THE DOL'S FIDUCIARY PROPOSALS:

The Impact on Recommendations of Annuities

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Fred Reish is a partner in the international law firm of Faegre Drinker Biddle & Reath LLP. His practice focuses on fiduciary responsibility, prohibited transactions and plan qualification issues. He has been recognized as one of the "legends" of the retirement industry by both *PlanSponsor* and *PlanAdviser* magazines. He has also been given lifetime achievement awards by *Institutional Investor* and *PlanSponsor* publications and received recognition from the Internal Revenue Service for his contributions to the retirement community.

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Joan Neri represents plan service providers — including registered investment advisers and broker-dealers — and employer plan sponsors, and counsels them on fulfilling their obligations under ERISA and complying with the Internal Revenue Code rules governing retirement plans and accounts. Joan advises on ERISA fiduciary status and responsibilities; avoidance of prohibited transactions; the considerations associated with structuring, developing, and offering investment products and services to ERISA plans; and day-to-day plan operational compliance issues. Joan is a frequent speaker throughout the country on legislative and regulatory developments impacting service providers to ERISA plans, plan sponsors, and other fiduciaries to retirement plans, and has authored numerous articles on these topics.

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Joshua Waldbeser counsels retirement plan sponsors, asset managers and funds, and financial service providers on their fiduciary responsibilities under ERISA, and keeps them on course with regulatory compliance matters. Formerly with the Department of Labor's Employee Benefits Security Administration, Joshua has an insider's view of the regulatory challenges faced by employers with respect to their own plans, and by insurance companies, investment advisers, broker-dealers, recordkeepers, banks and trust companies with respect to their services to plans and IRAs. He provides practical, business-oriented advice that reflects the interplay between ERISA, securities and other sources of law, and focuses on compliance and risk mitigation.

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Emily Kile-Maxwell represents commercial clients, benefit plans and plan fiduciaries, recordkeepers, third-party administrators, and insurance companies in ERISA/employee benefits disputes, arbitration, and litigation of all kinds, including cases alleging breaches of fiduciary duty, prohibited transactions, and improper denials of benefits. She also represents clients in government investigations and audits. Emily's litigation experience enables to her to provide practical, valuable counsel to clients on benefit claim administration, plan administration, and plan design.

The DOL's Fiduciary Proposal

The essence of the DOL's fiduciary proposals and their impact on distribution of annuities is found in:

- Retirement Security Rule: Definition of an Investment Advice Fiduciary
- Proposed Amendment to Prohibited Transaction Exemption 2020-02
- Proposed Amendment to Prohibited Transaction Exemption 84-24

Prohibited Transactions and Exemptions

- The DOL fiduciary definitions apply to ERISA-governed plans as a standard of conduct and for determination of prohibited transactions (that is, prohibited conflicts of interest).
- The definition is also used in the Internal Revenue Code for determining whether prohibited transactions have occurred, but not as a standard of care.
- In addition, the DOL has the authority to issue exemptions, or exceptions, from the prohibited transactions in the Code and ERISA.

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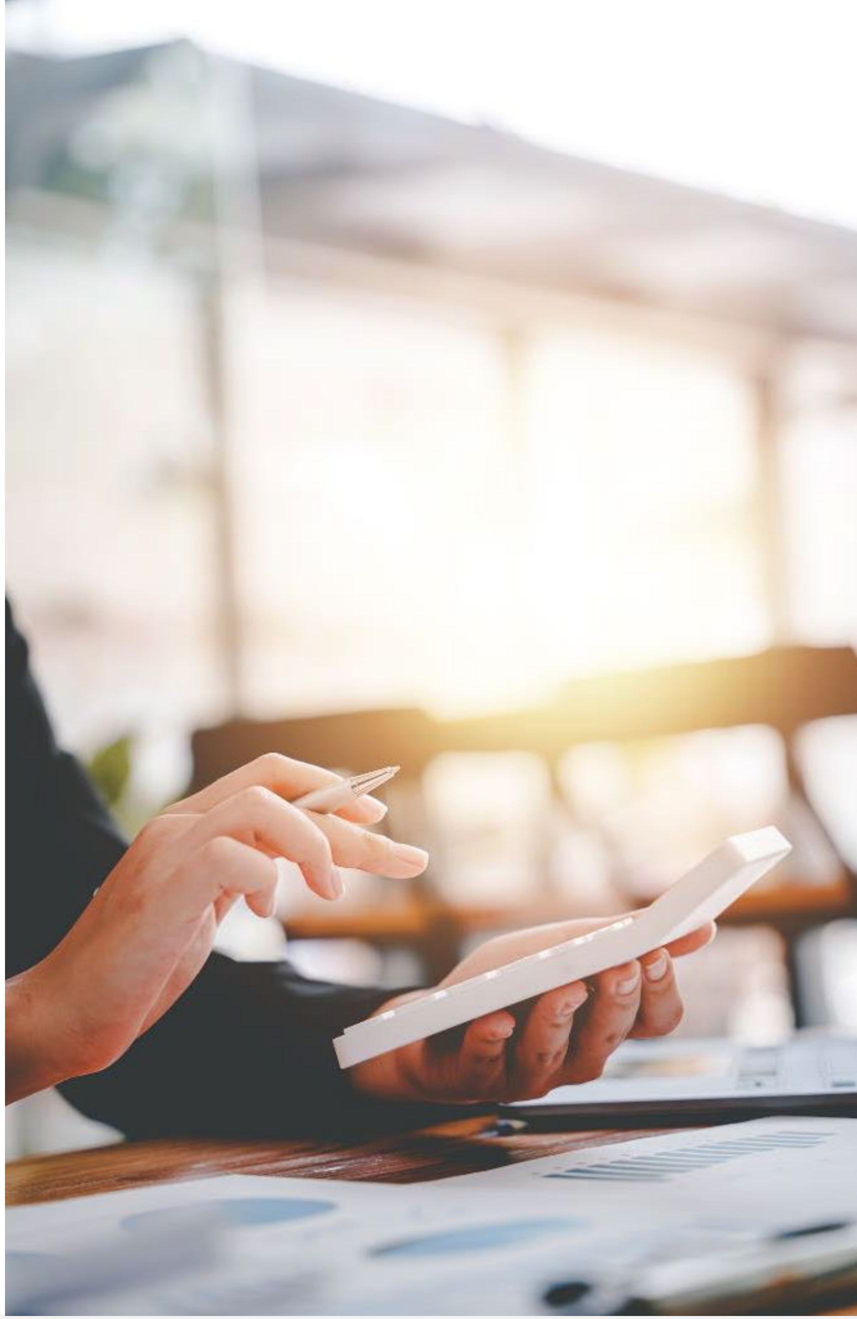
Prohibited Transactions and Exemptions

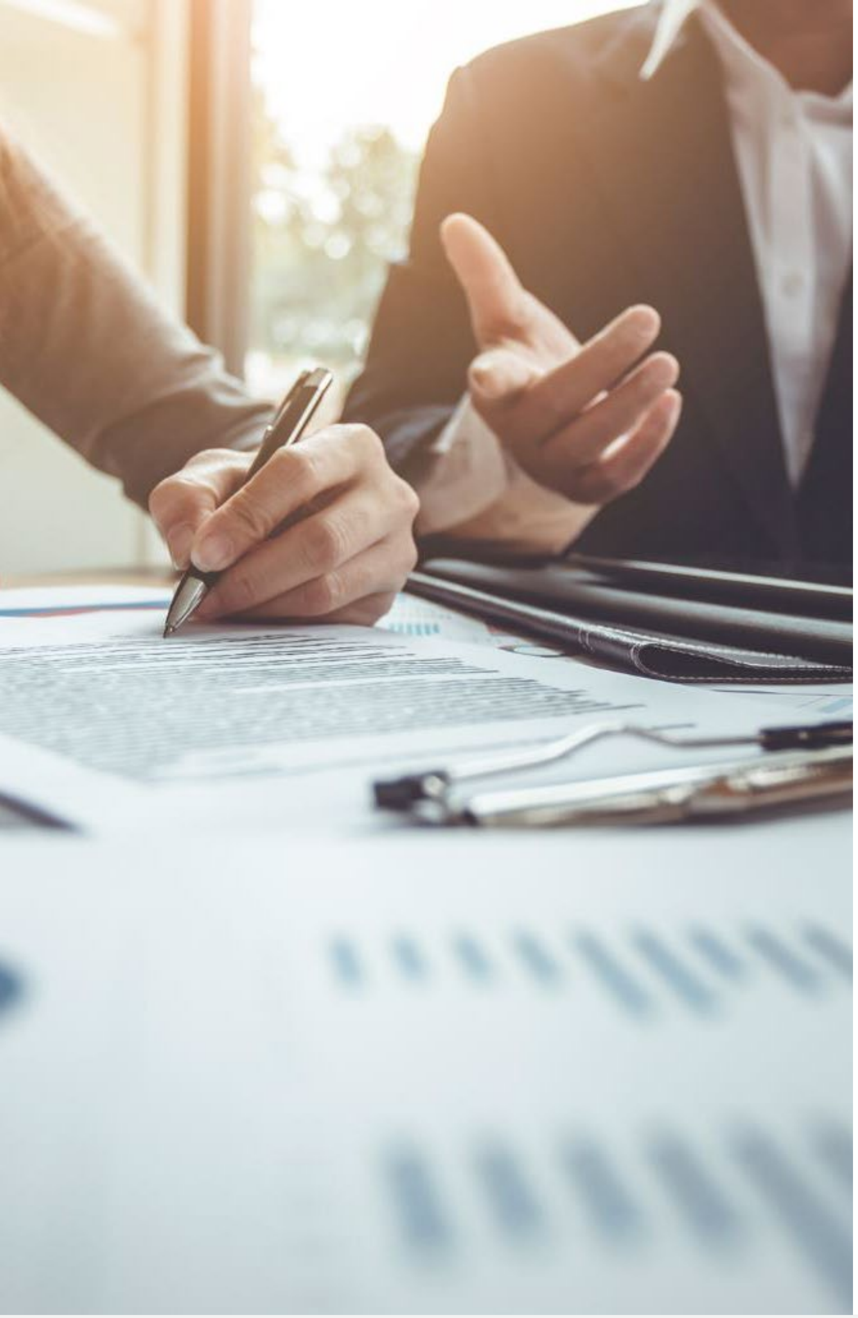
- PTE 2020-02 could be used for all prohibited transactions related to recommendations of insurance products, but the insurance company would have to serve as a cofiduciary with the producer.

- PTE 2020-02 would have to be used for **annuities that are securities** and would have to be used where **employees or statutory employees** are the producers.

Proposed Amendments to Prohibited Transaction Exemptions (PTEs)

PTE 84-24 could be used for independent producers (and only for independent producers) for fiduciary recommendations of insurance products that only require an insurance license; and in that case, the insurance company would not be a cofiduciary, but would have enhanced oversight responsibilities.





Prohibited Transaction Exemption 2020-02

PTE 2020-02 generally requires satisfaction of these conditions:

- Impartial Conduct Standards (best interest standard, reasonable compensation and best execution standards, no materially misleading statements)
- Pre-transaction disclosures
- Policies and procedures
- Annual retrospective review and report
- Correction of identified failures

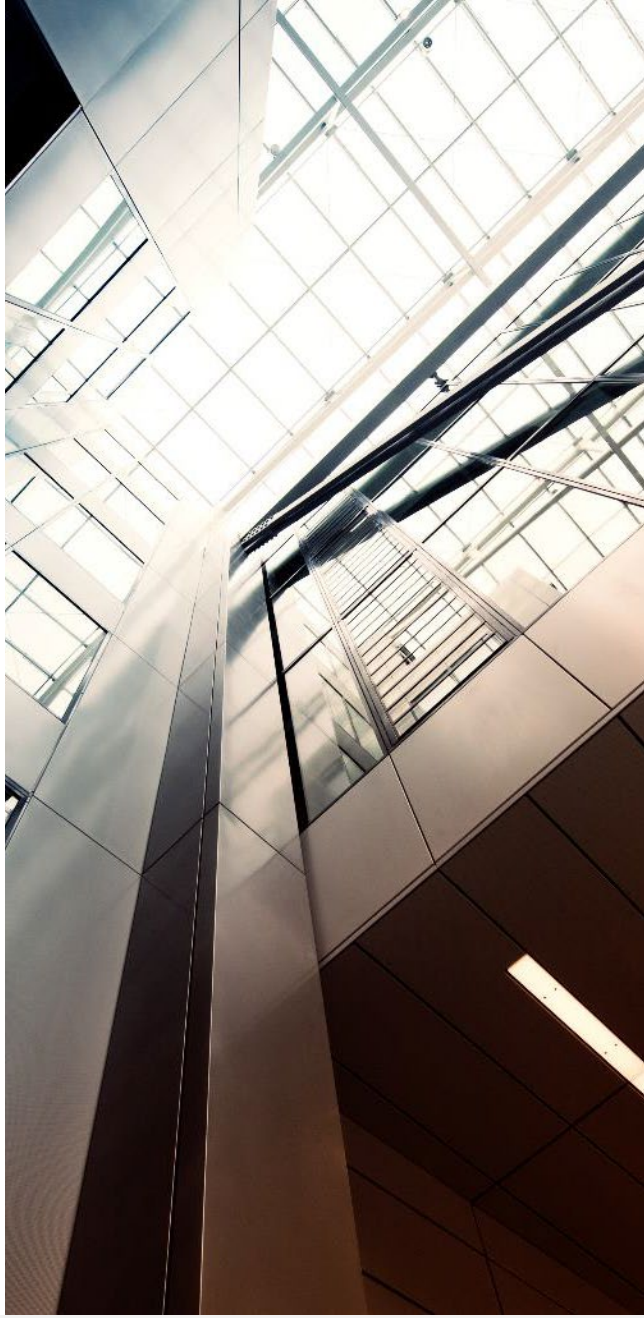
Proposed Amendments to PTE 84-24 — Best Interest Standard

PTE 84-24 has similar requirements, but the insurance company is not a cofiduciary with the producer.

The conditions are:

*(1)The **Independent Producer's** investment advice is, at the time it is provided, in the Retirement Investor's Best Interest.*

…advice is in the Retirement Investor's Best Interest if it:



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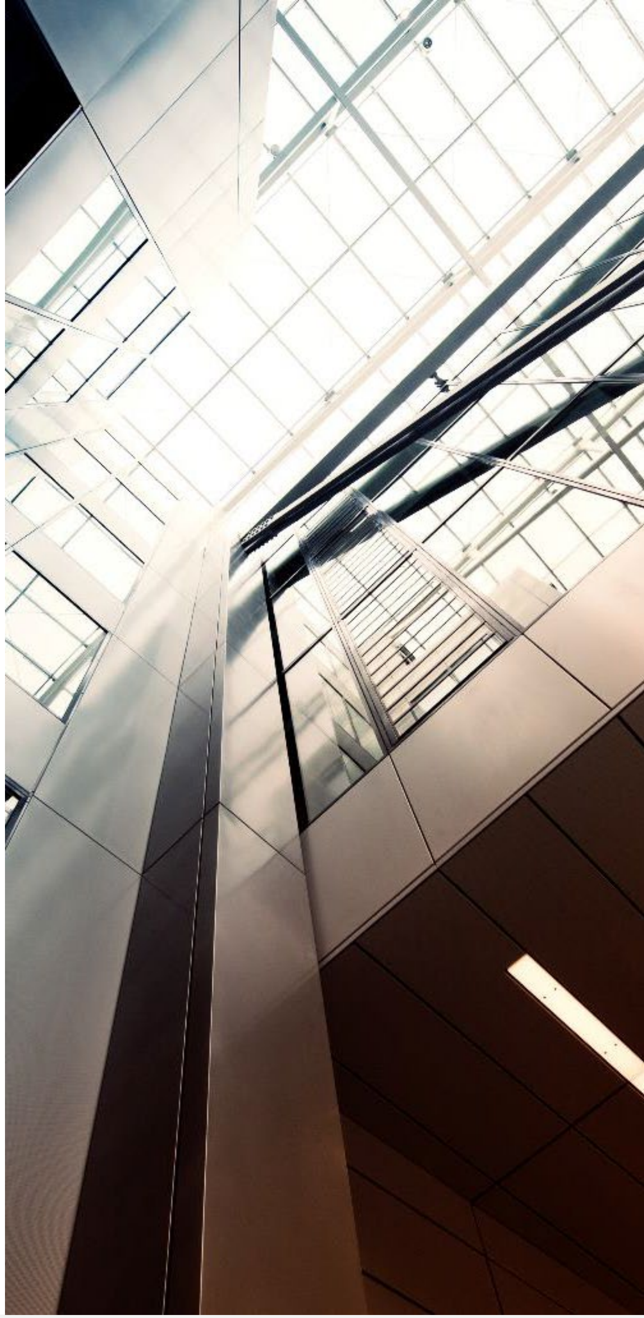
Proposed Amendments to PTE 84-24 — Best Interest Standard

(A) reflects 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 Retirement Investor, and

(B) does not place the financial or other interests of the ***Independent Producer****, Insurer or any Affiliate, Related Entity, or other party ahead of the Retirement Investor's interests, or subordinate the Retirement Investor's interests to those of the Independent Producer, Insurer or any Affiliate, Related Entity, or other party.*



Proposed Amendments to PTE 84-24 — Reasonable Compensation and No Misleading Statements

*(2) The **Independent Producer** receives no compensation in connection with the transaction other than the Insurance Sales Commission, and the Insurance Sales Commission does not exceed reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2); and*

*(3) The **Independent Producer's** statements to the Retirement Investor about the recommended transaction and other relevant matters are not, at the time the statements are made, materially misleading.*

Proposed Amendments to PTE 84-24 — Pre-transaction Disclosure

Prior to engaging in a transaction described in Section III(g), the ***Independent Producer*** *provides the [following] disclosures:*

(1) A written acknowledgment that the Independent Producer is a fiduciary under Title I and the Code, as applicable, with respect to any investment recommendation provided by the ***Independent Producer*** *to the Retirement Investor;*

(2) A written statement of the Best Interest standard of care owed by the Independent Producer to the Retirement Investor;

Proposed Amendments to PTE 84-24 — Disclosures of Services and Material Conflicts of Interest

(3) A written description of the services to be provided and the Independent Producer's material Conflicts of Interest that is accurate and not misleading in any material respects. The description will include the products the Independent Producer is licensed and authorized to sell. The description must inform the Retirement Investor in writing of any limits on the range of insurance products recommended. The Independent Producer must identify the specific Insurers and specific insurance products available for recommendation.

Proposed Amendments to PTE 84-24 — Pre-transaction Disclosure of Commissions

*(4) A written statement of the amount of the Insurance Commission that will be paid to the **Independent Producer** in connection with the purchase by a Retirement Investor of the recommended annuity. The statement must disclose the amount of expected Insurance Sales Commission, expressed both in dollars and as a percentage of gross annual premium payments, if applicable, for the first year and for each of the succeeding years.*

Proposed Amendments to PTE 84-24 — Definition of Commission

"Insurance Sales Commission" means a sales commission paid by the Insurance Company or an Affiliate to the Independent Producer for the service of recommending and/or effecting the purchase or sale of an insurance or annuity contract, including renewal fees and trailing fees, but excluding revenue sharing payments, administrative fees or marketing payments, payments from parties other than the Insurance Company or its Affiliates, or any other similar fees.

Proposed Amendments to PTE 84-24 — Best Interest Documentation and Rollover Disclosure

(6) Before the sale of a recommended annuity, the ***Independent Producer*** *considers and documents its conclusions as to whether the recommended annuity is in the Best Interest of the Retirement Investor and provides that documentation to both the Retirement Investor and to the Insurer;*

Proposed Amendments to PTE 84-24 — Best Interest Documentation and Rollover Disclosure

__(7) Rollover disclosure__. Before engaging in a rollover or making a recommendation to a Plan participant as to the post-rollover investment of assets currently held in a Plan, the Independent Producer must consider and document its conclusions as to whether a rollover is in the Retirement Investor's Best Interest and provide that documentation to both the Retirement Investor and to Insurer.

Proposed Amendments to PTE 84-24 — Rollover Disclosure

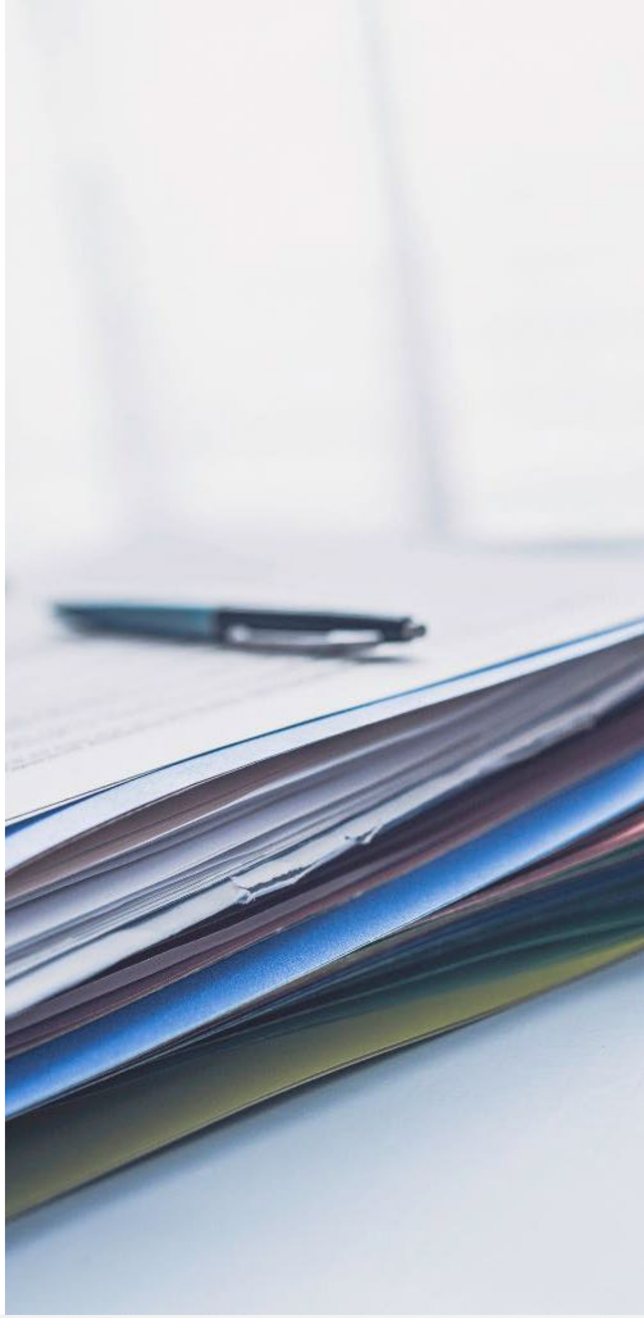
Relevant factors to consider must include to the extent applicable, but in any event are not limited to:

(A) the alternatives to a rollover, including leaving the money in the Plan, if applicable;

(B) the comparative fees and expenses;

(C) whether an employer or other party pays for some or all administrative expenses; and

(D) the different levels of fiduciary protection, services, and investments available.



Proposed Amendments to PTE 84-24 — Policies and Procedures

(c) Policies and Procedures

*(1) The **Insurer** establishes, maintains, and enforces written policies and procedures for the review of each recommendation before an annuity is issued to a Retirement Investor pursuant to an Independent Producer's recommendation that are prudently designed to ensure compliance with the Impartial Conduct Standards and other exemption conditions. The Insurer's prudent review of the Independent Producer's specific recommendations must be made without regard to the Insurer's own interests.*

Proposed Amendments to PTE 84-24 — Policies and Procedures to Mitigate Conflicts of Interest

*(2) The **Insurer's** policies and 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 the Independent Producer to place its interests, or those of the Insurer, or any Affiliate or Related Entity, ahead of the interests of the Retirement Investor.*

Proposed Amendments to PTE 84-24 — Policies and Procedures to Mitigate Conflicts of Interest

*The **Insurer's** procedures identify and eliminate quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation, or other similar actions or incentives that are intended, or that a reasonable person would conclude are likely, to result in recommendations that are not in the Retirement Investor's Best Interest, or that subordinate the interests of the Retirement Investor to the Independent Producer's own interests, or those of the Insurer, or to make recommendations based on the Independent Producer's considerations of factors or interests other than the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor.*

Proposed Amendments to PTE 84-24 — Policies and Procedures on Prudent Process

*(3) The **Insurer's** policies and procedures include a prudent process for determining whether to authorize an Independent Producer to sell the Insurer's annuity contracts to Retirement Investors, and for taking action to protect Retirement Investors from Independent Producers who have failed or are likely to fail to adhere to the Impartial Conduct Standards, or who lack the necessary education, training, or skill.*

Proposed Amendment to PTE 84-24 — Prudent Process

A prudent process includes careful review of customer complaints, disciplinary history, and regulatory actions concerning the Independent Producer, as well as the Insurer's review of the Independent Producer's training, education, and conduct with respect to the ***Insurer's*** *own products. The* ***Insurer*** *must document the basis for its initial determination that it can rely on the Independent Producer to adhere to the Impartial Conduct Standards, and must review that determination at least annually as part of the retrospective review….*

Proposed Amendments to PTE 84-24 — Retrospective Review

*The **Insurer** conducts a retrospective review, at least annually, that is reasonably designed to detect and prevent violations of, and achieve compliance with the conditions of the exemption, including the Impartial Conduct Standards, and the policies and procedures governing compliance with the exemption, including the effectiveness of the supervision system, the exceptions found, and corrective action taken or recommended, if any.*

Proposed Amendments to PTE 84-24 — Retrospective Review

*The retrospective review must also include a review of Independent Producers' rollover recommendations and the required rollover disclosure. As part of this review, the **Insurer** must prudently determine whether to continue to permit individual Independent Producers to sell the Insurer's annuity contracts to Retirement Investors.*

Proposed Amendments to PTE 84-24 — Senior Executive Officer Certification

A Senior Executive Officer of the Insurer certifies, annually, that:

- *The officer has reviewed the report of the retrospective review report;*
- *The **Insurer** has filed (or will file timely, including extensions) Form 5330 reporting any non-exempt prohibited transaction discovered by the Insurer in connection with investment advice covered under Code section 4975(e)(3)(B), advised the Independent Producer of the violation and any resulting excise taxes owed under Code section 4975, and notified the Department of Labor of the violation via email to PTE_84-24@dol.gov.*

Proposed Amendments to PTE 84-24 — Senior Executive Officer Certification

- *The **Insurer** has established policies and procedures prudently designed to ensure that Independent Producers achieve compliance with the conditions of this exemption, and has updated and modified the policies and procedures as appropriate after consideration of the findings in the retrospective review report; and*
- *The **Insurer** has in place a prudent process to modify such policies and procedures as set forth in Section II(d)(1).*

Proposed Amendments to PTE 84-24 — Self-Correction

(e) Self-Correction

A non-exempt prohibited transaction will not occur due to a violation of the exemption’s conditions with respect to a transaction, provided:

> *(1) Either the* ***Independent Producer*** *has refunded any charge to the Retirement Investor or the Insurer has rescinded a mis-sold annuity, canceling the contract and waiving the surrender charges;*
>
> *(2) The* ***Independent Producer*** *notifies the Department of Labor of the violation and the refund or rescission via email to PTE_84-24@dol.gov within 30 days of correction;*

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Proposed Amendments to PTE 84-24 — Self-Correction

*(3) The correction occurs no later than 90 days after the **Independent Producer** learned of the violation or reasonably should have learned of the violation; and*

*(4) The **Independent Producer** notifies the person(s) at the Insurer responsible for conducting the retrospective review during the applicable review cycle and the violation and correction is specifically set forth in the written report of the retrospective review….*

Questions?

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