

Locke Lord QuickStudy: Navigating the Impact of the New Fiduciary Rule on Insurers and Producers

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On April 23, 2024, the U.S. Department of Labor (the “DoL”) released its final rule (“Fiduciary Rule”) titled Retirement Security Rule: Definition of an Investment Advice Fiduciary (an “Investment Advice Fiduciary”), which will be effective on September 23, 2024. The Fiduciary Rule broadens the definition of an Investment Advice Fiduciary under the Employee Retirement Income Security Act (“ERISA”).

The Fiduciary Rule can make insurers and insurance producers Investment Advice Fiduciaries if certain factors are present, adding another layer of regulation and a new prudential regulator to an already complex regulatory regime.

Under the Fiduciary Rule, a person is an Investment Advice Fiduciary if they make an investment recommendation of any securities transaction or other investment transaction or any investment strategy involving securities or other investment property to a “retirement investor” for a fee or other compensation in one of the following contexts:

- The person directly or indirectly (e.g., through or together with an affiliate) makes professional investment recommendations to investors on a regular basis as part of their business, and the recommendation is made under circumstances that would indicate to the reasonable investor in like circumstances that the recommendation:
 - is based on 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; and
 - may be relied upon by the retirement investor as intended to advance the retirement investor's best interest;or
- The person represents or acknowledges that they are acting as a fiduciary under ERISA with respect to the recommendation.

One-Time Advice No Longer Excepted

Notably, the DoL states in its “Fact Sheet: Retirement Security Rule and Amendments to Class Prohibited Transaction Exemptions for Investment Advice Fiduciaries” (“Fact Sheet”) that the Fiduciary Rule is intended to close the loophole regarding “one-time” advice. A financial services provider will be deemed an Investment

Advice Fiduciary with respect to a recommendation to roll over assets from a workplace retirement plan (e.g., to a fixed annuity) if every element of the Investment Advice Fiduciary definition is satisfied. The DoL bases its position on the following assumptions: (i) amounts held in workplace retirement accounts often represent the largest savings an individual has; and (ii) financial services providers often have a strong economic incentive to recommend that investors roll money into one of their institution's annuities or other products. The DoL believes that applying the ERISA fiduciary standard in these transactions will provide significant protections for retirement investors.

Impact on Insurers and Producers

The Fact Sheet states that:

- more than 40 states have adopted, in some form, the National Association of Insurance Commissioners' ("NAIC") (2020) updated and more protective conduct standards for insurance agents and insurance companies who recommend annuities ("Model Regulation"). The DoL relies on this as the basis for its enhanced oversight of insurers and producers who recommend annuities and other products into the retirement market.
- the Fiduciary Rule imposes broader and more stringent standards of conduct and conflict mitigation than the NAIC Model Regulation, as applied to retirement investments and to be enforced by the DoL.
- the Fiduciary Rule reflects the DoL's focus to constrain conflicts of interest, and the need to apply a uniform standard for all retirement product vendors.
- an Investment Advice Fiduciary owes retirement investors an elevated standard of care, a duty of loyalty, and conflict-mitigation, regardless of who makes the recommendation.

New York's Adoption of the Fiduciary Rule

The State of New York did not adopt the updated NAIC Model Regulation but rather implements an insurance regulation that aligns more closely with the DoL's rule and exemptions. Under New York's law (11 NY Comp Codes Rules and Regs § 224.4), insurance producers' recommendations "must reflect the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use under the circumstances then prevailing." Additionally, the law provides that "only the interests of the consumer shall be considered in making the recommendation." Thus, insurance producers must act prudently in making a recommendation and must not allow compensation or other incentives to influence their recommendations.

To state the obvious, the Fiduciary Rule, which is enforced by the DoL, is in addition to applicable state insurance laws.

Amendment to Exemption for Transactions Involving Insurance Products and Investment Company Securities, Prohibited Transaction Exemptions ("PTEs")

The proposed amendment to Prohibited Transaction Exemption ("PTE") 84-24 introduces significant changes that directly impact insurers and producers who recommend products in the retirement market. Originally designed to provide a prohibited transaction exemption for specific transactions involving insurance contracts, annuities, and securities issued by investment companies, PTE 84-24 now undergoes substantial revisions in response to the broader Fiduciary Rule amendments.

Under the amended PTE 84-24, Investment Advice Fiduciaries, with the exception of “Independent Producers,” are no longer eligible to utilize this exemption for transactions involving insurance products and investment company securities. The term “Independent Producers” includes persons licensed to sell insurance contracts, including annuities, from multiple unaffiliated insurance companies, provided they are not employees of the insurance company. Consequently, Investment Advice Fiduciaries outside this category must turn to the relief offered by PTE 2020-02 to navigate transactions involving insurance contracts, annuities, or investment company securities.

Effective from September 23, 2024, the amended PTE 84-24 features a one-year phase-in period akin to PTE 2020-02, allowing stakeholders time to adjust to the new regulation. Conditions under the amended PTE 84-24, particularly concerning Independent Producers, mirror those outlined in PTE 2020-02. Notably, insurers that leverage Independent Producers to sell their retirement products are required to maintain rigorous supervisory measures over the Independent Producers. This entails implementing and enforcing written policies for reviewing Independent Producers’ recommendations and conducting retrospective reviews to detect and prevent violations of exemption conditions.

For Independent Producers adhering to the conditions of PTE 84-24, the exemption grants them the ability to receive reasonable compensation and sell fixed (e.g., non-security) annuity contracts or other insurance products not falling under federal securities laws’ definition of “security.” However, the exemption does not extend to the sale of variable annuities or other securities, requiring Independent Producers dealing in such products to rely on PTE 2020-02 for exemptive relief.

Moreover, the amendment to PTE 84-24 introduces provisions specifying circumstances under which Independent Producers or insurance companies become ineligible to rely on the exemption. These disqualification criteria, addressing convictions of crimes or other misconduct occurring on or after September 23, 2024, reinforce compliance and ethical standards within the insurance industry.

With the new limitations on PTE 84-24, insurers and producers must navigate the more stringent conditions of PTE 2020-02, necessitating a new set of compliance requirements and enhanced supervisory measures.

Potential Challenges to the Fiduciary Rule

We note that on May 2, 2024, a group of insurance organizations asked a Texas federal court to block the new Fiduciary Rule on the basis that the DoL violated the Administrative Procedure Act by exceeding its authority with a final rule and amended exemptions that are “arbitrary and capricious.” The plaintiffs are seeking a permanent injunction to stop the rule from going into effect September 23, 2024. In April 2016, the DoL promulgated a similar rule which was challenged by three separate groups of plaintiffs. Ultimately, the Fifth Circuit agreed with the plaintiffs and vacated the 2016 version of the rule.

Conclusion

This paper is intended as a guide only and is not a substitute for specific legal or tax advice. Please reach out to the authors for any specific questions. We expect to continue to monitor the topics addressed in this paper and provide future client updates when useful.

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