A SUMMARY OF THE NEW DOL FIDUCIARY RULE

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INTRODUCTION

On Friday, Nov. 3, 2023, the U.S. Department of Labor released a proposed rule package that would significantly revise the current five-part test used to determine fiduciary investment advice status under Title I and Title II of the Employee Retirement Income Security Act (ERISA), along with amending several existing prohibited transaction exemptions applicable to ERISA fiduciaries who provide investment advice to "retirement investors" – defined here to include both employer retirement plan participants as well as IRA owners. Under the DOL's new fiduciary rule proposal, a rollover recommendation is investment advice triggering fiduciary status. Accordingly, such recommendations that result in compensation to the financial professional – including investment advisers, broker-dealers, and insurance agents – will be considered a conflict of interest requiring satisfaction of a prohibited transaction exemption.

The broad impact of this new fiduciary rule is to expand fiduciary obligations on insurance agents when recommending the purchase of a non-security annuity (i.e., fixed and fixed indexed annuities) to fund rollovers from plans to individual retirement annuities.

Other than capturing more retirement advice activity under the fiduciary standard, the biggest change under the new Rule is in the DOL's proposed amended PTE 84-24.

PTE 84-24, which is currently broadly available to investment advice fiduciaries selling fixed and variable annuities and other insurance products, would be narrowly prescribed under the DOL's modified version for use only by independent insurance producers (defined as someone who sells annuities for two or more unrelated insurers) selling non-securities annuities and would only cover sales commissions paid to the independent producer by an insurer or affiliate; other investment professionals – including career or captive agents and independent insurance agents who sell only one insurance company's products – would now need to use the revised PTE 2020-02 in order to receive otherwise prohibited compensation.

The conditions of the proposed amended PTE 84-24 are very similar to the requirements of PTE 2020-02, including the inclusion of and the requirements under the impartial conduct standards and the best interest standard of care; greater written disclosures around compensation and acknowledgement of fiduciary status; an annual retrospective review; and new record keeping requirements, among others. Furthermore, insurance companies would have heightened supervisory requirements over independent insurance producers who sell their fixed and fixed indexed annuities.

RULEMAKING TIMING AND PROCEDURAL CONCERNS

As stated in the Federal Register under the DOL's Notice of Proposed Rulemaking, public comments are currently due on or before Jan. 2, 2024. The DOL intends to hold a public hearing on or around Dec. 18, 2023. This 60-day comment period is shorter by a third than that provided under the previous fiduciary rule proposals in 2010 and 2015, and, given the calendar constraints with several federally recognized holidays between now and Jan. 2, interested parties and stakeholders only have 39 business days to provide commentary on this sweeping regulation. Moreover the 60-day comment period is effectively truncated by the intervening public hearing that is likely to occur the week of Dec. 18 as commenters will necessarily need to have their arguments marshalled and articulated ahead of any public testimony.

Accordingly, NAFA, as part of a broad coalition of industry trade organizations sent a letter to the DOL on Nov. 8 requesting additional time for the comment period, to have the public hearing held after the close of the initial comment period, and to open up a second public comment period to allow stakeholders and interested parties to provide comment on issues addressed during the public hearing. Given the historical precedence for a more reasonable timeframe, we believe that the DOL will grant accommodation to allow for meaningful public engagement.

In terms of the applicability of the new fiduciary rule and its attendant amendments to existing PTEs, **DOL proposes to make the rule package effective 60 days after its publication in the Federal Register.** We can only guess at the time interval that might exist between review of the public comments and issues raised during the public hearing and the publication of a final rule in the Federal Register, but we anticipate that the Biden Administration wishes to avoid making the rule vulnerable to a possible delay or revocation by an incoming new administration under the Congressional Review Act. As such, we believe the DOL would want to see this rule finalized no later than late summer or early fall 2024.

The following is a summary of the three components of the new fiduciary rule package that is of greatest importance to NAFA members: the Proposed Amendment to PTE 84-24, the Proposed Amendment to PTE 2020-02, and the Retirement Security Rule - Definition of an Investment Advice Fiduciary.

THE NEW FIDUCIARY TEST

The DOL's proposed "Retirement Security Rule: Definition of an Investment Advice Fiduciary" would replace the existing five-part test that was adopted in 1975 with a new, expansive three-part test that would encompass many more activities as fiduciary in nature, including rollover recommendations, one-time advice, and distribution advice.

Under the DOL proposal, a person would be an investment advice fiduciary under Title I and Title II of ERISA if they:

- Provide investment advice or make an investment recommendation to a "retirement investor";

- Receive a fee or other compensation (direct or indirect) for that advice or recommendation; and
- Make the recommendation in one of the following contexts:
  - o The investment professional, either directly or through an affiliate, has discretionary control with respect to purchasing or selling securities or other investment property for the retirement investor;
  - o The investment professional, either directly or through an affiliate, makes investment recommendations to retirement investors on a regular basis as part of their business, and the recommendation is provided under circumstances indicating that the recommendation is based on the particular needs or individual circumstances of the retirement investor and will be relied upon by the retirement investor as a basis for the investment decisions that are in the retirement investor's best interest; or
  - o The investment professional represents or acknowledges that they are acting as a fiduciary in connection with the investment recommendation.

The biggest change to the definition of an investment advice fiduciary is to the "regular basis" prong. Under the 1975 test, investment advice had to be given to a particular retirement investor *on a regular basis*; now it is enough that making investment recommendations is part of an investment professional's *regular business*, untethering the "trust and confidence" foundation of a fiduciary relationship between an advisor and client and, rather, determining fiduciary status based upon a person's business model or practice.

The elimination of the current regular basis prong effectively makes any independent insurance producer who is in the business of providing rollover advice a fiduciary, requiring compliance with a prohibited transaction exemption in order to get paid a commission or fee for the annuity transaction.

CHANGES TO EXISTING PTE 84-24

Under the DOL proposal, the current PTE 84-24 is significantly modified and would only be available to independent insurance producers ("Independent Producers") who sell non-securities annuities on a commission or fee basis, as long as an expansive set of new conditions are met. Only Independent Producers who sell annuities from two or more unrelated insurers would be eligible for the amended exemption.

Advice from non-independent producers, such as captive or career agents, as well as agents who only are affiliated with one insurer, would need to comply with PTE 2020-02. As stated in the rule preamble, the amended PTE 84-24 is a "narrowly tailored, alternative exemption allowing independent insurance agents to receive commissions from insurance companies with respect to annuity recommendations."

The amended PTE 84-24 would provide exemptive relief only for the receipt of fully-disclosed commissions or fees paid in connection with the annuity recommendation and not other cash or non-cash compensation. Revenue sharing payments, administrative fees, marketing payments and third-party payments are prohibited.

Amended PTE 84-24 Conditions for Independent Insurance Producers

- **Compliance with Impartial Conduct Standards.** Requires the Independent Producer to comply with the Impartial Conduct Standards, which includes a best interest standard, when providing fiduciary investment advice to Retirement Investors. (Compliance with ICS is currently required under PTE 2020-02.) Generally, compliance with ICS requires that:
    - o The investment advice is in the best interest of the Retirement Investor, reflecting the care, skill, prudence, and diligence a prudent person acting in a like capacity and which does not place the financial or other interests of the Independent Producer or Insurer ahead of the Retirement Investor's interests;
    - o The Independent Producer receives no compensation in connection with the transaction other than the sales commission, and the sales commission does not exceed reasonable compensation; and
    - o The statements made to the Retirement Investor about the recommended transaction and other relevant matters are not materially misleading.

- **Disclosures.** Requires the Independent Producer to provide a number of disclosures to the Retirement Investor (to include IRA owners):
    - o Written acknowledgement that the Independent Producer is a fiduciary;
    - o Written statement of the best interest standard of care;
    - o Written description of the services they will provide and the products they are authorized to sell, including the identification of the specific insurers and specific insurance products available for recommendation;
    - o Written statement of their material conflicts of interest;
    - o Written disclosure of the amount of commission that will be paid to the Independent Producer in connection with the purchase of the recommended annuity expressed both in dollars and as a percentage of gross annual premium payments for the first year and, if applicable, for each successive year;
    - o Written statement that the Retirement Investor has the right to obtain additional information regarding costs, fees, and compensation and how they can get the information, free of charge;
    - o Written documentation as to the considerations made in determining that the annuity recommendation is in the best interest of the Retirement Investor (this documentation must also be made to the insurer).

- **Additional Disclosures Required for Rollover Recommendations.** Before making a recommendation as to the rollover of investment assets currently held in a plan, the Independent Producer must consider and document why the recommendation is in the Retirement Investor's best interest and provide that documentation to both the Retirement Investor and the insurer. Relevant factors to consider must include but are not limited to:
    - o Alternatives to the rollover recommendation, including leaving money in the plan;

  - The comparative fees and expenses;
  - Whether an employee or other party pays for some or all of the administrative expenses; and
  - The different levels of fiduciary protection, services, and investments available.

- **Recordkeeping.** Records necessary to determine whether the conditions of the exemption have been met must be maintained for six (6) years from the date of the transaction in a manner that is reasonably accessible for examination.

Amended PTE 84-24 Conditions for Insurers

Although insurers are not required to be fiduciaries under the proposed amended PTE 84-24, they would be required to adopt, maintain, and enforce (and update if necessary) written policies and procedures prudently designed to ensure the Independent Producer's compliance with the Impartial Conduct Standards and other conditions of the exemption. These heightened supervisory requirements include:

- **Mitigation of Conflicts of Interest.** Insurers must identify and eliminate incentive-based or differential compensation structures (e.g., quotas, bonuses, contests) that a reasonable person would conclude result in a recommendation not in the Retirement Investor's best interest. Recommendations must be based only on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor.

- **Determining who can sell the Insurer's products; Identification of "Bad Actors."** Insurers must undertake a prudent process in determining whether to authorize an Independent Producer to sell their annuity contracts and whether the Independent Producer is unlikely to adhere to the Impartial Conduct Standards or lacks the necessary education, training, or skill. The insurer must document the basis for its determination that the Independent Producer will adhere to the Impartial Conduct Standards and must review that determination annually.

- **Retrospective Review.** Insurers must conduct a review – at least annually – that is reasonably designed to detect and prevent violations of and achieve compliance with the conditions of the exemption and includes the Insurer consider the effectiveness of its supervision system, any exceptions found, and any action taken or recommended.
  - **The retrospective review must also include a review of rollover recommendations and required rollover disclosures.**
  - As part of this review, the insurer must prudently determine whether to continue to permit individual Insurance Producers to sell the insurer's annuity contracts to Retirement Investors.
  - The insurer must provide a written report detailing the Retrospective Review to a Senior Executive Officer of the insurer for certification.
  - The review, report, and certification must be completed no later than six months following the end of the period covered by the review.

- The insurer must retain the report, certification, and supporting data for a period and six years and must make the report, certification, and supporting data available to the DOL within ten (10) business days upon request.

- **Self-Correction in the Event of a Violation of the Exemption's Conditions.** Violations of the exemption's conditions can be corrected provided that:
  - Either the Independent Producer has refunded any charge to the Retirement Investor, or the insurer has rescinded the annuity, cancelled the contract, and waived any surrender charges;
  - The Independent Producer notifies DOL of the violation and corrective actions with 30 days of the correction;
  - The correction occurs no later than 90 days after the Independent Producer learned of the violation or reasonably should have; and
  - The Independent Producer timely notifies the person(s) at the Insurer responsible for conducting the retrospective review and the violation and corrective action is specifically set forth in the written report of the retrospective review.

- **Ineligibility for Violations of the Exemption's Conditions.** Violations of the conditions of the exemption that are not corrected, along with other circumstances that could cause ineligibility, would result in a 10-year prohibition against an Independent Producer's or insurer's reliance on the exemption.

CHANGES TO EXISTING PTE 2020-02

Broadly speaking, the prohibited transaction exemption that was adopted in December 2020 and finalized in February 2021, PTE 2020-02, is largely kept intact, but the proposed amendment expands on and revises the conditions of the exemption and is intended to be the primary PTE that most investment professionals – including insurance agents who do not meet the definition of an Independent Producer under the proposed amended PTE 84-24 – and insurers will have to rely upon when providing fiduciary investment advice to plans, plan participants, and IRAs.

The proposed amendment to PTE 2020-02 retains the Impartial Conduct Standards (which includes adherence to a best interest standard), but it includes new and revised disclosures, reporting, and record keeping requirements and expands the scope of penalties for violations of the exemption's conditions.

New and Amended Disclosures

- **Best Interest Disclosure.** Prior to the transaction the Financial Institution and the Investment Professional must provide a written statement of the best interest standard of care owed to the Retirement Investor. (This is similar to the Amendment to PTE 84-24.)

- **Fee/Compensation Disclosure.** In addition to the current PTE 2020-02 requirement to provide a written description of the services to be provided and any material conflicts of interest, the proposal would require

disclosure of any amount the Retirement Investor will directly pay for such services and the amount(s) the Financial Institution and Investment Professional receives from other sources, including through third-party payments.

- o Information regarding compensation must be provided in sufficient detail for the Retirement Investor to make an informed judgment about the costs of the transaction and the significance and severity of the conflicts of interest.
- o Financial Institutions must maintain sufficient records to allow them to respond meaningfully to Retirement Investors' requests regarding how the Financial Institution and its Investment Professional are compensated.
- o Financial Institutions would be required to inform Retirement Investors of their right to obtain specific information regarding costs, fees and compensation that is described in dollar amounts, percentages, formulas, or other means reasonably designed to present materially accurate disclosure of their scope, magnitude, and nature.

- **Fiduciary Acknowledgement.** The current PTE 2020-02 requires Financial Institutions and Investment Professionals to provide written acknowledgement that they are fiduciaries under Title I and/or the Code. In the preamble to the Amendment to PTE 2020-02, DOL expresses concern that the current condition is being met through "artful phrasing," by saying that they "may" be fiduciaries or that they are fiduciaries to the extent they meet the definition of fiduciary investment advice under ERISA or the Code. Accordingly, the proposed amendment requires written acknowledgement that the Financial Institution and the Investment Professional are providing fiduciary investment advice and are fiduciaries under Title I, the Code, or both.

- **Rollover Disclosure.** Similar to the new rollover disclosures required under the proposed amended PTE 84-24 as previously discussed, the Financial Institution (the insurer) and the Investment Professional must consider and document why the recommendation is in the Retirement Investor's best interest and provide that documentation to the Retirement Investor and the relevant factors to consider in making a rollover recommendation are identical to those above.
  - o When considering alternatives to a rollover recommendation, the Financial Institution and Investment Professional must consider other investment options in the existing plan or IRA.
  - o Investment Professionals and Financial Institutions must make diligent and prudent efforts to obtain information about the fees, expenses, and investment options offered in the Retirement Investor's plan account.
  - o If the Retirement Investor refuses to provide such information the Financial Institution and Investment Professional must make a reasonable estimate of the plan's expenses, asset values, risk, and returns based on publicly available information.
    - * The assumption used in these estimates must be explained and documented.
    - * DOL notes that it would be permissible for the Financial Institution to charge a discrete but reasonable fee for the rollover analysis and charge separately for advice following the rollover.

Amended Policies and Procedures

Currently, PTE 2020-02 requires Financial Institutions to establish, maintain, and enforce written policies and procedures prudently designed to ensure that conflicts of interest are mitigated and that the Financial Institution and Investment Professional comply with the Impartial Conduct Standards.

- The Amendment to PTE 2020-02 would prohibit the use of quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation of other similar actions or incentives the are intended to – or that a reasonable person would conclude are likely to – result in recommendations that are not in the Retirement Investor's best interest.
  - o In the Preamble to the proposed Amendment, the DOL states that Financial Institutions should not offer incentive vacations, or even paid trips to educational conferences, if the desirability of the destination is based on sales volume and satisfaction of sales quotes.
- Financial institutions would be required to provide their complete policies and procedures to DOL upon request within 10 days of such request.
- **Retrospective Review.** The annual retrospective review requirements under the current PTE 2020-02 are retained with modifications. The review must be reasonably designed to detect and prevent violations of, and achieve compliance with, the conditions of the exemption, including the Impartial Conduct Standards, and the policies and procedures governing compliance with the exemption.
  - o The proposed Amendment to PTE 2020-02 would clarify that, as part of the review, it expects Financial Institutions to determine whether they have complied with each exemption conditions.
  - o Moreover, Financial Institutions would be required to update its policies and procedures as business, regulatory, and legislative changes and events dictate.
  - o The Financial Institution's methodology and results of the retrospective review must be reduced to a written report provided to and certified by a Senior Executive Officer of the Financial Institution.
    - * As part of the certification process, the Senior Executive Officer would be required to carefully review non-exempt prohibited transactions identified in the retrospective review, report those transactions to the IRS, correct any violations, and pay any required excise taxes.
    - * Failure to correct prohibited transactions, report those transactions to the IRS, or pay the resulting excise tax imposed under the Code would result in the Financial Institution being ineligible to rely on the exemption for a period of 10 years.
  - o The review, report, and certification must be completed no later than six months following the end of the period covered by the review. The Financial Institution must retain the report, certification, and any supporting data for six years and provide such information to the DOL within 10 business days upon request.
- **Self-Correction.** Currently, PTE 2020-02 allows self-correction in certain circumstances if the violation did not result in an investment loss to the Retirement Investor or if the Financial Institution made the

Retirement Investor whole for any losses resulting from the violation. The proposed amendment to PTE 2020-02 would retain the self-correction conditions of the current exemption but requests comment on whether additional clarification is necessary as to the types of transactions that would be eligible for corrective action under the exemption.

- **Eligibility.** The proposed Amendment to PTE 2020-02 would expand the circumstances under which an Investment Professional or Financial Institution would, for a period of 10 years, become ineligible to rely upon the exemption and would extend ineligibility to misconduct by Affiliates of a Financial Institution. In addition, the proposed amendment sets forth specific crimes that could cause ineligibility. Currently, the exemption's ineligibility rule only applies to crimes arising out of the provision of investment advice; as amended, the enumerated crimes would result in ineligibility, regardless of the conduct under which they arose. Also, ineligibility would be triggered for a systematic pattern or practice of failing to correct prohibited transactions, report those transactions to the IRS, or pay the resulting excise taxes imposed under the Code in connection with non-exempt prohibited transactions involving fiduciary investment advice. Furthermore, the proposal would change the current timing and scope of ineligibility – the so-called wind-down period – from its current one-year period to six months.

- **Recordkeeping.** Currently, PTE 2020-02 requires Financial Institutions to maintain records demonstrating compliance with the exemption for a period of six years and to make such records available to any authorized employee of the DOL or the Department of Treasury. In the preamble to the proposed amendment, DOL indicates that it is considering amending the recordkeeping to allow additional parties – including plan participants and beneficiaries, unions, and IRA owners – to review these records. The proposal includes a new section that would replace the current recordkeeping section and seeks comment on both the burden to Financial Institutions and the benefits to Retirement Investors if they were to have access to this information on request.

CONCLUSION

Annuity professionals – along with the retirement consumers they serve – have been in a state of flux for more than a dozen years since the Department of Labor first embarked down the fiduciary rulemaking path. Beginning with the 2010 proposal and withdrawal, to the 2015-2016 finalized rule and subsequent 2018 court vacatur, followed by three years of a temporary enforcement policy requiring adherence to impartial conduct standards, to a new PTE and reinterpretation of who is a fiduciary in 2020, we have continued to respond in a manner conducive to protecting independent distribution, fixed annuities and the future of American retirement. The newest proposed rulemaking package is unwarranted, unworkable and supported by unproven assumptions cobbled together to mask DOL's failed policies with words and phrases that rachet up political rhetoric.

NAFA will remain at the forefront of combatting such ill-conceived "consumer protections" and use all avenues to ensure Main Street consumers have access to the products and professional advice needed to secure their retirement future.