Finseca

Finseca December Alert

DOL Finalizes the Fiduciary Rule and Rollover Guidance, but It May Be Too Little, Too Late: What Producers Should Know About the Details and the Timing

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December 18, 2020

In July, the U.S. Department of Labor ("DOL") proposed a new and somewhat controversial regulatory and guidance package commonly called the "Fiduciary Rule." The new package offered guidance interpreting when producers and other financial professionals are considered fiduciaries under the Employee Retirement Income Security Act ("ERISA") for recommending rollovers. It also proposed a new regulation, called a class exemption, that would establish new conditions based on the SEC's Regulation Best Interest ("Reg BI") that were intended to make it easier for producers and other financial professionals to be paid commissions and other forms of reasonable compensation for their fiduciary advice. The final rule was released on December 15, will now be published in the federal register, and will become effective 60 days after that date.

Top Takeaways

- The Department of Labor has created a new class exemption, modeled after the SEC's REG BI, that would make it easier for producers and other financial professional to be paid a commission
- The Department reaffirmed its belief that more rollover recommendations constitute a fiduciary relationship
- Changes to the five-part test are immediately effective; The new class exemption goes into effect in March 2021
- Because of the delay in releasing the regulatory package the Biden administration has the option of delaying and ultimately withdrawing the new class exemption
- Finseca Members are advised to touch base with the carriers they work with to determine next steps and may need to utilize PTE 84-24 in future situations when a rollover is recommended

Finseca Worked to Improve the Proposal:

Some of the class exemption provisions could help producers better serve their clients. Finseca was generally supportive of that part of the package, though it recommended several specific changes needed to better accommodate producers not currently subject to Reg BI.

Finseca opposed the new guidance, however, because it inappropriately expanded ERISA fiduciary investment advice to include many rollover recommendations that previously were considered non-fiduciary sales transactions by producers. Finseca worked with the Department to argue for needed changes, including writing comments and testifying on behalf of our members at a public hearing.

Final Rule Out—Too Little, Too Late:

On December 15, DOL released the final version of the class exemption and the guidance. While DOL adopted a few of Finseca's recommendations to the class exemption, the reality is the regulation likely was completed too late in the regulatory process. It is very likely that the Biden Administration will be able to withdraw the rule before it goes into effect. As a result, the new rules making it easier for fiduciaries to receive commissions and other types of reasonable compensation may not ultimately become available.

Unfortunately, the revised guidance goes into effect right away, and while it also was slightly improved, it still has the effect of making many producer rollover recommendations more likely to be ERISA fiduciary investment advice. Where such a recommendation is fiduciary advice, the transaction will need to comply with either the new exemption (should it remain in effect) or one of the existing exemptions to allow producers to receive commissions. As a result, producers may see carriers begin to require new disclosures and documentation when producers recommend annuities and insurance products in connection with ERISA plans and IRAs.

What Does the Final Rule Package Do?

Like the July proposal, the final rule has two parts: the class exemption providing a new set of conditions allowing producers and others to be paid for providing ERISA fiduciary advice, and new guidance interpreting when a producer or other financial professional is a fiduciary in the first place. If a producer' recommendation of a rollover makes him or her a fiduciary, then an exemption, whether the new one just released or an older one, such as Prohibited Transaction Exemption 84-24, ("PTE 84-24"), must be met to allow the receipt of a commission.

- **The Final Class Exemption Remains Modeled on SEC's Reg BI**

The final exemption continues to model itself on the SEC's Reg BI. For producers operating through a broker-dealer, the class exemption will seem familiar. However, for producers recommending annuities and insurance contracts under state insurance law, the new conditions may be very difficult to meet. Finseca urged DOL to adopt a final rule modeled more closely on the new NAIC Model Rule for annuity recommendations, but DOL did not do so.

Impartial Conduct Standards. The final exemption requires adopting Impartial Conduct Standards that include a best interest recommendation that puts the interests of the retirement investors ahead of the interests of the financial institution or investment professional. There can also be no materially misleading statements, and fees must be reasonable.

Monitoring. The final exemption retains the confusion from the proposal regarding ongoing monitoring—while the best interest standard does not automatically require ongoing monitoring, DOL notes that prudence dictates some investments are unusually complex or risky and may require monitoring. The final exemption leaves this up to financial professionals to decide on a case-by-case basis, and it is not yet clear whether this class could include some insurance products.

Disclosures. Contrary to Finseca's request, the final exemption requires the Financial Institution and the Financial Professional to acknowledge fiduciary status as a condition of the exemption. This prevents its use by a professional that is unsure of fiduciary status under the guidance, and is concerned about a possible prohibited transaction if the relationship is later determined to be fiduciary. Other disclosures related to conflicts of interest and services are also required.

Written Policies and Procedures. As in the proposal, the financial institution must adopt written policies and procedures designed to ensure its investment professionals comply with the Impartial Conduct Standards. These policies and procedures should include supervision of investment professionals, as well as mitigating conflicts caused by compensation. This requirements are very similar to those in Reg BI. In developing and implementing these policies, and in supervising producers, the proposal permits insurance carriers to contract with intermediaries, but intermediaries are not eligible to be financial institutions themselves.

Annual Compliance Certification. The financial institution must annually assess its compliance with the exemption and prepare a written report on compliance. In a change from the proposal, certain senior officers, not just the CEO, may review and certify the report.

- **The Final Guidance Retains the Broad Rollover Interpretation**

The final rule includes a detailed discussion of when DOL believes a producer could become an ERISA fiduciary. It does so through its new interpretation of the 1975 regulation that establishes a five-part test. To be a fiduciary advisor, the producer would have to (1) provide individualized advice, (2) for a fee, (3) on regular basis, (4) subject to a “mutual understanding” that (5) the advice would be “a primary basis” for the recipient’s decision-making.

DOL remains consistent in the final guidance that a one-time sales transaction is not fiduciary advice. However, DOL is reversing its old view explained in Advisory Opinion 2005-23A that most rollover recommendations do not meet the five-part test by rescinding that opinion and coming up with new ways to interpret the rule that make it harder to tell when a “one-time” sales transaction has taken place.

Under the new DOL interpretation, whether advice has been provided on “regular basis” depends on whether the producer either has an “ongoing” relationship with the client, or is establishing a new “anticipated ongoing” relationship. In response to comments from Finseca and others, DOL did make some adjustments to the guidance.

Under the proposal, a producer could have an ongoing relationship triggering ERISA fiduciary status if he or she had previously recommended “securities or financial instruments” to the retirement investor. This could have included term life policies unrelated to ERISA. In response, DOL wrote in the Final that the prior recommendation needs to be in connection with a retirement savings vehicle, like an ERISA plan or IRA, to count as an “ongoing” relationship.

The Final retains the view that a single meeting between a producer and a new client could count as “regular basis” advice if the two intended to meet again to provide additional recommendation. Finseca strongly opposed this view, arguing that advice provided on a regular basis must occur at least more than once.

Conclusion:

So what does it all mean for producers? If you recommend a rollover and plan on providing additional recommendations after the initial meeting, DOL will likely assert that you are giving a fiduciary recommendation. For most producers, their carrier is likely to require certain disclosures and other paperwork associated with PTE 84-24 to ensure the transaction is permitted and to allow the producer to receive a commission. Producers are well-advised to touch base with the carriers they represent to determine what changes are anticipated. While the new class exemption may be a compliance option if it takes effect in March 2021 as scheduled, producers should be aware the exemption may likely not be allowed to proceed by the incoming Biden Administration.