

Deciphering the DOL Rule Implementation Essentials

A Special Series from AALU & Drinker Biddle



What Does June 9th Really Mean? Before & After Examples of the Fiduciary Rule in Action

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As June 9th is only a few days away, many producers are working hard to understand when the Fiduciary Rule applies to their business, and how to comply. To augment our previous alerts explaining the Rule and the Transition Exemptions needed to receive commissions—Transition Prohibited Transaction Exemption 84-24 (“Transition 84-24”) and Transition Best Interest Contract Exemption (“Transition BIC”)—this alert will provide “Before June 9th” and “After June 9th” comparisons for common insurance-based transactions. These examples should help illustrate when and how the Rule applies, and give a basic checklist for compliance. Following the examples are summary explanations of the key terms (such as “Best Interest”). As always, this summary cannot replace legal advice, and producers are encouraged to work with their compliance partners or to seek legal counsel regarding their specific needs.

The Fiduciary Rule in Action—Before and After:

Scenario #1: Recommending a Rollover from a Plan to an IRA

<i>Before</i>	<i>After</i>
Likely was not fiduciary advice ¹	Definitely Fiduciary Advice
Insurance/securities law applies to sale ²	Best Interest Standard <u>also</u> applies ³
PTE 84-24 likely used	Either Transition 84-24 or Transition BIC needed to receive commission

Comments: Recommending a rollover is now fiduciary advice requiring a thorough, well-documented fiduciary process. The producer must gather information about the plan the rollover is coming from to prudently evaluate whether the rollover is in the Best Interest of the participant. This includes the plan’s investments and services, whether individual investment advice is available in the plan, what the plan distribution options are, and the fees and expenses of the plan. These must be compared with the investments, fees, and services available in the IRA, as well as the client’s needs and financial goals and objectives.

¹ Prior to the Fiduciary Rule, rollover advice was fiduciary advice only if the producer was already a fiduciary to the plan the rollover came from.

² Whether insurance or securities law applies is determined by the product recommended, the producer’s license, and the capacity in which the producer acts—many producers hold both insurance and securities licenses.

³ The Fiduciary Rule applies in addition to the producer’s “normal” regulatory requirements—while it may impose more requirements, it adds to, but does not replace, the producer’s existing regulatory requirements.

Scenario #2: Recommending Investments, Annuities, or Certain Insurance Contracts⁴ Inside an ERISA Plan:

<i>Before</i>	<i>After</i>
Likely was not fiduciary advice ⁵	Definitely fiduciary advice
Insurance/securities law applies to sale	ERISA fiduciary and Best Interest Standards <u>also</u> apply
84-24 likely used	Transition 84-24 or Transition BIC necessary to receive commission

Comments: Recommending insurance investment products, such as annuities, to a plan fiduciary, or to plan participants within the plan, is ERISA fiduciary advice. Among the relevant factors to consider is an assessment of the ability of the insurance carrier to meet its obligations, as well as all of the fees, requirements, and restrictions related to the product. Producers must also amend their existing 408(b)(2) service provider disclosures as close to June 9th as possible to address their change in fiduciary status—this can be done through contract amendments.

Scenario #3: Recommending Annuities inside an IRA:

<i>Before</i>	<i>After</i>
Likely was not fiduciary advice	Definitely fiduciary advice
Insurance/securities law applies to sale	Best Interest Standard <u>also</u> applies
84-24 likely used	Transition 84-24 or Transition BIC necessary to receive commission

⁴ Not all insurance contracts are subject to the Rule—for example, group term life insurance generally is not because it has no investment component.

⁵ Most producers, even when advising ERISA plans, took the position that they were not fiduciaries under the 1975 “five part test” the Fiduciary Rule is replacing (likely because there was no “mutual understanding” or because the advice was not “regularly provided”).

Comments: Recommending an annuity for purchase within an IRA is fiduciary advice. Among the relevant factors to consider is an assessment of the ability of the insurance carrier to meet its obligations, as well as all of the fees, requirements, and restrictions related to the product. The producer must also take into account the retirement needs, risk tolerance, and financial goals and objectives of the IRA owner. 408(b)(2) does not apply to IRAs.

Scenario #4: Recommending Purchase of Life Insurance Using a Plan or IRA Distribution – Including RMDs:

<i>Before</i>	<i>After</i>
Was not fiduciary advice	Definitely fiduciary advice
Insurance law applies to sale	Best Interest Standard <u>also</u> applies
No exemption needed	Transition 84-24 or Transition BIC necessary to receive commission

Comment: This is one of the most far-reaching aspects of the Fiduciary Rule. If a producer recommends that an individual take a distribution from a plan or IRA to purchase life insurance (or any other investment or insurance product), the Rule applies, even though the life insurance sale itself may have nothing to do with retirement advice. This Rule applies if the recommendation is made while the funds are still in the plan or IRA, and it includes Required Minimum Distributions.

Key Terms:

Fiduciary Advice: Under the new definition, producers are giving fiduciary advice if they:

- Recommend rolling retirement plan benefits over to IRAs, including individual retirement annuities;
- Recommend transferring existing IRAs from other institutions;
- Recommend taking distributions from retirement plans or IRAs (such as to purchase annuities or insurance with the proceeds); and
- Recommend purchasing annuities or other investments within plans or IRAs.

Best Interest: The standard of care required by the Impartial Conduct Standards that is a condition of both Transition 84-24 and Transition BIC, requires a producer to make a recommendation:

“...with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances and needs of the Plan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate or other party.”

In practice, this mean employing a thorough, prudent, and well-documented process that takes into account all of the relevant factors in developing a recommendation.

Transition 84-24: An exemption allowing the receipt of commissions and other compensation related to the sale of annuities and insurance contracts to ERISA plans or IRAs. It may be used for recommendations of all types of annuities throughout 2017, including fixed-rate, fixed indexed, and variable annuities. Transition 84-24 conditions are:

- The transaction is effected by the insurance agent, broker, pension consultant, or insurance company in the ordinary course of its business;
- The transaction is at least as favorable to the plan or IRA as an “arm’s length” transaction with an unrelated party would be;
- The combined total of all fees, commissions, and other payments received by the various parties to the transaction does not exceed reasonable compensation;

- Written disclosure of:
 - Any affiliation with the recommended insurance company, or any limitations on recommendations resulting from an agreement with the insurance company;
 - The sales commission, expressed as a percentage of the gross annual premium payment for the first year, and for each renewal year that will be paid by the insurance company **to the agent, broker, or consultant** in connection with the purchase of the recommended contract. (Note: “insurance agent or broker” and “pension consultant” is defined to include “such **persons and any affiliates** thereof”); and
 - A description of and charges, fees, discounts, penalties, or adjustments which may be imposed under the contract related to holding, exchange, termination, or sale of the contract.
- Written approval of the transaction by the plan or IRA before execution.
- Adherence to the Impartial Conduct Standards (see below).

Transition BIC Exemption: This very broad exemption requires a financial institution (insurance carrier, bank, broker-dealer, or RIA) to accept responsibility for the producer, but applies to a wide range of transactions, including rollovers, variable compensation, commissions, and proprietary product recommendations. It overlaps with, and can be used instead of Transition 84-24, if the financial institution is willing to do so for the producer (many independent producers will use 84-24 for this reason). The Transition BIC’s only requirements are the Impartial Conduct Standards (see below), though recent DOL guidance urges enhanced supervision of advisors by financial institutions where “conflicted” compensation is received.

Impartial Conduct Standards: These are requirements of both Transition BIC and Transition 84-24. There are three elements:

- Advice must be in the client’s “Best Interest” – the fiduciary duties of prudence and loyalty are observed by employing a thorough, well-documented fiduciary process that takes into account all the relevant factors going into the recommendation;
- All compensation must not exceed a reasonable level – this typically is measured by comparison to industry standards in light of the services being provided; and
- All statements to the client about products, material conflicts of interest (e.g., compensation incentives), fees, and other relevant matters must not be materially misleading.

Conclusion:

While the Trump Administration is likely to make changes to the Rule down the road, the fiduciary provisions will apply as currently written for at least the rest of 2017. DOL has also adopted an enforcement policy that will not punish the honest mistakes made by producers and others who are “working diligently” and “in good faith” to achieve compliance. While this helps somewhat, producers need to make changes very quickly if they haven’t already. This Alert illustrates how the Rule applies in some situations and can help get producers started, but producers are well-advised to seek professional assistance on their individual compliance efforts.