NAFA GRC: SUMMARY OF PROHIBITED TRANSACTION EXEMPTION (PTE) 84-24
PURSUANT TO DOL PROPOSED FIDUCIARY RULE

Current application of PTE 84-24

PTE 84-24 provides regulatory relief to insurance agents and brokers, pension consultants, insurance companies, and investment company underwriters *who are fiduciaries* under ERISA or under the Tax Code and who receive payments from third parties in connection with transactions involving an ERISA plan or IRA.[1]

As it relates to insurance or annuity contracts, PTE 84-24 permits these fiduciaries to receive, directly or indirectly, a commission for selling insurance or annuity contracts to ERISA plans or IRAs. Certain conditions must be met in order to have the exemption apply:

- ✓ The transactions must be effected by the fiduciary in the ordinary course of business;
- ✓ The terms of the transaction must be at least as favorable to the plan or IRA as an arm's-length transaction; and
- ✓ The fiduciary relying on the exemption must receive no more than reasonable compensation.

Also, the exemption requires that certain disclosures be made to an independent fiduciary of the plan or IRA, following which the independent fiduciary must approve the transaction. In the case of the purchase of an insurance or annuity contract, the fiduciary (e.g., the agent) seeking the exemption must disclose (1) its relationship with the insurance company; (2) the sales commission it will receive (including for renewal years); and (3) a description of any charges, fees, discounts, penalties, or adjustments which may be imposed in connection with purchase, holding, exchange, termination, or sale of the recommended insurance or annuity contract.

Even though PTE 84-24 has been around since 1977 (and was most recently amended in 2006), the fixed annuity industry has not needed to consider utilizing this exemption *because we have not been considered fiduciaries* pursuant to the current, 5-prong definition of fiduciary under 29 CFR 2510.3-21. However, under the DOL proposed rule, the base definition of "fiduciary" is greatly expanded: if the proposed rule goes through as currently written, fiduciary status and duties would be triggered for almost all annuity contract transactions involving ERISA plans and IRAs. And, once a fiduciary, insurance agents and brokers will need to utilize this exemption.

Changes to PTE 84-24 under the Proposed Rule

The proposed amendments to PTE 84-24 include:

- o Requires fiduciaries who are engaging in the exempted transactions to adhere to a new **Impartial Conduct Standard**, which requires the fiduciary to:
    1. Act in the plan's or IRA's 'best interest' when providing investment advice regarding the purchase of the insurance or annuity contract, with respect to the assets involved in the transaction. *Best interest is defined as acting with the care, skill, prudence, and diligence*

[1] Although PTE 84-24 addresses plan and IRA transactions involving mutual fund shares, this summary will address PTE 84-24 to the extent that it relates to annuities.

under the circumstances then prevailing that a prudent person would exercise based on the investment tolerance, financial circumstances, and needs of the plan or IRA. Further, best interest requires that the fiduciary act without regard to the fiduciary's own financial or other interests or those of any affiliate or other party. The fiduciary must put the interests of the plan or IRA ahead of the fiduciary's – or those of its affiliates.

2. <u>Disclose any material conflict of interest and make no misleading statements</u> relevant to the services the fiduciary is providing. *The failure to disclose a material conflict is deemed to be a misleading statement.*

- **Defines insurance commissions** as a sales commission paid by the insurance company or an affiliate to the insurance agent or broker for the service of effecting the purchase of an insurance or annuity contract, including renewal fees and trailers. Insurance commissions would NOT include revenue sharing payments, administrative fees, or marketing fees; nor would payments from parties other than the insurance company or its affiliate(s).
- Adds **new record keeping requirements**, requiring records regarding the transaction to be kept for six (6) years and to be available for review.
- **Revokes exemption relief for variable annuities** and other annuity contracts that are securities under federal securities law for transactions involving IRAs; however, for ERISA plans, the exemption can be used for all types of annuities and mutual funds.

<u>NAFA's Concerns Regarding PTE 84-24: first Comment Letter, dated July 21, 2015</u>

NAFA agreed that, under the Proposed Rule, PTE 84-24 is the appropriate exemption for 'non-security' annuities (especially as compared to the Best Interest Contract (BIC) Exemption); however, the amended PTE 84-24 requires further refinements and clarification and offered the following comments:

- <u>The scope of the exemption is ambiguous.</u> As written, the exemption would not apply to the purchase by an IRA of a variable annuity contract 'or other annuity contract that is a security under federal securities law' (in addition to mutual fund shares). NAFA requested clarifying language that the intent of the amended PTE was to disallow annuity contracts that are registered under federal securities law.
- <u>'Best Interest' and 'Material Conflict of Interest' are defined too broadly.</u> Requiring agents to engage in annuity transactions 'without regard' to their financial interests and defining a material conflict of interest as one in which a person's financial interest 'could affect' the exercise of judgment is unreasonable and unworkable. Without greater clarity, it is conceivable that the payment of any commission would create – even with proper disclosure – a material conflict of interest in violation of the Impartial Conduct Standard, inviting confusion and legal exposure.
- <u>'Assets involved in the transaction' must recognize real world of insurance sales and agency relationship.</u> Most fixed annuity agents have a limited and defined array of products that they may recommend for purchase to a consumer. Insurance agents can only offer fixed annuity products that are available to them to sell from the insurance companies with which they have a contractual/agency relationship. We believe that when the assets involved in the transaction are fixed annuities, the Best Interest standard is met as long as the insurance agent considers all of the fixed annuity products that such agent is authorized by one or more insurance company to sell at the time the recommendation is made and acts in accordance with all applicable laws and regulations, including state insurance suitability requirements.

- The term 'reasonable compensation' needs further clarification. As it pertains to Insurance Commissions, the determination as to whether compensation is "reasonable" should be fact-specific to the writing agent. In other words, the reasonable compensation would be based on the array of fixed annuity products and associated product specific commission arrangements available from the company or companies with whom the agent has an appointment or agent contract at the time of sale. Additionally, because it is difficult, if not impossible in practical terms, to determine the ultimate "compensation" to the issuing insurance company on the sale of a fixed annuity, the reasonable compensation analysis should be focused exclusively on the compensation received by the writing agent.
- 'Independent fiduciary' must be defined as the IRA owner or plan recipient or beneficiary. The Proposed Rule would require that the independent fiduciary acknowledge in writing receipt of the required disclosure information with respect to the transaction, as well as written approval on behalf of the plan [or IRA]. The marketplace reality is that parties who one would normally consider to be independent fiduciaries are not readily available in IRA transactions. Therefore, NAFA seeks clarification that the independent fiduciary is the IRA owner or plan recipient or beneficiary
- With respect to repeat disclosure requirements for the purchase of subsequent or additional annuity contracts, the Department should clarify how it will define and apply whether such a transaction is "materially different.

In addition to PTE 84-24, NAFA addressed the changes to the base definition of 'fiduciary', what constitutes investment advice, the application of the seller's exception, and the scope of the education carve-out under the base rule in the first Comment letter. Also, in our meetings with DOL, NAFA argued that reasonable compensation must recognize prevailing market conditions, comparing compensation for similar products across the market.

QUESTIONS REMAIN…

→ How will the insurance industry and state insurance regulators handle annuity sales using qualified monies (fiduciary) vs. non-qualified monies (suitability)?

→ Without regard to any new fiduciary obligations, will FIA and FA transactions using qualified money (e.g., rollovers) still be subject to suitability standards under federal (i.e., Dodd-Frank) and state laws? If they are not required to meet suitability requirements, will the products fall outside the "safe harbor"?

→ How is PTE 84-24 obtained? (See 29 CFR 2570.) Who is obligated to apply for the exemption?

→ What exactly is reasonable compensation? And what compensation is unreasonable?

→ How will current industry compensation practices involving non-cash compensation and/or marketing payments change?

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