# DOL FIDUCIARY RULE 3.0 BEST PRACTICES

3.0

A PRACTICAL GUIDE FOR ANNUITY PROFESSIONALS

NAFA®

NATIONAL ASSOCIATION FOR FIXED ANNUITIES

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# OVERVIEW

## WHAT IS THE DOL FIDUCIARY RULE 3.0?

On February 16, 2021, a new prohibited transaction class exemption for investment advice fiduciaries went into effect. The exemption, Prohibited Transaction Exemption (PTE) 2020-02 – *Improving Investment Advice for Workers and Retirees* ("the Exemption"), was proposed in July 2020 by the U.S. Department of Labor (the "Department" or "DOL") and finalized on December 18, 2020.[1] The Exemption is targeted at rollover recommendations, which are defined as recommendations to take a distribution of assets from a workplace retirement plan (e.g., a 401(k)) and roll them over to an IRA.

Dubbed the Fiduciary Rule 3.0,[2] the new Exemption can be best understood as two distinct-yet-related regulatory applications: ***the actual exemption itself*** and ***the guidance set forth in the preamble*** to the Exemption.

The new Exemption permits investment advice fiduciaries to receive compensation related to rollover recommendations – something that is otherwise prohibited in the absence of an exemption. The Exemption's new prohibited transaction class exemption is available to federal- and state-regulated registered investment advisers, broker-dealers, insurance companies, and banks, and to the individual investment professionals who are their employees or agents. The exemption permits commission to be received for providing fiduciary investment advice to roll over assets from a workplace retirement plan to an IRA, as well as other similar types of rollover recommendations (i.e., IRA to IRA transfers).[3]

It is the guidance in the preamble, however, that has a greater impact for annuity professionals. There, the Department **reinterprets and broadens the definition of who is considered an investment advice fiduciary** under Title I of the Employee Retirement Income Security Act of 1974 (ERISA) and under the Internal Revenue Code (the Code) and what constitutes "investment advice." In particular, the guidance provides insight into how the Department will begin to apply the 1975 "five-part test" used to determine what "investment advice" is – and, consequently, who is acting in a fiduciary capacity – as it applies to rollover recommendations.

The result of this broader application of the five-part test is that many more rollover recommendations will be considered investment advice that triggers fiduciary duties, causing a greater number of annuity professionals to be considered "investment advice fiduciaries."

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[1] The announcement by the U.S. Department of Labor's Employee Benefits Security Administration (EBSA) that it would allow PTE 2020-02 to go into effect as scheduled took industry by surprise; most industry observers presumed that the Biden administration would delay the effective date pursuant to the White House memorandum issued on January 20, 2021, and make the Exemption a candidate for review and ultimate withdrawal. The announcement also provided notice that the temporary enforcement policy (TEP) already in place would be extended until December 20, 2021. Then, on October 25, 2021, the TEP was extended again through January 31, 2022. A discussion of the applicability of the TEP and the Rule's compliance deadlines can be found on page 10 of this document.

[2] PTE 2020-02, *Improving Investment Advice for Workers and Retirees*, is the third iteration of a fiduciary rule by the Department of Labor: The Department first introduced a fiduciary rule in 2010, which was withdrawn a year later, and made a second attempt with a much broader rule in 2016. The 2016 iteration was vacated in March 2018 by the U.S. Court of Appeals for the Fifth Circuit.

[3] Rollover recommendations include Plan-to-IRA, IRA-to-IRA, Plan-to-Plan, IRA-to-Plan, and changes of account types in retirement accounts.

# PTE 2020-02: THE EXEMPTION + THE PREAMBLE

## THE EXEMPTION

A person who provides "investment advice" *and* receives a fee or other compensation for such advice is an "investment advice fiduciary" under Title I of ERISA and under the Code.

ERISA imposes duties of prudence and loyalty on investment advice fiduciaries with respect to workplace retirement plans. Furthermore, ERISA and the Code prohibit investment advice fiduciaries from receiving compensation from sales transactions involving plans and IRAs (so-called prohibited transactions), unless an exemption applies. Using an exemption permits annuity and other financial professionals who are investment advice fiduciaries to receive compensation when providing fiduciary investment advice.

Keep in mind there are other PTEs already in existence that can be used in order to make a compliant sale, including one that has been around for several decades: PTE 84-24. PTE 84-24 is a class exemption that covers the sale of insurance or annuity contracts to qualified plans and the commissions paid to insurance agents with respect to such sales. **In other words, the PTE 2020-02 is an *additional* compliance pathway to use in the rollover space.**

Despite having been around since the late 1970s, most annuity professionals – especially those in the independent distribution channel (in particular, independent insurance-only licensed agents) – have not used PTE 84-24 because they were not considered investment advice fiduciaries in the first place. The new Exemption changes that basic understanding. Annuity professionals who have never in their careers been subject to a DOL regulatory regime or in need of a PTE may now find themselves required to satisfy the requirements of a PTE in order to receive compensation.

## THE PREAMBLE: THE DOL'S NEW INTERPRETATION OF WHO IS A FIDUCIARY

With the exception of the two years that Fiduciary Rule 2.0 was in place from 2016 to 2018, a one-time rollover recommendation to purchase an annuity to a plan participant or IRA owner had never been understood to be subject to a fiduciary standard. This had been the case for decades. The 2020 preamble guidance fundamentally changes that understanding.

First, the Department announced it was withdrawing an Advisory Opinion it had issued in 2005 ("the *Deseret* letter"),[4] which excluded rollover recommendations from the definition of fiduciary investment advice. In withdrawing the *Deseret* letter, the Department has taken the position that its 2005 opinion was incorrect.

Having removed *Deseret's* safe harbor for rollover recommendations, the Department reinterpreted the 1975 five-part test for determining investment advice fiduciary status, asserting that rollover advice is, in fact, advice

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[4] Employee Benefits Security Administration's Advisory Opinion 2005-23A - WITHDRAWN AS OF 6/29/2020, available here.

to sell, withdraw, or transfer plan assets and, therefore, falls within the definition of fiduciary advice if all five parts of the 1975 test are satisfied. Moreover, certain prongs of the test are more liberally applied to a greater number of rollover transactions.

Accordingly, annuity professionals who (1) provide rollover advice *and* (2) meet all five prongs of the five-part test *and* (3) receive payment for that advice are investment advice fiduciaries subject to the fiduciary duties imposed by Title I of ERISA and to the prohibited transactions provisions of ERISA and the Code.

## DEFINING INVESTMENT ADVICE FIDUCIARY

In 1975, the DOL established a five-part test to determine fiduciary status under ERISA; an identical test was subsequently adopted in the Code.[5] This test remained in place until 2016, when the Department replaced the five-part test with a revised fiduciary regulation: a conflicts of interest rule that, among other things, created a Best Interest Contract Exemption.[6] Two years later, the U.S. Court of Appeals for the Fifth Circuit vacated the rule in its entirety, which effectively reinstated the prior regulatory text, including the 1975 five-part test.

As previously discussed, to be deemed an investment advice fiduciary under ERISA and the Code, one must provide investment advice for a fee or other compensation with respect to any assets of a workplace retirement plan. The Department's 1975 five-part test defines what constitutes "investment advice." For advice to meet the definition of investment advice, a financial institution or financial professional must:

(1) **Render advice** to the plan as to the value of securities or other property, **or make recommendations** as to the advisability of investing in, purchasing, or selling securities or other properties;

(2) **on a regular basis**;

(3) **pursuant to a mutual agreement** or understanding with the plan participant or IRA owner;

(4) that the **advice will service as a primary basis** for the investment decisions; and

(5) that the **advice will be individualized**, based on the particular needs of the plan or IRA.

**All five parts or prongs of the test must be satisfied in order for a financial professional to be an investment advice fiduciary; whether or not the five prongs are satisfied is determined on a "facts and circumstances" basis.** In the Preamble to the Exemption, the Department states that a facts and circumstances approach is centered on whether the parties have entered into a relationship of trust and confidence. Whether such a relationship exists is determined by applying the five-part test pursuant to the Department's new interpretation.

[5] 29 CFR 2510.3-21 - Definition of "Fiduciary," available here.

[6] Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20946 (April 8, 2016), available here.

## SATISFYING PRONG 1:

### *RENDERING ADVICE OR MAKING RECOMMENDATIONS*

The Department states that a rollover recommendation *is* advice to sell, withdraw, and/or transfer assets currently held in the plan. Accordingly, making a rollover recommendation is likely – by implicit definition or default – going to satisfy the first prong of the five-part test.

## SATISFYING PRONG 2:

### *ON A REGULAR BASIS*

Less clear is the Department's interpretation of the second prong: What behavior or activity satisfies the "regular basis" prong? It is the interpretation of this prong that will be very "facts and circumstances" dependent.

On the one hand, the Department notes that a one-time sales transaction in which there is no ongoing investment advice relationship or expectation of such a relationship will not satisfy the regular basis prong. Similarly, isolated or sporadic interactions between a financial professional and the retirement plan participant do not meet the regular basis prong.

However, the Department also observes that the decision to roll over retirement plan assets to an IRA is potentially a consequential financial decision representing an individual's lifetime of savings; because the advice to do so is so important, the Department takes the view that, generally, a rollover recommendation is the beginning of an ongoing advice relationship, thereby satisfying the regular basis prong. A relationship that is recurring, non-sporadic, and expected to continue would be considered as one that is on a regular basis. By way of example, the Department suggests that where an annuity professional frequently – or periodically – makes an individualized recommendation regarding annuity products or its features, or recommends putting additional assets in an existing product, as having the potential to meet the regular basis prong of the five-part test.

Whether insurance transactions will fall within or outside of the fiduciary definition will depend on the related facts and circumstances that exist at the time of the recommendation. Where a rollover recommendation marks the beginning of an ongoing advice relationship, fiduciary status extends to the entire advisory relationship, including the first instance of advice.

## SATISFYING PRONG 3:

### *PURSUANT TO A MUTUAL AGREEMENT OR UNDERSTANDING*

The third prong, the "mutual understanding or agreement," must be read in connection with the fourth prong – that is, whether there is a mutual understanding between the annuity professional and the client that the advice given is going to be used by the plan participant as a primary basis for making the decision to sell, withdraw, or transfer assets currently held in the plan.

The determination as to whether the parties have arrived at a mutual agreement or understanding that the investment advice will serve as a primary basis for the investment decision will be based largely upon the parties' reasonable understanding of their relationship. The Department states that written statements disclaiming such an understanding may be considered in determining whether a mutual understanding exists, but that such statements are not determinative.

Specifically, the Department warns that "boilerplate" disclaimers will not do: financial professionals can contractually disclaim engaging in activities that trigger elements of the five-part test, but such communications must (1) clearly demonstrate that there is no mutual agreement or understanding to the contrary and (2) the parties' actual behavior must demonstrate adherence to the contractual arrangement. Written disclaimers cannot be used to undermine reasonable investor understandings. Also, written statements disclaiming other parts of the five-part test will not be determinative of fiduciary status.

## SATISFYING PRONG 4:

### *THE ADVICE SERVES A PRIMARY BASIS FOR THE INVESTMENT DECISION*

In determining if the advice will serve as a primary basis for the investment decision, the Department states that it does not intend to consider whether the advice serves as ''the'' primary basis of investment decisions, but whether it serves as ''a'' primary basis (as the regulatory text states). If there is a reasonable understanding between the parties that the advice is important to the retirement investor and could determine the outcome of his or her decision that is enough to satisfy the "primary basis" prong of the five-part test.

Thus, the rollover recommendation – advice that is arguably important to the retirement investor – could be one of any number of "primary" bases for the investment decision and would satisfy the standard. The presumption here is that rollover advice is *a* primary basis for the investment decision by the plan participant or owner. As a result, Prong 4 is almost certainly satisfied.

## SATISFYING PRONG 5:

### *THE ADVICE IS INDIVIDUALIZED*

A rollover recommendation will generally satisfy the fifth prong of the five-part test because the rollover recommendation is individualized – it is addressed specifically to an individual plan participant (or IRA owner based) on that person's particular financial needs.

Again, annuity professionals must satisfy ALL five prongs of the five-part test in order to be considered an investment advice fiduciary. Any rollover recommendation will generally satisfy Prongs 1, 4, and 5; arguably, there is greater ambiguity around the facts and circumstances necessary to satisfy prongs 2 and 3. ***Nevertheless, it is likely that most rollover recommendations will now be considered fiduciary investment advice.***

# FIDUCIARY DUTIES UNDER ERISA AND THE CODE

Investment advice fiduciaries who make rollover recommendations are subject to the fiduciary duties imposed by Title I of ERISA, as well as the prohibited transaction provisions of ERISA and the Code. In other words, certain general fiduciary obligations will apply to the conduct of the financial services professional irrespective of the application of a PTE necessary to receive permissible compensation.

Assuming an annuity professional meets ERISA's five-part test for being a fiduciary when making a rollover recommendation, he or she must meet the ERISA fiduciary standard if the recommendation involves a rollover from an ERISA-covered plan, like a 401(k) plan. This recommendation is subject to Title I of ERISA because it is considered a recommendation regarding the plan, and therefore the full scope of ERISA's fiduciary duties of prudence and loyalty apply. (However, if the rollover is coming from an IRA – in other words, an IRA-to-IRA rollover – meeting the five-part test determines whether a prohibited transaction has occurred, but does not impose a separate duty of care. That is because this recommendation is subject to Title II of ERISA, which does not impose the same duties of prudence and loyalty).

When an annuity professional considers whether to recommend a rollover from an ERISA plan, which would be subject to Title I, he or she must employ a **prudent and thorough** fiduciary process to determine whether a rollover is in the best interest of the participant. **The first step is to gather the relevant information necessary to analyze the options available to the participants. That means the annuity professional will now need to know what investments are available in the plan, what services are available in the plan, and the costs of those services and investments.** Typically, this information can be found in the participant's quarterly benefit statement and in the annual 404(a)(5) participant disclosure. (Gathering this information can be difficult, as not all participants will be able to provide that information at the time they want a recommendation. How the annuity professional proceeds if the information is not available depends on several other factors. For example, if relying on PTE 2020-02, that exemption has specific requirements about a diligent and thorough effort to obtain this information, to explain its importance to the participants if they don't have it, and to document alternative information used in its absence, such as the Form 5500 plan data or benchmarking data.)

Once the annuity professional obtains the required plan information, **next step is to analyze that information and other relevant factors, and, taking into account all germane information, make a recommendation that is in the best interest of the participant.** This individualized recommendation should consider the rollover option as well as the option to leave assets in the plan, comparing the relative advantages and disadvantages of both options. It is advisable (and required under PTE 2020-02, if used) to **document the reasons why the recommendation is in the participant's best interest**. The annuity professional should remember that the ERISA fiduciary obligation applies concurrently with applicable state insurance suitability or best interest requirements, which may also require documentation of the recommendation, and the producer must comply with both sets of requirements. (NOTE: The current NAIC Suitability in Annuity Transactions Model Regulation requires such documentation.)

Then, **in order to receive permissible compensation for providing the investment advice** – i.e., for making the rollover recommendation to purchase an annuity – **an annuity professional must rely on a prohibited transaction exemption** and comply with the requirements of the chosen exemption.

*The new Exemption (PTE 2020-02) allows insurance companies that sell fixed and fixed indexed annuities through a captive or career sales force of employee agents or through independent insurance agents to have compliance relief for these transactions. However, the insurance industry is more likely to use PTE 84-24 as the appropriate compliance pathway for annuity sales in the rollover space, as this exemption was designed for the purchase of insurance or annuity contracts with Plan assets and does not require insurance companies to act in a co-fiduciary capacity with independent agents, which, due to the unique nature of the relationship, they are per se unable to do.*

## PROHIBITED TRANSACTION EXEMPTION 84-24

Even though PTE 84-24 has been around since 1977 (and amended several times since), the fixed annuity industry has not utilized this exemption very frequently because, prior to the reinterpretation of the five-part test, insurance agents and annuity professionals were not considered fiduciaries. However, as the definition of who is considered to be a "fiduciary" is now greatly expanded under the DOL's guidance to the new Exemption, many annuity transactions involving ERISA plans and IRAs may trigger fiduciary status and associated duties. Once defined as a fiduciary, annuity professionals will need an exemption in order to permissibly receive compensation.

PTE 84-24 provides regulatory relief to insurance agents and brokers, pension consultants, insurance companies, and investment company underwriters who are investment advice fiduciaries under ERISA or the Code and who receive payments from third parties in connection with transactions involving an ERISA plan or IRA.[7] PTE 84-24 permits the receipt, either directly or indirectly, of a sales 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 with an unrelated party** would be; and
- ✓ The fiduciary relying on the exemption must receive **no more than reasonable compensation**.

Also, PTE 84-24 requires that **certain disclosures be made to the plan participant or IRA owner, after which the participant or owner must acknowledge in writing receipt of such information and approve the transaction.** An annuity professional seeking to rely on the exemption must disclose:

1. The **nature of any affiliation or relationship with the insurance company** whose annuity contract is being recommended, along with **any limitations on the products that can be recommended**;
2. **The sales commission**, expressed as a percentage of gross annual premium payments for the first year and for each of the succeeding renewal years that will be paid by the insurance company to the agent in connection with purchase of the recommended contract; and
3. A **description of any charges, fees, discounts, penalties or adjustments** under the contract.

[7] Although PTE 84-24 addresses plan and IRA transactions involving mutual fund shares and investment company securities, this summary addresses PTE 84-24 to the extent that it relates to annuity contracts.

Additionally, the 84-24 disclosure form must be written to be understood by a participant or owner who has no special expertise in insurance or investment matters. Importantly, and unlike other PTEs (including under the new Exemption), it is not necessary to disclose to the client that you are a fiduciary.

A sample 84-24 form is available at the end of this document. In addition, many insurers may provide 84-24 forms and may even assist with prefilling certain information. Insurers may, but are not required to, require the form to be submitted with applications.

## COMPLIANCE TIMELINE FOR DOL 3.0

When the Department announced in February 2021 that the Exemption would become effective as scheduled, it also stated that it would be publishing related guidance for retirement investors, employee benefit plans, and investment advice providers and would continue its outreach to stakeholders to determine how it might improve on the exemption, the definition as to who is an investment advice fiduciary, and other related exemptions. On April 12, 2021, the Department **issued** this related guidance: a set of **FAQs** intended to address compliance with the new Exemption and the interpretation of the five-part test, along with a **consumer-focused guide**.

The agency also indicated that the temporary enforcement policy ("TEP") set forth in **Field Assistance Bulletin (FAB) 2018-02** (in effect since June 9, 2017) would remain in place until December 20, 2021. Much has been written and discussed about the scope and applicability of this extension of the temporary enforcement policy; however, the preamble suggests that this extension should be viewed as a transition period during which the Department will not pursue claims. The Department indicated that extending the enforcement deadline until December 20 would allow investment advice fiduciaries working diligently and in good faith the time to come into compliance with the requirements under PTE 2020-02.

Subsequently, on Tuesday, October 25, 2021, the DOL **announced** it would extend through January 31, 2022 the temporary enforcement policy that had been scheduled to expire on December 20, 2021. Investment advice fiduciaries who continued to operate in good faith to comply with the **impartial conduct standards** for transactions exempted under PTE 2020-02 would remain under the protections of the temporary enforcement policy for that extended period of time. Additionally, through June 30, 2022, the Department stated it would not pursue prohibited transactions claims against investment advice fiduciaries who were otherwise in compliance with PTE 2020-02 solely for their failure to comply with the disclosure and documentation requirements under that exemption; however, all other requirements of PTE 2020-02 went into effect February 1, 2022. **As of July 1, 2022, all requirements and obligations under PTE 2020-02, including the Department's new interpretation of the five-part test determining fiduciary status, are in full effect.**

## ALIGNMENT WITH OTHER SALES CONDUCT STANDARDS

Throughout the past several years, regulators across multiple segments of the financial services industry have been working toward the establishment of a best interest standard for retirement-focused transactions. These regimes include the Securities and Exchange Commission's Regulation Best Interest ("Reg. BI"), the duties of registered investment advisers under securities laws, and annuity transactions under the **NAIC Suitability in Annuity Transactions Model Regulation - #275** ("MDL 275"). The Department is clear that it does not view compliance with the new Exemption as providing a safe harbor for compliance with the conduct standards of other regulators. Moreover, the fact that an annuity professional is not a fiduciary under other laws – such as securities law or state insurance law – is not determinative as to whether he or she is a fiduciary under PTE 2020-02.

However, the Department notes that the best interest standard in the new Exemption is intended to align with the conduct standards of the other regulatory bodies, including the conduct standards of Reg. BI and the fiduciary duty of registered investment advisers under securities law. For non-qualified annuity sales transactions, annuity professionals would comply with the best interest standards and requirements reflected in the revised NAIC MDL 275. For annuity transactions in the qualified space, the conditions of the Exemption – in particular, the application of the five-part test as newly-interpreted by the Department – would apply. And, if the application of the five-part test results in an annuity professional being deemed an investment advice fiduciary, fiduciary obligations would attach and a prohibited transaction exemption would be required to receive permissible compensation.

## ENFORCEMENT OF PTE 2020-02 AND PTE 84-24

According to the April 2021 **FAQs**, the Department has "investigative and interpretive authority with respect to exemption compliance." (*See* Q21.) The Department will undertake compliance investigation for ERISA Title I plans and will enforce the Title I protections. Plan Participants may also pursue a statutory cause of action for fiduciary breaches and for prohibited transactions under Section 502 of ERISA. For IRAs (and other non-Title I plans), the Department confirms its authority to determine whether the exemption conditions have been satisfied and may inform the IRS of a failure to satisfy the exemption conditions. The IRS may enforce such violations through the excise tax. However, unlike the 2016 rule, PTE 2020-02 does not impose contract or warranty requirements on the financial institution or financial professional responsible for compliance. And, the new Exemption does not create any new legal claims under ERISA or the Code for plan participants or IRA owners, nor does it expand their ability to enforce their rights in court.

Financial institutions can correct violations of the exemption within 90 days after learning – or after they should reasonably have learned – of a violation. If the violation did not result in any investment loss to the retirement investor or if the financial institution made the retirement investor "whole" for any losses incurred, it can correct the violation and notify the Department within 30 days of correction.

Yet financial institutions and investment advice fiduciaries could lose the ability to use the new exemption for a period of ten (10) years for certain criminal convictions in connection with providing fiduciary investment advice; for systemic or intentional violation of the conditions of the exemption; or for providing materially misleading information to the Department in relation to conduct under the exemption. (NOTE: Ineligible financial institutions and investment advice fiduciaries may rely on existing class exemptions or seek an individual PTE from the Department. Further, the Department will provide financial institutions with the opportunity to respond prior to becoming ineligible, and, if they do become ineligible, will have a one-year "winding down" period to avoid disruptive transitions.)

The basic enforcement mechanism is essentially the same for both PTE 2020-02 and PTE 84-24; however, there is some difference, depending on whether the transaction involves a workplace retirement plan or only an IRA.

**FOR PLAN-TO-IRA ROLLOVERS:** Where a plan is involved and an investment advice fiduciary fails to meet PTE 84-24 requirements, the result is a violation of both ERISA and Code prohibited transaction rules. The Department of Labor would require that the plan participant be restored to the position he or she would have been in but for the transaction, and the annuity professional would have to disgorge any profits related to the transaction. And, the IRS would levy an excise tax on the amount involved. There may also be a breach of fiduciary duty under ERISA, but the remedy is essentially the same here: making the plan participant "whole" for any losses incurred. (Whether any federal or state securities or insurance law remedies would apply would depend on the capacity in which the annuity professional was acting.)

**FOR IRA-TO-IRA TRANSFERS:** If the annuity professional is deemed an investment advice fiduciary but does not meet the 84-24 requirements, the result would be a violation of the Code's prohibited transaction rules; ERISA rules and fiduciary requirements would not apply in this instance. The IRS would levy an excise tax on the amount involved. (As above, whether any federal or state securities or insurance law remedies would apply would depend on the capacity in which the annuity professional was acting.)

## WHAT'S NEXT

In its answer to Question 5 of the industry-focused FAQs published in April 2021, the Department made clear that we should anticipate additional rulemaking related to PTE 2020-02 and, more generally, how the Department regulates fiduciary investment advice. The DOL also indicated it may also amend or revoke some of the other existing class exemptions available to investment advice fiduciaries. PTE 84-24 may well be on the table for further amendment – or even possible revocation. The Department further stated that while future actions are under consideration to improve PTE 2020-02, the core components of the exemption – including the Impartial Conduct Standards and other "strong policies and procedures" – are fundamental investor protections that should not be delayed, even while additional protections and clarifications to the exemption are considered.

The Department of Labor/Employee Benefits Security Administration (DOL/EBSA) formally announced its intention to amend the regulatory definition of the term "fiduciary" under ERISA and the Code and to also evaluate the available PTEs and consider amending the existing exemptions or proposing new exemptions in June 2021 as part of the Office of Management and Budget's Spring Agency Regulatory Agenda. Industry and other stakeholders anticipated further rulemaking in late 2021, but, as of this writing, no new or amended rule has been proposed. However, the Department reaffirmed its commitment to amending the definition of the term fiduciary and to evaluate current prohibited transaction exemptions in the OMB's Spring 2022 Unified Agenda of Regulatory and Deregulatory Actions. According to the Department's abstract (which is identical to the language included in the 2021 agenda):

> This rulemaking would amend the regulatory definition of the term fiduciary set forth at 29 CFR 2510.3-21(c) to more appropriately define when persons who render investment advice for a fee to employee benefit plans and IRAs are fiduciaries within the meaning of section 3(21) of ERISA and section 4975(e)(3) of the Internal Revenue Code. The amendment would take into account practices of investment advisers, and the expectations of plan officials and participants, and IRA owners who receive investment advice, as well as developments in the investment marketplace, including in the ways advisers are compensated that can subject advisers to harmful conflicts of interest. In conjunction with this rulemaking,
>
> EBSA also will evaluate available prohibited transaction class exemptions and consider proposing amendments or new exemptions to ensure consistent protection of employee benefit plan and IRA investors.

As was the case with the 2021 agenda, the 2022 timeline for an anticipated notice of proposed rulemaking (NPRM) Is sometime in December. There are, however, significant potential stumbling blocks that may delay that timeline, including the November 2022 midterm elections and the outcome of two lawsuits challenging Fiduciary Rule 3.0 that are currently being litigated against the Department in the federal district court. Nevertheless, we could see an NPRM sometime in 2023, and most industry observers believe that a new proposed rule – a Fiduciary Rule 4.0 – will more closely resemble the 2016 Obama-era fiduciary rule. Moreover, we can anticipate that the Department will take a close look at amending PTE 84-24, in particular expanding disclosures around commissions and material conflicts of interest – not to mention addressing the definition and scope of compensation that would be permissible under the exemption and requiring fiduciary acknowledgment.

***This leaves industry in the difficult position of implementing compliance processes and protocols that are likely to be insufficient under a future regulatory regime, resulting in continuing confusion and disruption.***

## CONCLUSION

Annuity professionals – along with the retirement consumers they serve – have been in a state of flux for nearly 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 the 2020 new PTE and reinterpretation of who is a fiduciary, to anticipated further rulemaking in 2023, to the uncertainty of current – and perhaps future – legal challenges to the current rule, the regulatory ground beneath our collective feet has been ever shifting.

# GLOSSARY OF TERMS

### Arm's-Length Transaction

A legal term of art generally understood to be a business agreement between two unrelated parties with roughly equal bargaining power that is voluntary (i.e., without compulsion or duress); that takes place in the open market; and where the parties are each acting in their own self interest.

### Best Interest

Under PTE 2020-02, the best interest standard is satisfied if the investment advice is *prudent* and *loyal*. The Exemption requires the financial institution (the investment advice fiduciary) to document the specific reasons that the recommendation to roll over workplace retirement plan assets to an IRA, or from one type of account to another, is in the best interest of the retirement investor.

### ERISA

ERISA is the Employee Retirement Income Security Act of 1974, enacted September 2, 1974, which sets forth and regulates the minimum standards for employee pension plans in private-sector employment. ERISA protects the interests of employee benefit plan participants and their beneficiaries by requiring certain disclosures of financial and other information to plan participants and beneficiaries, establishing conduct standards for plan fiduciaries, and providing legal remedies in the federal court system.

### Fiduciary

A fiduciary is a person who acts on behalf on another person or persons, putting their interests ahead of his or her own.

### Fiduciary Rule 3.0

Shorthand reference to PTE 2020-02, *Improving Investment Advice for Workers & Retirees*, adopted by the U.S. Department of Labor on December 18, 2020 and made effective February 16, 2021. This new class exemption is generally considered the third iteration of the Department's attempt to impose a broader fiduciary standard of care on financial institutions and professionals in the workplace retirement plan space.

### Five-Part Test

In 1975, the Department issued a regulation establishing a five-part test to determine fiduciary status under ERISA. An identical test also applies to the definition of fiduciary in the Code. For advice to constitute "investment advice," all five parts or prongs of this test must be satisfied. Whether all prongs of the test are satisfied is determined based on all the surrounding facts and circumstances. (See pg. 5 – 7 of this guidance document for a further elaboration of the five-part test.)

### Impartial Conduct Standards

The Impartial Conduct Standards are set forth in the PTE 2020-02 requirements: the best interest standard of care, a reasonable compensation standard, and a prohibition of materially misleading statements about recommended investment transactions and other relevant matters.

### Internal Revenue Code

The Internal Revenue Code (IRC – "the Code") is the domestic portion of federal statutory tax law in the United States (published at Title 26 of the U.S. Code). For purposes of this discussion, I.R.C. §4975 imposes an excise tax on certain prohibited transactions related to qualified employer plans. The Code's implementing federal agency is the Internal Revenue Service.

### Investment Advice

For advice to constitute "investment advice," all five parts or prongs of the 1975 five-part test must be satisfied.

### Investment Advice Fiduciary

A financial institution or investment professional who provides "investment advice" for a fee or other compensation (direct or indirect) for such advice with respect to any moneys or other property of a workplace retirement plan is an investment advice fiduciary under Title I of ERISA and under the Code.

### IRA

An Individual Retirement Account (or, sometimes, individual retirement arrangements) are accounts that have tax advantages which individuals use to set aside money for retirement. There are a number of different types of IRAs (e.g., traditional, Roth, SEP, SIMPLE), each of which have different rules regarding eligibility, taxation, and withdrawals.

### Loyalty

Under the duty of loyalty, when making the recommendation the advice must not place the financial interests of the investment professional, financial institution, related affiliate or entity, or other party ahead of the interests of the retirement investor – nor subordinate the retirement investor's interests to their own.

### Material Conflict of Interest

A material conflict of interest arises when a financial professional has a financial interest in the sale of a product that a reasonable person would conclude affects or influences the impartiality of the recommendation. Receipt of cash and non-cash compensation for the sale of a product using assets from a workplace retirement plan should be considered in determining if a material conflict of interest exists.

### Prohibited Transaction Exemption (PTE)

Under Title I of ERISA and the Code, investment advice fiduciaries are prohibited from "self dealing" – that is, causing themselves or their affiliates or related entities to receive additional compensation from transactions involving workplace retirement plans or IRAs – unless a prohibited transaction exemption (PTE) applies. Utilizing a PTE permits investment advice fiduciaries to receive compensation as a result of providing fiduciary investment advice.

### Prudence

Title I of ERISA imposes fundamental duties of prudence and loyalty on investment advice fiduciaries with respect to workplace retirement plans. Under ERISA, acting with prudence means satisfying a standard of care that requires the financial professional to give appropriate consideration to the facts and circumstances relevant to the particular investment or investment course of action and the role the investment plays in the workplace retirement plan's portfolio and to act accordingly. The financial professional must investigate and evaluate investments based on the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor, provide advice, and exercise sound judgment in the same manner that a knowledgeable and impartial professional would.

### PTE 84-24

A prohibited transaction class exemption (PTE) that provides relief for certain transactions relating to the purchase of investment company securities or insurance or annuity contracts with workplace plan assets and the payment of sales commissions to insurance agents and brokers (inter alia) associated with the purchase. Most recently amended in 2006. (See pages 9 – 10.)

### PTE 2020-02

A prohibited transaction class exemption (PTE) for investment advice fiduciaries introduced in July 2020, finalized in December 2020, and made effective as of February 16, 2021, also called Improving Investment Advice for Workers & Retirees. Exemption is available to RIAs, B-Ds, insurance companies, and banks – and the individual investment professionals who are their employees or agents. (See pg. 3 – 4)

### Rollover Recommendation or Rollover Advice

A recommendation to take a distribution of assets from a workplace retirement plan and "roll" them over to an IRA. Also applies to other similar types of recommendations, e.g., an IRA-to-IRA rollover.

### Sales Commission

The compensation, generally reflected as a percentage of gross annual premium payments, paid to the selling agent by the issuing insurance company in connection with the annuity contract.

### Workplace Retirement Plan

Also, a Defined Contribution (DC) Plan. Generally, DC plans are tax deferred (such as a 401(k) or 403(b)) and are ones in which the employee contributes some of his or her paycheck to an account that is intended to help fund retirement. Often the sponsoring company (the employer) will match a portion of the employee contribution as an added benefit. There are restrictions on when and how the employee can withdraw funds from these accounts without incurring a penalty.

# MAKING A ROLLOVER RECOMMENDATION
## BEST PRACTICES CHECKLIST

For the purposes of this best practices guidance, we are going to assume that the rollover recommendation made by the independent insurance producer satisfies the five-part test. We will also assume that the producer receives a fee or other compensation for that advice. Accordingly, the producer is an investment advice fiduciary under Title I of ERISA and the Code. As stated previously, when a producer considers whether to recommend a rollover from an ERISA plan and would be subject to Title I, the producer must employ a **prudent and thorough** fiduciary process to determine whether a rollover is in the best interest of the participant.

✓ **Gather the relevant information necessary to analyze the options available to the participants.**

- The producer needs to know what investments are available in the plan, what services are available in the plan, and the costs of those services and investments.
- Typically, this information can be found in the participant's quarterly benefit statement and in the annual 404(a)(5) participant disclosure.
    - Gathering this information can be difficult, as not all participants will be able to provide that information at the time they want a recommendation. How the producer proceeds if the information is not available depends on several other factors. For example, if the producer is going to rely on PTE 2020-02, that exemption has specific requirements about a diligent and thorough effort to obtain this information, to explain its importance to the participants if they don't have it, and to document alternative information used in its absence, such as the Form 5500 plan data or benchmarking data.

✓ **Analyze that information and other relevant factors in order to make a recommendation that is in the best interest of the participant.**

- This individualized recommendation should consider the rollover option as well as the option to leave assets in the plan, comparing the relative advantages and disadvantages of all options.

✓ **Document the reasons why the recommendation is in the participant's best interest.**

- The producer should remember that the ERISA fiduciary obligation applies concurrently with state insurance suitability or best interest requirements, and the producer must comply with both sets of requirements. (NOTE: NAIC MDL 275 requires such documentation.)

✓ **To receive permissible compensation for the recommendation, comply with the conditions and**

**requirements of a Prohibited Transaction Exemption (PTE).**

- While PTE 2020-02 is available to insurance companies and agents to use for compliance relief, independent insurance producers will most likely use PTE 84-24 as the appropriate compliance pathway for annuity sales in the rollover space.
- PTE 84-24 conditions that must be satisfied include:
  - Transaction is effected in the ordinary course of business
  - Transaction is at least as favorable to the plan as an arm's-length transaction with an unrelated party would be
  - Combined total of all fees, commissions, and other consideration is not in excess of reasonable compensation
- PTE 84-24 disclosures that must be provided include:
  - The nature of the affiliation or relationship the producer has with the issuing insurance company and any limitations the insurance company places on the producer to recommend the annuity contract
  - The sales commission paid by the insurance company to the producer, expressed as a percentage of gross annual premium for the first year and any succeeding renewal years
  - A description of any charges, fees, discounts, penalties or adjustments which may be imposed under the annuity contract in connection with the purchase, holding, exchange, or termination of the contract

✓ **Prior to finalizing the transaction, have the Client execute the 84-24 disclosure form, acknowledging in writing receipt of the disclosures and approving the purchase of the contract.**

✓ **Maintain appropriate record-keeping protocols.**

# PROHIBITED TRANSACTION EXEMPTION (PTE) 84-24
## DISCLOSURE AND ACKNOWLEDGMENT FORM*

**This disclosure and acknowledgment form ("Form") provides important information for you to consider prior to making the purchase of an annuity or other insurance product ("Contract") issued by an insurance company with funds from an IRA or other retirement plan subject to the Employment Retirement Security Act of 1974 (ERISA), as amended. The information provided in this Form is intended to satisfy the requirements and conditions of U.S. Department of Labor Prohibited Transaction Exemption 84-24 (PTE 84-24). This form describes:**

- The nature of the relationship between the agent and the insurance company;
- The sales commission the agent will receive in connection with your purchase of this Contract; and
- Certain charges and fees that may be imposed in connection with the purchase, holding, exchange, termination or sale of the Contract.

NAME OF AGENT ________________________________________________

NAME OF PROPOSED IRA OWNER ("Applicant") ____________________________

ANNUITY BEING PURCHASED ("the Contract") ______________________________

INSURANCE COMPANY ISSUING THE CONTRACT ___________________________

### RELATIONSHIP OF THE AGENT TO THE INSURANCE COMPANY

The Agent can only sell annuity and insurance products which his/her license allows and which are issued by an insurance company with whom they are authorized to sell. The Agent from whom you are purchasing this annuity Contract is independent of the issuing Insurance Company listed above and is under no contractual obligation to recommend or offer the above Insurance Company's annuity or insurance products. The Agent is licensed and appointed with a number of insurance companies and may recommend annuity contracts that are issued by the Insurance Company listed above, as well as other insurance companies. The Agent may not waive or modify any terms of the Contract.

### COMPENSATION PAYABLE TO THE AGENT

The Insurance Company will pay a sales commission to the Agent when you purchase this Contract. The commission is paid by the Insurance Company, and one-hundred percent of your premium payment(s) will be credited to the accumulation value of your Contract. If you purchase the Contract, the Insurance Company will pay the Agent a commission as follows:

_____% of the gross annual premium received by the Insurance Company during the first year of the Contract; and

_____% of the gross annual premium payments for ______ years after the first year of the Contract (if any – leave blank if no additional payments are made).

## CONTRACT CHARGES

The Contract may include certain charges, fees, discounts, penalties, or adjustments imposed by the Insurance Company as the issuer of the Contract. These may include surrender charges, bonus recapture provisions, market value adjustments, or fees for optional annuity contract features available through a rider to the Contract. The charges and provisions applicable to this Contract are described in detail in the Annuity Disclosure Statement that has been provided to you and signed by you in connection with your application to purchase this Contract. It is important that you understand the charges that may be imposed under the Contract you are purchasing. Please ask the Agent if you have any questions or would like additional information.

## ACKNOWLEDGMENT OF DISCLOSURE/APPROVAL

I acknowledge receipt of the information contained in this Form (including the Agent's relationship to the issuing Insurance Company, the commission the Agent will receive in connection with the purchase of the Contract, and the charges and fees associated with this Contract) and the Annuity Disclosure Statement referenced above. I acknowledge that I received this information prior to the purchase of the Contract.

I approve the purchase of the Contract for funding contributions to the IRA. I understand that this Form is not a contract and does not create any enforceable obligations between me and the Agent, any applicable insurance agency, the Insurance Company, or any other party.

**This form is not a contract and does not create any enforceable obligations between You and the Agent.**

APPLICANT SIGNATURE DATE

## AGENT CERTIFICATION/ACKNOWLEDGMENT

I certify and acknowledge that I have provided to the applicant all disclosures required in this Form and have satisfied the requirements of PTE 84-24.

AGENT/PRODUCER SIGNATURE DATE

* This sample form is intended for educational purposes only and is not intended to be legal advice. Consult your own legal and compliance professionals regarding the content and applicability of PTE 84-24 and its disclosure requirements.