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DOL Fiduciary Rule: Tips & Traps for PTE 20-02 Compliance

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Agenda

1. Recap of New Interpretations & ERISA/IRC Prohibited Transactions
2. Recap of Coverage & Deadlines
3. Impartial Conduct Standards & Conditions for PTE 2020-02
    a. Policies & Procedures
    b. Information Gathering & Analysis
    c. Documentation & Disclosure
4. Best Practices for Best Interest™
5. Next Steps & Action Items

Investment Advice =

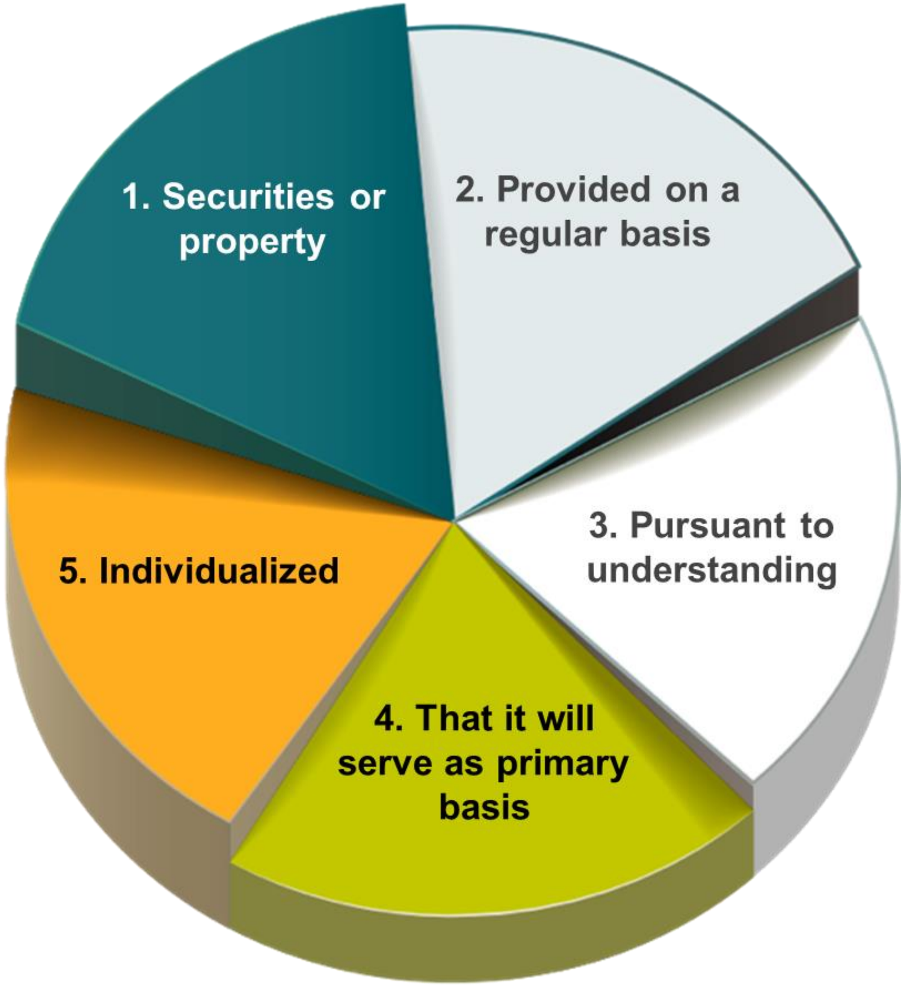
(1) render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing, or selling securities or other property;

(2) on a regular basis

(3) pursuant to a mutual agreement, arrangement, or understanding with the Plan, Plan fiduciary or IRA owner, that

(4) the advice will serve as a primary basis for investment decisions with respect to Plan or IRA assets, and that

(5) the advice will be individualized based on the particular needs of the Plan or IRA.



Investment Advice & Rollover Recommendations =

If you provided "investment advice" regarding the individual's tax-advantaged account(s) prior to recommending the rollover, then the recommendation will be considered fiduciary under ERISA; and/or

If there is a reasonable understanding that you will be providing investment advice on the assets rolled over, then the recommendation will be considered fiduciary under the Code.

In other words, the only time a recommendation will not be considered fiduciary under ERISA or the Code is when you did/will not provide investment advice before or after the rollover.

Fiduciaries are prohibited from…

- **Self-Dealing** e.g., providing advice that can increase your compensation;
- **Dual Representation** e.g., acting on behalf both buyer and seller in a transaction involving plan or IRA assets; and/or
- **Receiving third-party payments** e.g., receiving compensation from anyone other than the client (i.e., commissions, 12b-1, trail and/or solicitor fees, etc.) for providing investment advice or exercising discretion

<u>You must comply with a Prohibited Transaction Exemption (“PTE”) to avoid significant penalties (i.e., disgorgement, restoration of losses, excise taxes, etc.)</u>

Investment Advice vs. Education

Advice	Education = Describing
DOL Prohibited Transaction Exemption 2020-02 indicates that a recommendation to roll over assets from a plan to IRA, plan to plan, IRA to IRA or IRA to plan (as well as recommendation to change account types e.g., commission to fee-based) will be considered fiduciary "investment advice" if: • you provided investment advice to the client regarding his/her tax-advantaged retirement account(s) prior to making the recommendation; **<u>and/or</u>** • you and the client have a mutual understanding that you will provide investment advice on a "regular basis" after the recommended transaction (e.g., on how to invest the rollover IRA) If the firm or any affiliate(s) will receive more compensation or third-party payments (i.e., commissions, 12b-1, revenue sharing, solicitor fees, etc.), then you must satisfy the conditions of a PTE (i.e., 2020-02).	▪ terms or operation of the plan/IRA; ▪ benefits of plan/IRA participation or increasing plan/IRA contributions; ▪ retirement income needs, impact of preretirement withdrawals on retirement income, varying forms of distributions, including rollovers, annuitization and other forms of lifetime income payment options; ▪ advantages, disadvantages & risks of different forms of distributions, including rollovers; ▪ product features and fee & expense information; and/or ▪ investment alternatives available under the plan or IRA.

Recap of Coverage & Deadlines

- PTE only covers conflicts stemming from "investment advice" (vs. discretion);
- PTE 20-02 allows for "a wide variety of payments that would otherwise violate [PT] rules" including those connected to rollover advice and principal transactions;
- PTE 20-02 became effective on Feb. 16, 2021, <u>including new interpretations relating to rollover advice</u>;
- Compliance with most conditions became mandatory on Feb. 1, 2022;
- Disclosure of "specific reasons" supporting <u>rollover</u> recommendations must be delivered to clients beginning July 1, 2022; and
- While enforcement of PTs is limited to DOL and IRS, <u>violation of policies can be a predicate for other regulators (e.g., SEC, FINRA, OCC, etc.) and/or claimants/plaintiffs (i.e., breach of fiduciary duty, failure to supervise, etc.)</u>.

Impartial Conduct Standards

1. Investment advice, at the time it is provided, is in Best Interest of the Retirement Investor:
   - ✓ Duty of prudence; and
   - ✓ Duty of loyalty.
2. Financial Institutions, Investment Professionals, their affiliates and related entities Receive no more than reasonable compensation, directly or indirectly.
3. Financial Institutions' and Investment Professionals' statements to the Retirement Investor about the recommended transaction and other relevant matters are not, at the time the statements are made, materially misleading.

PTE 2020-02 Conditions

- Compliance with Impartial Conduct Standards.
- Written disclosures re:
  - ERISA and/or IRC fiduciary acknowledgment;
  - description of services to be provided and material conflicts of interest; and
  - for rollovers, documentation of specific reasons for why the recommendation is in the client's best interest.*
- Compliance procedures and recordkeeping requirements that allow the DOL and IRS (and other regulators) to obtain access to a Financial Institution's records.
- Retrospective review "certified" by Senior Executive Officer.
- Self-correction provision if violations are discovered before DOL investigates.

** Applies to: i) rollover from plan to another plan; ii) from an IRA to a plan; iii) from an IRA to another IRA; or iv) from one type of account to another (e.g., commission to fee-based).*

Three requirements regarding Policies & Procedures =

1. Establish, maintain and enforce written policies & procedures prudently designed to ensure that the Financial Institution and Investment Professionals comply with the Impartial Conduct Standards;
2. Policies & procedures mitigate Conflicts of Interest to the extent that a reasonable person reviewing the policies and procedures and incentive practices as a whole would conclude that they do not create an incentive for a Financial Institution or Investment Professional to place their interests ahead of the interest of the Retirement Investor; and
3. Document the specific reasons that any recommendation to roll over assets from a Plan to another Plan or IRA, from an IRA to a Plan, from an IRA to another IRA, or from one type account to another (e.g., from a commission-based account to a fee-based account) is in the Best Interest of the Retirement Investor.

You must consider and document…

i) The Retirement Investor's alternatives to a rollover, including leaving the money in his or her current employer's Plan, if permitted,

ii) selecting different investment options;

iii) the fees and expenses associated with both the Plan and the IRA;

iv) whether the employer pays for some or all of the Plan's administrative expenses; and

v) the different levels of services and investments available under the Plan and the IRA.

For rollovers from another IRA or changes from a commission-based account to a fee-based arrangement, a prudent recommendation would include consideration and documentation of the services that would be provided under the new arrangement.

Source: [DOL Investment Advice Exemption 20-02]

According to the SEC…

In addition to investments, services and fees, financial professional should consider a variety of additional factors to compare the customer's existing account to the IRA, including:

i) Ability to take penalty-free withdrawals;
ii) Application of required minimum distributions;
iii) Protection from creditors and legal judgements;
iv) Holdings of employer stock; and
v) Any special features of the existing account.

"… certain factors may have more or less relevance, depending upon the customers' goals and objectives" and "an IRA having 'more investment options' [can not be the sole] basis for recommending a rollover."

Source: *SEC Regulation Best interest, pages 295-96*

Alternative Data & Software:

If the Retirement Investor is unwilling to provide the information, even after a full explanation of its significance, and the information is not otherwise readily available, the Financial Institution and Investment Professional should make a reasonable estimation of expenses, asset values, risk, and returns based on publicly available information. The Financial Institution and Investment Professional should document and explain the assumptions used and their limitations. In such cases, the Investment Professional could rely on alternative data sources, such as the most recent Form 5500 or reliable benchmarks on typical fees and expenses for the type and size of Plan at issue.

Model Language for Fiduciary Acknowledgement:

"When we provide investment advice to you regarding your retirement plan account or individual retirement account, we are fiduciaries within the meaning of Title I of the Employee Retirement Income Security Act and/or the Internal Revenue Code, as applicable, which are laws governing retirement accounts. The way we make money creates some conflicts with your interests, so we operate under a special rule that requires us to act in your best interest and not put our interest ahead of yours."

See Preamble at p. 129

PRI

Disclosure Requirements:

Sec. II(b)(3) requires Financial Institutions to provide Retirement Investors, prior to engaging in a rollover recommended pursuant to the exemption, with documentation of the specific reasons that the recommendation to roll over assets is in the best interest of the Retirement Investor. This requirement extends to recommended rollovers from a Plan to another Plan or IRA as defined in Code section 4975(e)(1)(B) or (C), from an IRA as defined in Code section 4975(e)(1)(B) or (C) to a Plan, from an IRA to another IRA, or from one type of account to another (e.g., from a commission-based account to a fee-based account).

Five requirements regarding a retrospective review =

1. Conduct a retrospective review, at least annually, reasonably designed to assist the Financial Institution in detecting and preventing violations of, and achieving compliance with, the Impartial Conduct Standards and the policies and procedures governing compliance with the exemption;

2. Methodology & results of the retrospective review are reduced to a written report provided to a Senior Executive Officer;

3. Who certifies, annually, that: A) s/he has reviewed the report; B) policies and procedures are in place to achieve compliance with conditions of the exemption; and C) <u>a prudent process is in place to modify such policies and procedures as business, regulatory, and legislative changes and events dictate</u>, and to test their effectiveness on a periodic basis, the timing and extent of which is reasonably designed to ensure continuing compliance with the conditions of the exemption;

4. The review, report and certification are completed no later than six months following the end of the period covered by the review; and

5. The report, certification and supporting data is retained for a period of six years and are made available to the Department within 10 business days of request.

Best Practices for Best Interest™

PRI

PRI has created a Guide to Recommending Distributions & Rollovers promote a consistent process;

Three steps:

1. Info Gathering;
2. Analysis; and
3. Documentation;

Information-Gathering

Participant Demographics

- Current age & target retirement date (investment time horizon)
- Employment status
- Account balance/deferral & match
- Investment experience & risk tolerance
- Income & dependents
- Net worth & other retirement assets
- Current & expected liabilities

Participant Objectives

- Amount of desired accumulation or retirement income
- Frequency of trading expected
- Desire for ongoing investment advice or management
- Other services desired by participant (i.e., financial, retirement income or legacy planning)

Plan Documentation (Current & New Plan)

- Most recent participant fee disclosure notice(s) (404a5)
- Current version of Summary Plan Description(s) (SPD)
- Up to 4 quarterly participant statements

Additional Factors (See PRI Worksheet)

Analysis

Can goals be met in current plan/new plan?

- **Compare alignment of participant objectives in current plan vs. new plan:**
  - Investments available
  - Current vs. recommended allocation/ strategy
  - Services & features
  - Fees & expenses paid by participant vs. employer
  - Additional Factors

Can goals be better met in IRA?

- Compare alignment of participant objectives in current plan vs. new plan:
  - Investments available
  - Current vs. recommended allocation/ strategy
  - Services & features
  - Fees & expenses
  - Additional Factors

If fees increase, do benefits exceed costs?

- Compare risks & costs of status quo vs. implementing desired strategy

Will your fees be reasonable in light of the value to Participant?

- Compare nature, scope & frequency of services to be provided

Documentation

Fiduciary File should include:

- **Documents & information requested from and provided by the participant:**
  - Demographics
  - Objectives
  - Plan Documentation
  - Additional Factors
- **Documents supporting answers to analysis questions:**
  - Whether to distribute or transfer assets?
  - To what destination account?
  - To pursue what investment strategy?
- **Evidence that retirement assets are diversified (consider recommended investments & other retirement assets)**
- **Evidence that appropriate disclosures were delivered to the participant (check with your supervisor)**
- **Any additional documentation required by your supervisor**

Factors	401(k)	IRA	Notes
Access to withdrawals at age 55 without additional 10% tax	+	-	Participants who separate from service with their employer may be able to begin taking distributions at 55 vs. 59 ½ in an IRA without incurring 10% additional tax.
Access to withdrawals in certain circumstances without additional 10% tax	-	+	Withdrawals may be made in the event of unemployment, higher education expenses or first-time home-buyers (but see Contingency planning below) without incurring 10% additional tax.
Delaying RMDs	+	-	If still employed, the 401(k) may allow money to stay in the plan (for non-5% owners) vs. RMDs at age 72 in an IRA.
Spousal Delay of RMDs after employee's death	-	+	A surviving spouse who is named as beneficiary can to be treated as the new owner of the IRA or can withdraw all of the decedent's IRA and roll it over to an IRA in his or her name. The surviving spouse thereby avoids the need to receive distributions in accordance with the after-death minimum distribution rules (or even the surviving spouse exception from those rules). Instead, the surviving spouse need not be concerned with required minimum distributions until he/she reaches age 72. Spousal RMDs are not impacted by the changes to the non-spousal beneficiary rules under the SECURE Act.
Source of RMDs	-	+	Participants must withdraw RMD from each 401(k) or other plan account. If there are multiple IRAs the RMDs required for each IRA may be withdrawn from any IRA.
Creditor and/or legal protection	+	-	IRAs are protected by state laws that vary from state-to-state.
Employer Stock	+	-	If the participant holds appreciated employer stock in the 401(k), rollover to an IRA may result in loss of the ordinary income exclusion for net unrealized appreciation.
Consolidation of retirement accounts	-	+	Not all 401(k) plans permit rollovers from other plans; rolling over to IRA can enable participant to consolidate accounts
Naming Beneficiaries	-	+	Many plans will require 401(k) accounts be cashed out upon death and could trigger undesirable tax consequences, whereas IRAs typically provide more flexibility to heirs in terms of taking RMDs (non-spousal beneficiaries will now be limited to 10 years for distributions as a result of the SECURE Act). Also, federal law requires spousal consent before naming non-spouse beneficiaries on 401k accounts but only some states require such consent in IRAs.
Contingency planning	+	-	Employer plans may offer loans and hardship withdrawals whereas taxes and penalties will likely apply to early IRA distributions.
Broad range of distribution options, including guaranteed income	-	+	Distribution options from a 401(k) may be more limited than in an IRA; not all 401(k) plans offer annuity options.
Desire to sever relationship with former employer	-	+	Participant may no longer wish to have contact with the former employer.
Roth tax treatment	-	+	Not all 401(k) plans offer designated Roth accounts; rolling over can get participant access to Roth conversion.
Control of the account	-	+	Employers decide if/when/how to change a 401(k), not participants. IRA decisions are made by the account owner, not an Employer.
Tax Withholding	-	+	Most withdrawals from a 401(k) are subject to a 20% federal withholding tax. Some states impose a withholding tax as well. Withdrawals from IRAs are not subject to any federal withholding tax. State withholding tax rules vary.

Next Steps & Action Items

Educate financial professionals and supervisors of the new interpretations

Evaluate policies and procedures to ensure compliance w/ TEP

Determine whether rollovers are recommended -- If not, get attestation signed by client -- If so, document (internally, for now) the basis upon which it is deemed to be in client's best interest

Review marketing materials, contracts and disclosures to determine whether they align w/ new interpretations and PTE 20-02 conditions

Define how your firm will gather and evaluate required information, provide written disclosures, and retain documentation

Questions & Additional Resources

PRI PENSION RESOURCE INSTITUTE

RETIREMENT LAW GROUP

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