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Your Challenge, Our Solutions™

The new DOL fiduciary rule: Balancing the interests

For over a decade, the Department of Labor (DOL) has wrestled with how to protect retirement plan investors from advisors with conflicts of interest—while also avoiding regulations that may limit the access that investors have to competent advisers. And the rules have changed during this time. Litigation has blocked certain requirements from implementation, and policies have shifted with different federal administrations. As a result, many investors and advisers remain confused about the current situation.

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. Then the DOL released regulations just after ERISA was enacted. But the retirement world has changed radically since then. Defined benefit pension plans were much more common then. And these days, 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.

With all the changes to investing and retirement plans over the past 50 years, different federal and state agencies have attempted to govern fiduciaries, with varying degrees of success. But the reason for this lack of comprehensive guidance overseen by one entity is clear. For example, the SEC is charged primarily with creating rules for securities transactions, while state agencies make rules for insurance products. So the DOL is trying to craft broader protections that won't be based on the investment product. Rather, the rule looks at the relationship between the financial professional and the retirement plan investor, and at the level of trust that the investor has that the adviser's recommendations can reasonably be relied upon.

In 2016, after considerable effort and after years of proposals, the DOL released a final fiduciary rule. Without recounting all the details, a federal appeals court invalidated this rule, sending the DOL back to square one. Now the DOL, with its new rule, is trying to balance protecting retirement investors with the legitimate concerns of investment advisers. In addition, the DOL is attempting to construct a rule that will survive any anticipated legal challenge, which is almost sure to arise.

Who's an investment advice fiduciary?

On October 31, 2023, the Department of Labor (DOL) released proposed regulations defining "investment advice fiduciary." This definition is important because it dictates the standards under which many investment professionals must act when working with clients. It could require more diligence by these professionals because their clients

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will have more remedies if they fail to act with the appropriate standard of care.

The DOL's new rule defines an investment advice fiduciary as a person who:

- Provides investment advice or makes an investment recommendation to a retirement investor;
- Provides this advice for a (direct or indirect) fee or other compensation; and
- Makes the recommendation in one of these contexts:
  - — The person has direct or indirect authority or control to buy or sell retirement assets for the investor;
  - — The person regularly makes investment recommendations to investors as part of their business; or
  - — The person acknowledges or represents that they are acting as a fiduciary.

The rule is "intended to protect the interests of retirement investors [including plan sponsors] by requiring investment advice providers to adhere to stringent conduct standards and mitigate their conflicts of interest." By creating a more uniform fiduciary standard, irrespective of the investment product, the DOL hopes to honor retirement investors' reasonable expectations when they get advice from financial professionals who hold themselves out as trusted advice providers.

What's next?

After the normal regulatory comment and review period, the DOL will commence drafting a final rule. This could take many months, depending on numerous variables. And despite the DOL's good intentions—that the rule will benefit plan sponsors and other retirement investors without imposing unnecessary burdens on advisers—the rule will likely face court challenges. But at least the DOL seems to be making progress toward a workable, uniform fiduciary standard that expands protections for retirement investors.

Long-term, part-time employees will get a break

Many plan sponsors impose a one-year, 1000 hours-of-service requirement on employees before they are eligible to participate in their workplace retirement plan. So some part-time employees may never become eligible if they don't meet that service requirement. But these long-term, part-time (LTPT) employees may soon be able to defer their compensation into a 401(k) or 403(b) plan under fairly recent legislation.

The SECURE Act of 2019 (or SECURE 1.0) required employers to allow employees who had worked at least 500 hours in three consecutive years to participate in the business's cash or deferred arrangement (CODA). The SECURE 2.0 Act of 2022 shortened this wait to two years and 2024 is the first year that plan sponsors may have to allow LTPT employees to defer.

The SECURE 1.0 Act's three-year rule

Starting with the 2021 plan year, plan administrators needed to track part timers' hours to determine whether they would be eligible to defer.

Although these eligible LTPT employees may defer, they are not entitled to any employer contributions, such as matching or profit-sharing contributions. They must also meet any age requirement (e.g., age 21) that the plan imposes.

Example: Jen was hired in 2019 as a part-time employee. She works about 15 hours per week, or about 800 hours each year. Because she worked at least 500 hours in 2021, 2022, and 2023, Jen must be permitted to begin deferring into her 401(k) plan starting in 2024.

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And fortunately for plan sponsors, such LTPT employees may be carved out from a plan's normal nondiscrimination testing.

The SECURE 2.0 Act's two-year rule

SECURE 2.0 tightened the time frame for LTPT employees with at least 500 hours from three years to two consecutive years. But this new rule doesn't become effective until the 2025 plan year. So there is a natural transition from the three-year rule to the two-year rule. Under SECURE 1.0, the first year that an employer would have to allow LTPT employees to defer is 2024; under SECURE 2.0, the first year is 2025 (counting the hours worked in 2023 and 2024).

LTPT proposed regulations released

On November 27, 2023, the IRS published a proposed rule in the Federal Register, outlining the details of both the SECURE 1.0 and SECURE 2.0 long-term, part-time provisions. Although this lengthy document gives us numerous examples to lock in when employees are considered "long-term, part-timers," it does not necessarily provide new guidance that will help most plan sponsors with some of more practical implications of the new rule.

Implications for plan sponsors

Two important considerations seem to come in to play with the LTPT employee rule. One is that you should make certain to count the hours of any of your part-time employees. If you have employees that worked at least 500 hours in 2021, 2022, and 2023, they must be allowed to defer in 2024.

The second consideration is more strategic. It involves assessing your workforce and your retirement plan objectives. And it may differ from business to business. For example, if you employ only a handful of part-time employees, it may be simpler to amend your plan by lowering—to 500—the number of hours needed to become eligible. This would eliminate the need to separately track those with deferral-only eligibility. This may require additional employer contributions, but it may save time and effort and expense by reducing some administrative burden.

Congress seems committed to creating laws that will encourage (or require) businesses to help workers save for retirement. Some of these provisions will force plan sponsors to respond—as with this LTPT deferral rule. But it also creates an opportunity to revisit how to make your workplace retirement plan as effective as it can be.

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