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The *WRMarketplace* is created exclusively for AALU Members by the AALU staff and Greenberg Traurig, one of the nation's leading tax and wealth management law firms. The WRMarketplace provides deep insight into trends and events impacting the use of life insurance products, including key take-aways, for AALU members, clients and advisors.

Newswire Special: House Financial Services Committee Passes CHOICE Act – Outlook in Senate Uncertain

Last week, the House Financial Services Committee passed the CHOICE Act (HR 10) on a 34-26 party-line vote. The bill rolls back a number of Dodd-Frank provisions that Republicans say place unnecessary burdens on banks and financial institutions. One provision would prevent the DOL from moving forward with a fiduciary rule without the SEC going first. However, there are significant challenges to getting this bill passed by the full House, the Senate, and signed by the President, especially before the applicability date for the DOL fiduciary rule becomes effective on June 9. For the latest update on the DOL fiduciary rule and the importance of the June 9 compliance date, click here. Republicans remain focused on using reconciliation for health care reform and tax reform, which means that 60 votes will be needed to pass the CHOICE Act in the Senate. Given the current Congressional calendar and environment in the Senate, it will be difficult to get anything done quickly, particularly on a bipartisan basis. While some Democratic senators understand the challenges posed by the fiduciary rule, and could be open to changes, they are likely to be hesitant to fully repeal the fiduciary rule without anything else in place. AALU continues to work to extend the delay of the DOL fiduciary rule so that it can be fully studied per the White House's February 3 memo. We submitted a comment letter on April 17 detailing the reasons for further delay, and have been talking to Administration officials about the urgency of addressing this issue immediately to ensure that retirement savers are not negatively impacted. We will continue to keep you posted on the latest developments

THE FIDUCIARY RULE GOES INTO EFFECT ON JUNE 9TH:
WHAT DOES IT MEAN AND WHAT DO YOU NEED TO DO?

April 28, 2017

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As was widely anticipated, the Trump Administration issued a final rule on April 7th (the "Delay Rule") that delayed the applicability date of the Fiduciary Rule by 60 days, from April 10th until June 9th. As we explain in more detail below, the Delay Rule also provides new, streamlined, transitional versions of the Best Interest Contract Exemption ("BIC Exemption") and Prohibited Transaction Exemption 84-24 ("PTE 84-24") that permit the continuation of traditional insurance commissions and other forms of compensation. These new transitional versions of the exemptions have very few conditions and are relatively easy to use, and are available from June 9 through December 31, 2017. However, there was also a surprise twist—the Department of Labor ("Department") wrote that they do not anticipate any further delays in the applicability date beyond June 9th.

This was a surprise because everyone thought the Department would continue delaying the Fiduciary Rule until it had completed the review ordered by President Trump and had decided whether to repeal or amend the Rule. Instead, the Department is providing just the 60-day delay before implementing the Fiduciary Rule, modified only by the addition of the more "user-friendly" temporary exemptions. In other words, the plan of "delay and decide" we were led to expect has been replaced with "implement and review"—the Department will decide whether and how to repeal or change the Fiduciary Rule before the end of the year. AALU (and many other organizations) has formally objected to this decision, and called on the Department to delay the applicability date beyond June 9th until it completes its review. However, as the compliance deadline is now only a few weeks away, producers must focus their efforts on getting ready for the June 9th deadline.

What Does This Mean for Producers, Carriers, and Our Clients?

It means the new, expanded definition of “fiduciary” investment advice will apply. Beginning on June 9th, many recommendations of annuities, insurance products, and investments that would not have been considered “fiduciary” in nature prior to June 9 will begin to be treated as fiduciary advice. As a result, the traditional commissions received by agents and advisors, though legal under insurance or securities laws, will become prohibited transactions in connection with sales to IRAs or plans, or in connection with assets recommended to be distributed from IRAs or plans. (Traditional commissions are prohibited forms of compensation for fiduciaries because they are payments from third parties, and because they typically vary from one investment to another—getting paid more by Investment A than by Investment B is prohibited for fiduciaries because it would allow them to affect their compensation by recommending investments that pay them more.)

However, there are special rules, called prohibited transaction exemptions, that allow commissions to be received provided certain conditions are met. Beginning June 9th, the new transitional forms of the BIC Exemption and PTE 8-24 waive some of the more burdensome and challenging conditions until January 1, 2018.

The net result is that producers will need to move quickly to implement a thorough, well-documented, prudent fiduciary process for recommendations by June 9, but generally they will be able to keep current compensation arrangements by taking advantage of broad prohibited transaction relief for the rest of 2017.

Which Recommendations Become Fiduciary Advice?

On and after June 9, advice that will “become fiduciary” under the Rule includes:

- Recommendations to roll retirement plan benefits over to IRAs, including individual retirement annuities, or to transfer existing IRAs from other institutions;
- Recommendations to take distributions from retirement plans or IRAs and purchase annuities or insurance products with the proceeds (for example, recommending using an upcoming required minimum distribution to buy a life insurance policy for estate planning purposes); and
- Recommendations to purchase annuities or other investments within IRAs, even if the recommendations are given on an infrequent basis, or have traditionally been regarded as “sales” communications rather than “investment advice.”

What Are the Transitional Exemptions Available from June 9th to December 31st?

The Department significantly liberalized the conditions of the prohibited transaction exemptions most likely to be used by producers during the transition period, specifically PTE 84-24 and the BIC Exemption.

- PTE 84-24

PTE 84-24 is an existing exemption used by the insurance industry since the late 1970's. The Fiduciary Rule amended its requirements significantly. Most importantly, PTE 84-24 could no longer be used for variable annuities ("VA") or fixed index annuities ("FIA"), but only for fixed-rate annuities. The Fiduciary Rule also narrowed the definition of "insurance commission," required new disclosures, and imposed the Impartial Conduct Standards (described in detail below, these are the "Best Interest" standard of care, no more than reasonable fees, and no materially misleading statements).

However, during the new transition period just announced, PTE 84-24 will be available for recommendations of all types of annuities throughout 2017. This includes fixed-rate, fixed indexed, and variable annuities. Most of the other new conditions are also removed during the transition period, including the new definition of commission and the new disclosure requirements. What remains of the Fiduciary Rule changes is the Impartial Conduct Standards, which must be met beginning June 9th.

- BIC Exemption

The BIC Exemption was a new exemption created in the Fiduciary Rule that was intended to be used for a wide array of transactions, including rollovers. It could be used instead of PTE 84-24—insurance carriers may be able to choose which exemption to utilize if they can meet the conditions of both. When the "full" BIC Exemption applies beginning in 2018, its conditions are extensive and have been the source of controversy. For example, it would require a written contract between the financial institution and the IRA owner in which, subject to a state-law class action for breach of contract, the financial institution would warrant and agree to many conditions regarding level and un-conflicted compensation for agents and advisors, make extensive disclosures, and take special steps relating to proprietary products. There was also an "old" transition period in the original Fiduciary Rule, which did not fully impose all of these conditions, but did require the Impartial Conduct Standards and a variety of disclosure statements and information to be provided to advice recipients.

However, during the new transition period just announced running from June 9th through the end of 2017, the only requirement that will apply is the Impartial Conduct Standards. Even the disclosure documents from the "old" transition period are waived.

What about Independent Producers and the Proposed Insurance Intermediaries Class Exemption for FMOs and IMOs?

The short answer is that the transition version of PTE 84-24 largely solves this problem, at least until the end of the year, by allowing all annuities, not just fixed-rate annuities, to be eligible for the exemption. The Fiduciary Rule originally removed VAs and FIAs from the scope of PTE 84-24—as a result, the BIC Exemption would be the only viable option for producers receiving commissions to sell FIAs and VAs.

However, the BIC Exemption requires a financial institution to enter into the arrangement on behalf of the advisor, and limited the definition of financial institution to include only banks, broker-dealers, registered investment advisors, and insurance carriers. As insurance carriers are unlikely to take on the liability risk imposed by the BIC Exemption for producers they do not supervise, and as IMOs, FMOs, and similar organizations could not be financial institutions under the BIC Exemption, independent producers without a securities license would have no ready way to sell FIAs and VAs in connection with plans and IRAs.

To address this, many FMOs, IMOs, and others (collectively, the Department decided to call them "insurance intermediaries") applied for a new exemption to allow them to enter into BIC arrangements. The Department ultimately proposed a new class exemption for insurance intermediaries modeled on the BIC Exemption at the end of the Obama Administration. However, the proposed insurance intermediaries class exemption was quite controversial due to the very restrictive conditions for its use proposed by the Obama Administration. The Trump Administration has not given any indication of what it may do with the proposed class exemption.

The Delay Rule temporarily fixes the problem for the rest of the year by allowing PTE 84-24 to revert back to its original form (with the addition of the Impartial Conducts Standards), allowing it to be used for all annuities. The fate of the proposed class exemption is still unknown, as it is connected with the review the Department is conducting to decide its next steps on the Fiduciary Rule.

What Are the Impartial Conduct Standards?

Regardless of whether the BIC Exemption, PTE 84-24, or both will be relied upon, producers and carriers need to prepare for compliance with the Impartial Conduct Standards on June 9th. They are:

- Advice must be in the client's "Best Interest" – which requires that fiduciary duties of prudence and loyalty be observed. There should be 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.

Advice is considered to be in a plan or IRA investor's "Best Interest" if the person giving the advice:

"…acts 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 short, a fiduciary advisor needs to collect the relevant information about the investor, analyze it, and proceed accordingly. While documenting the process may not be expressly required, it is essential to demonstrate compliance.

What Do We Have to Do By June 9th?

The biggest challenge is to develop, and to train everyone involved in using, a new prudent fiduciary process that meets the Best Interest standard. Existing forms and questionnaires used to document sales, such as suitability forms or "Know Your Customer" forms can form the foundation for a "Best Interest" fiduciary process, but it is likely they will need to be augmented with additional and more comprehensive questions.

Two key areas that will require new documentation in relation to the Fiduciary Rule are recommendations relating to rollovers from plans, and considering the fitness of the carrier providing a recommended annuity.

- Required Rollover Information

In order to make a prudent or Best Interest recommendation, the producer will need to gather and consider information about the plan that the rollover is coming from. This information includes the available investments under the plan, the available services (such as individual investment advice) under the plan, distribution options available under the plan, and the administrative and investment fees and expenses of the plan. This information must be considered in determining that the rollover recommendation is prudent and in the Best Interest of the participant. If the necessary information can't be collected from the participant, alternative means can be used, such as the plan's most recent Form 5500, or benchmark information for similar plans.

- Annuity Carrier Information

With respect to annuities, the producer will need to be able to show that he or she considered information related to the solvency and the ability of the carrier to make the promised annuity payments. This review does not have to be performed by the producer—for example, an intermediary organization may do that screening and analysis on behalf of the producer.

Producers, carriers and others also need to document that they have reviewed their fees

and found them reasonable. The extent to which other compliance steps will be necessary before June 9 may depend on circumstances. Under the BIC Exemption, only the Impartial Conduct Standards described above are imposed *per se* during 2017. During the transition period from June 9 through December 31, the BIC Exemption's restrictions on advisor compensation and other requirements will not yet be imposed. And, as only the Impartial Conduct Standards are being added to PTE 84-24, existing 84-24 disclosures should generally continue to be usable, although they may need to be updated to disclose material conflicts of interest.

Finally, to the extent your organization is involved in making recommendations to ERISA plans, new fiduciary status typically would require amending previously provided 408(b)(2) disclosures.

What Needs to be Done Before December 31st?

Unfortunately, there is no clear answer to this question. The Trump Administration is reviewing the Rule and may well make significant changes that we cannot predict at this point. If they don't, the exemptions and their requirements are quite different beginning January 1, 2018, and would require revisiting the decisions made for compliance with the June 9th deadline.

While it is too early to speculate about specifics changes, it is not too early to think about what changes would be desirable. While the Trump Administration is still just getting started on appointing the Department's leadership, the key staff will likely be in place over the summer, and we are advising clients to make their concerns and requests known so their input can be understood and considered by the new leaders.

Conclusion

The short term focus must be on building a prudent, thorough, and well-documented Best Interest recommendation processes ready for use by June 9th. This is doubly important because this process is not only required for the recommendation, but is one of the key requirements of the exemptions permitting the receipt of commissions. Some "business judgment" calls may be necessary as there are still ambiguities and unanswered questions about implementing the Fiduciary Rule. While the Trump Administration's decision is resulting in partial implementation of the Rule, we still have a long way to go after June 9th, and a very uncertain future about what may happen after this year.

AALU, along with our industry partners, is working to extend the delay of the Fiduciary Rule so that it can be fully studied per the White House February 3rd memo directing the Department of Labor to review the rule. We submitted a comment letter on April 17th detailing the reasons for further delay, and have been talking to Administration officials

about the urgency of addressing this issue immediately to ensure retirement savers are not negatively impacted. We will continue to keep you posted on the latest developments.

Regards,

David Stertzer
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AALU
