://www.federalregister.gov/documents/2016/04/08/2016-07924/definition-of-the-term-fiduciary-conflict-of-interest-rule-retirement-investment-advice.

[3] *U.S. Chamber of Commerce v. U.S. Department of Labor*, No. 17-10238, 2018 WL 1325019 (5th Cir. Mar. 15, 2018).

4 Improving Investment Advice for Workers & Retirees, Notification of Proposed Class Exemption, 85 Fed. Reg. 40834 (July 7, 2020). Available at https://www.federalregister.gov/documents/2020/07/07/2020-14261/improving-investment-advice-for-workers-and-retirees.

[5] *Id.* at 40834-35.

[6] Prohibited Transaction Exemption 2020-02, Improving Investment Advice for Workers & Retirees, 85 Fed. Reg. 82798 (Dec. 18, 2020). Available at https://www.federalregister.gov/documents/2020/12/18/2020-27825/prohibited-transaction-exemption-2020-02-improving-investment-advice-for-workers-and-retirees.

[7] *Id.* at 82803.