

The Fiduciary Rule and IRA Fixed Annuity Sales

In 2020, the Department of Labor adopted PTE 2020-02 and also issued guidance reinterpreting the test used to determine who is an investment advice fiduciary. While PTE 2020-02 became effective in 2021, the DOL delayed enforcement of the certain disclosure and documentation requirements until July 1, 2022.

Since that date is quickly approaching, it's a good time to review where things stand regarding the fiduciary rule.

Who is a fiduciary? To be considered a fiduciary, you first must engage in the act of providing investment advice. Since 1975, a 5-part test had been used to determine if investment advice was being provided. Investment advice was defined as advice regarding valuation or buy, hold or sell that was:

1. regularly provided;
2. for a fee;
3. individualized to the Plan;
4. pursuant to a mutual understanding;
5. that the advice will be the primary basis for the Plan decision making.

In 2020, the 5-part test was reinterpreted to take a very expansive view of when investment advice is provided on a regular basis, increasing the likelihood that agents selling annuities as IRA's will be treated as fiduciaries.

Why it matters. Depending upon the plan involved (rollover from ERISA plans vs IRA transfers), fiduciaries may be subject to duties of prudence and loyalty. In addition, both ERISA and the Internal Revenue Code (IRC) contain prohibited transaction rules which prohibit receipt of compensation resulting from fiduciary advice unless a Prohibited Transaction Exemption is satisfied (PTE).

Important Distinction. There's an important distinction to be made between IRA rollovers from ERISA plans and transfers between IRA's. Rollovers from ERISA plans to IRA's are subject to both ERISA's duty of prudence and loyalty and compliance with the prohibited transaction rule. The duty of prudence and loyalty means comparing the existing plan benefits with the benefits of the proposed IRA and then with the participants' investment profile in mind, making a recommendation in the best interests of the participant. In addition, receipt of compensation also requires compliance with the requirements of a PTE. ERISA also allows for personal causes of action (lawsuits) for violations of the fiduciary rule.

Non-ERISA rollovers and IRA transfers are not subject to ERISA's duty of prudence and loyalty but are subject to the IRC's prohibited transaction rules. If compensation is involved, compliance with a PTE is required. This is important because some PTE's require extensive documentation (PTE 2020-02 imposes its own documentation requirements on both IRA transfers and rollovers) while other PTE's (84-24) have more limited documentation.

What's a prohibited transaction? The prohibited transaction rules basically prohibit an agent who is acting as a fiduciary from receiving compensation on the sale of an IRA unless a prohibited transaction exemption is satisfied.

What's the Penalty for Violating the IRC's Prohibited Transaction Rule. The penalty for violating the prohibited transaction rule is a 15% excise tax increasing to 100% if not corrected in a timely manner.

How to Comply with a Prohibited Transaction Exemption (PTE). There are two PTE's that insurance agents can use to allow for the receipt of compensation on the sale of an IRA. PTE 2020-02 requires several conditions that must be met by both the agent and the financial institution, including impartial conduct standards, disclosures, supervision, and recordkeeping. Compliance with these requirements can be quite burdensome.

Fortunately there is an alternative PTE (PTE 84-24) that is available for agents selling annuity IRA's. There are several important benefits to the use of PTE 84-24. First, it does not require the agent to acknowledge that they are acting as a fiduciary. So in situations where you are unsure whether your activities rise to the level of a fiduciary, you can use PTE 84-24 as protection in case it is later determined you were acting as a fiduciary.

PTE 84-24 has both disclosure and non-disclosure requirements. The non-disclosure requirements can be summarized as follows:

1. The transaction is in the ordinary course of the agent's business;
2. No more than reasonable compensation be paid;
3. No shared financial interest with the client;
4. Records retained for 6 years.

The disclosure requirements are relatively straightforward and must be disclosed prior to the sale:

1. Their relationship as an independent agent to the company;
2. The sales commission;
3. A description of product charges.

The disclosure must be acknowledged by the client and retained in the agent's files for 6 years.

We have sample PTE 84-24 templates available on our website. Most companies do not mandate the use of a specific form or even want copies of the disclosure as part of their new business requirements and leave compliance and responsibility up to the agent.

Suggestions going forward:

1. Rollovers from ERISA plans, because they are subject to ERISA's duties of prudence and loyalty, require the greatest documentation and violations are subject to DOL enforcement. You should be prepared to document the provisions and features of the existing plan, how they compare to the IRA's benefits, the advantages and disadvantages of each, and how the transaction is in the best interest of the client.

2. IRA transfers and rollovers from non-ERISA plans aren't subject to ERISA's duty of prudence and care, but they are subject to the IRC's prohibited transaction rules. PTE 84-24 requires the least amount of documentation but can only be used for annuities. If you must rely on PTE 2020-02, the documentation requirements become significantly more rigorous.
3. They may be additional disclosure and recordkeeping requirements based on the version of the NAIC suitability/best interest rule that has been adopted by your state.