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WRNewswire: DOL Finally Takes the Next Step: What Producers Need to Know about Rollovers and Commissions in the DOL's Fiduciary Rule 2.0

This WRNewswire was created exclusively for AALU members by ***Ken Kies****, Managing Director, Federal Policy Group and AALU outside tax counsel.*

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For more than five years, producers and other financial professionals have been contending with the fallout from the Department of Labor's ("DOL") efforts to change the definition of fiduciary investment advice under the Employee Retirement Income Security Act ("ERISA"). More than $10 trillion is held by ERISA- covered retirement plans and IRAs, and this definition determines when producers and other financial professionals have to follow special ERISA rules in addition to their usual compliance requirements. Producers can be subject to these rules not only when directly advising a retirement plan or plan participant on investments, but also when recommending that funds held by a retirement plan or IRA be "rolled over" or used to purchase another product. In this Alert, we'll examine why DOL is coming back to this issue again, what they are proposing, and what it means for producers.

Why is DOL Issuing This Proposal?

The history of the DOL "fiduciary rule" (which is actually a package of related administrative rulemakings and interpretations) is a regulatory roller-coaster ride. Finalized in 2016, the rule took effect in 2017, and was struck down by a Federal court of appeals in 2018. The result was confusion—the 1975 rule became the law again, but producers and others had made significant changes to comply with the new rule. To minimize the fallout, DOL put in place a temporary enforcement policy to address short-term compliance questions, and announced that it would propose a new package of rules to clean up the mess. That was two years ago.

On July 7th, DOL finally put out its long-awaited proposal to fix things. The comment period of 30 days is unusually short for such an important issue, and suggests that the Trump Administration wants to resolve the rulemaking before the election in November.

What Does the New DOL Proposal Do?

The new DOL proposal has two parts: a proposed class exemption (a new rule) addressing the conditions for producers and others to be paid for providing ERISA fiduciary advice, and a declaration of new guidance interpreting the 1975 regulation regarding the ERISA fiduciary status of rollover recommendations.

- *New "Class Exemption" Harmonizing DOL and SEC Requirements*

First, DOL proposes a new set of rules called a "class exemption" that models the ERISA requirements for receiving commissions and other forms of reasonable compensation on the new requirements of the Security and Exchange Commission's ("SEC") Regulation Best Interest ("Reg BI"). The goal is to "harmonize" the DOL and SEC standards so that one set of compliance processes will meet both agencies' requirements. This part of the proposal does not determine whether a producer is an ERISA fiduciary—what it does is lay out the conditions a producer who is already a fiduciary must meet to be able to receive compensation. For producers who are registered representatives of broker-dealers, this part of the proposal will look very familiar to Reg BI. While there are several specific issues for which commenters will likely seek change or clarification, most financial institutions appear to support DOL's intent behind this proposal.

- *New Interpretation of the Old Fiduciary Regulation Regarding Rollovers*

Second, DOL announced new guidance reinterpreting the existing 1975 regulation defining when a producer would be an ERISA fiduciary. The effect will be to make more producers subject to ERISA fiduciary status when they recommend a rollover or transfer from an ERISA plan or IRA, or when they recommend taking a distribution from a plan or IRA. This is a major policy change, but it is being done in a very unusual way. Unlike the 2016 rule, in which DOL changed the words of the 1975 regulation through notice and comment rulemaking, this is not a regulatory proposal on which they seek comments. DOL isn't changing the words in the old rule. Instead it is announcing that it has changed its mind about what those words mean. This is a controversial decision that likely will have a material impact on many producers and other financial professionals, and it is likely there will be requests for additional guidance.

How Did DOL Change its Rollover Interpretation?

The 1975 regulation establishes a five-part test to determine when a person is providing fiduciary investment advice under ERISA. 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.

With respect to rollovers, DOL adopted the view in Advisory Opinion 2005-23A that most rollovers would not be ERISA fiduciary advice. The primary reason was that DOL viewed the rollover recommendation as a single transaction, not part of advice that is “regularly” provided. Because the advice was not regularly provided, it didn’t meet the definition.

DOL now says that it got it wrong back in 2005, and rescinds the opinion. You can’t view the rollover transaction in isolation, says DOL. The issue is whether the rollover recommendation is part of an ongoing relationship between the financial professional and the individual receiving the advice. This can be either an existing relationship, or the rollover recommendation can be the start of the ongoing relationship.

How Does this New Interpretation Apply to Producers?

Under the new DOL interpretation, the central issue is whether the producer has an ongoing relationship with the client. As DOL notes specifically in its guidance:

“…a one-time sales transaction, such as the one-time sale of an insurance product, does not by itself confer fiduciary status under ERISA or the Code, even if accompanied by a recommendation that the product is well suited to the investor and would be a valuable purchase.”

However, DOL goes on to draw a distinction between one-time transactions and ongoing service to the client, stating:

“Like other Investment Professionals, however, insurance agents may have or contemplate an ongoing advice relationship with a customer. For example, agents who receive trailing commissions on annuity transactions may continue to provide ongoing recommendations or service with respect to the annuity.”

In other words, whether ERISA fiduciary status applies depends in part on what contact the producer is likely to have with the participant after the sale.

Example A: The producer recommends that a person take a distribution from a 401(k) plan to purchase a fixed annuity. Neither the producer nor the client expect additional advice or services from the producer after the sale. Result: this sale likely is not subject to ERISA fiduciary status because there is no ongoing relationship.

Example B: The producer recommends that a person rollover their 401(k) balance to an IRA and invest in a variable annuity. The producer and the client expect that the producer will provide future recommendations about how to invest assets within the variable annuity. Result: Even though this may be the first time the producer has made a recommendation to the client, it likely is subject to ERISA fiduciary status because both parties expect that there will be an ongoing relationship (assuming the other four requirements of the test are met).

What Does it Mean if a Producer is an ERISA Fiduciary Under the New Interpretation?

If a producer is acting as an ERISA fiduciary, he or she has to make a recommendation that is solely in the interest of the recipient employing a prudent, thorough, and well-documented process that takes into account all relevant factors. Further, the producer likely will need to meet the conditions of the proposed class exemption in order to be able to receive commissions for the work.

This is essentially the same situation producers faced for the year the 2016 rule was in effect before the court vacated it in 2018. Most rollover advice was ERISA fiduciary advice during that period, and producers needed to meet the requirements of an applicable exemption to receive a commission (PTE 84-24, etc.). If the DOL finalizes the new class exemption, it would be an exemption that could be used as well.

What Does the New Class Exemption Do?

The new class exemption permits reasonable compensation for “financial institutions” and “investment professionals” who make investment recommendations as ERISA fiduciaries to “retirement investors.” A financial institution is a bank, investment company, insurance company, registered investment advisor, or broker-dealer—the definition does not include insurance intermediaries. An investment professional is an employee, agent, or representative of a financial institution licensed under Federal or state law. A retirement investor is an ERISA plan fiduciary, participant, or beneficiary; or an IRA owner or beneficiary. The exemption also permits certain financial institutions to engage in principal transactions.

The exemption is needed because ERISA's conflict of interest rules (called prohibited transactions) are very broad, and would generally prohibit commissions, variable compensation, 3rd party payments, or any scenario in which compensation can be influenced by the fiduciary's advice. The proposed exemption would be useful for a wide array of financial transactions involving plans and IRAs.

What are the Conditions of the Proposed Class Exemption?

The proposed conditions are modeled on the SEC Reg BI requirements in order to reduce compliance burdens that would result from different standards between DOL and SEC.

- *Impartial Conduct Standards*

The recommendation must adhere to the Impartial Conduct Standards. The Impartial Conduct Standards include a best interest recommendation that puts the interests of the retirement investors ahead of the interests of the financial institution or investment professional. It is essentially the same as the Reg BI standard. There can be no materially misleading statements, and fees must be reasonable.

While the best interest standard does not automatically require ongoing monitoring, DOL notes that investments that are unusually complex or risky may require monitoring if they are recommended. There was no definition of what such investments might include.

- *Written Disclosures*

The financial institution must provide the retirement investor a written disclosure prior to engaging in the recommended transaction in which fiduciary status is disclosed along with the services to be provided and all material conflicts of interest. As long as these elements are included, DOL allows the fiduciary to use a disclosure document required by another regulator (such as Reg BI disclosures, Form CRS, Form ADV, etc.).

- *Written Policies and Procedures*

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 the mitigation of conflicts caused by compensation. These 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.

- *Annual Compliance Certification*

Finally, a financial institution must annually assess its compliance with the exemption, including sampling transactions, and prepare a written report on compliance. The CEO must review and certify the report. This report would be kept for six years and given to any federal or state regulator on request.

DOL explains that financial intuitions and investment professionals would not be able to use the exemption if they have been convicted of certain crimes, or if the DOL determines that they have violated the exemption or made misleading statements to the Department.

Conclusion:

The proposal makes some significant changes for producers, intermediaries, and carriers. For producers working with broker-dealers, the new class exemption closely tracks Reg BI, and may not present major compliance challenges. The new fiduciary interpretation raises concerns for many producers. AALU/GAMA will be developing a comment letter identifying issues facing producers and suggesting changes for DOL. Please contact David Hollingsworth (hollingsworth@aalu.org; 202- 742-4589) for more information.