

Fiduciary Status & IRA Rollovers: The Advisor Impact of PTE 2020-02

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KEY TAKEAWAYS

- New regulatory interpretation from the DOL implicates the investment advice that financial advisors provide, notably to rollover retirement funds from an employer plan to an IRA.
- For a fiduciary under ERISA and the tax code, such as a typical advisor recommending an IRA rollover, certain transactions are prohibited unless subject to an exemption.
- Investment advice that increases the advisor's fees results in a prohibited transaction
- The exemption requires that the fiduciary follow the impartial conduct standards, notably in the best interest of the client.
- To meet the exemption PTE 2020-02, advisors follow policies and procedures demonstrating the impartial conduct standards.
- Rigorous information gathering and analysis is the foundation of the DOL's documentation requirement.
- The exemption is reinforced by a number of documentation and disclosure requirements.
- Broadridge Fi360 Solutions solves for the most common challenges advisors face in complying with the DOL exemption requirements.

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OVERVIEW

The Department of Labor's new regulatory interpretation impacts advisors making IRA rollover recommendations. Most advisors will need to meet the requirements of the Prohibited Transaction Exemption (PTE) 2020-02 to be compensated. This sets forth specific requirements for analysis, documentation, oversight, and review. Broadridge provides advisors a tool to meet these requirements.

CONTEXT

Leading experts explained immediate changes facing advisors due to the new DOL regulations. They shared the impact of these requirements on common practices and described a powerful platform to satisfy these new requirements.

KEY TAKEAWAYS

New regulatory interpretation from the DOL implicates the investment advice that financial advisors provide, notably to rollover retirement funds from an employer plan to an IRA.

A new regulatory interpretation by the Department of Labor (DOL), taking effect February 1, 2022, significantly affects the ability of an advisor to receive compensation for an IRA rollover recommendation, due to the DOL's definition of "investment advice" under Prohibited Transaction Exemption (PTE) 2020-02.

Most advisors will need to comply with specific requirements for documentation, oversight practices, and client communication to build a showing that the advice was in the client's best interest. Advisors must consider several factors when determining if they are covered by the DOL regulations.

- **The first key question is what constitutes investment advice.** Because providing investment advice is what makes the recommendation considered

fiduciary under ERISA, it is vital to know what is considered investment advice. The key question is whether the advisor made a recommendation as to certain investments, rather than merely providing educational information.

It really focuses on are you giving advice concerning the advisability of investing in securities or other investment property? And are you doing that on a regular basis?

Jason Roberts, Pension Resource Institute & Retirement Law Group

- **It is risky for advisors to claim they solely provide education, not recommendations, to avoid the regulation.** While tempting, pursuing an "education-only" strategy to avoid the regulation carries risk. While some communications in isolation may look more like education (objectively explaining the terms or operation of the plan compared to an IRA), all information is considered in the aggregate and could be viewed as a recommendation. For a financial institution, if one advisor recommends the rollover one time, there is a nonexempt prohibited transaction with real penalties.

You have to be very, very careful if you're going to subscribe to an education-only approach that, in fact, your communications in the aggregate are not viewed as a recommendation.

Jason Roberts, Pension Resource Institute & Retirement Law Group

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For a fiduciary under ERISA and the tax code, such as a typical advisor recommending an IRA rollover, certain transactions are prohibited unless subject to an exemption.

Fiduciaries are subject to a number of prohibitions, including:

- **Self-dealing:** providing advice that can increase compensation, such as fees from the IRA;
- **Dual representation:** acting on behalf both buyer and seller in a transaction involving plan or IRA assets; and/or
- **Receiving third-party payments:** receiving compensation from anyone other than the client (such as commissions) for providing investment advice or exercising discretion over assets.

To avoid significant and costly penalties, such as disgorgement, restoration of losses, or excise taxes, an advisor must comply with a Prohibited Transaction Exemption (“PTE”).

Investment advice that increases the advisor’s fees results in a prohibited transaction.

If an advisor has an “advice relationship” prior to or will have after recommending a rollover, the DOL views the recommendation to be investment advice, and any increase in advisor compensation if the client accepts that advice to be a potential conflict. This interpretation renders many benign sales practices to be considered self-dealing. The pathways for an advisor’s “investment advice” concerning a rollover to NOT be considered fiduciary under ERISA and/or the tax code are very limited.

The Limited Path for Rollover Investment Advice to Avoid Fiduciary Obligations

- If an advisor 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 the advisor will be providing investment advice on the assets rolled over (how to invest the IRA), 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 the advisor did/ will not provide investment advice before or after the rollover. **This is likely to be a very rare scenario – particularly for investment advisors and bank trust officers.**

The exemption requires that the fiduciary follow the impartial conduct standards, notably in the best interest of the client.

The impartial conduct standards lay out three requirements:

1. The investment advice must be in the best interest of the client.
2. The advisor’s compensation must be reasonable.
3. The advisor must not make materially misleading statements.

The determinative factor is whether the advice is in the best interest of the client and how to demonstrate that, given that reasonable compensation and avoiding misleading statements are foundational.

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Compliance with the exemption requires advisors to provide written disclosure to clients regarding the fiduciary obligation under ERISA and conflicts of interest. The DOL has provided model language, which is strongly recommended.

To meet the exemption PTE 2020-02, advisors follow policies and procedures demonstrating the impartial conduct standards.

The DOL exemption regulation requires that the advisor establish, maintain, and enforce written policies and procedures to comply with the impartial conduct standards and mitigate the conflict of interest, including documenting the specific reasons for the rollover recommendation. Documents must be maintained, and the advisor must follow a retrospective review requirement.

Compliance procedures and recommended recordkeeping requirements essentially allow the DOL and the IRS to request documents from you. And you're required to have them in your files.

Jason Roberts, Pension Resource Institute & Retirement Law Group

Under these policies and procedures, a reasonable person would conclude that they don't create incentives to put the financial professional's interest ahead of the client's, requiring advisors to think through all potential conflicts.

Rigorous information gathering and analysis is the foundation of the DOL's documentation requirement.

The documentation must include significant and clear information.

- The client's alternatives to a rollover, including leaving the money in the employer's plan;
- Selecting different investment options;
- Fees and expenses associated with both the plan and the IRA;
- Whether the employer pays for some or all of the plan's expenses; and
- 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.

Many advisors take the strategic posture of conceding that fees will increase with the rollover compared to the employer plan and take care that robust consideration of other factors support a rollover recommendation.

DOL regulations acknowledge that plan information can be difficult to obtain and allow financial advisors to estimate using "reliable benchmarks."

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The exemption is reinforced by a number of documentation and disclosure requirements.

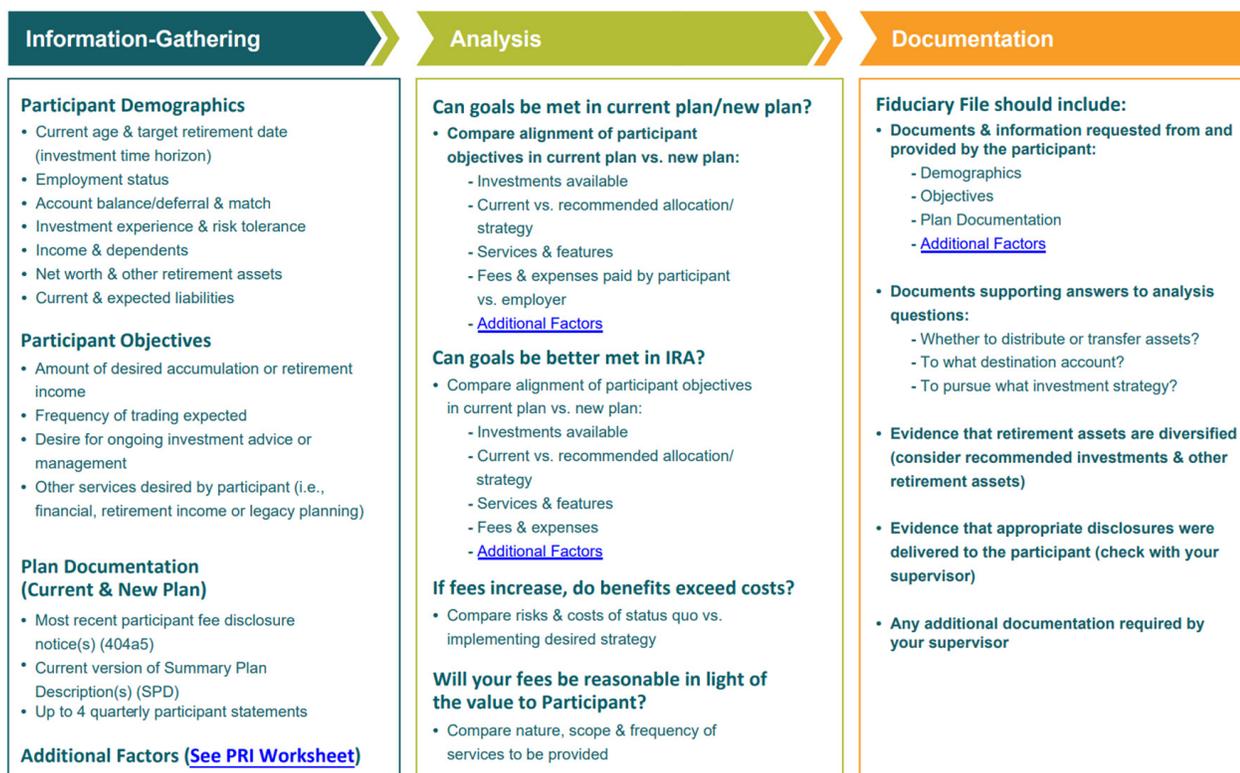
Documentation and disclosure are required at different stages of the rollover process, as follows.

- **Fiduciary acknowledgement.** Among the requirements is the fiduciary acknowledgement for which the model language from the DOL is extremely useful.
- **“Rollover playback.”** DOL requires the documentation of the specific reasons that the recommendation is in the client’s best interest, to be delivered in writing to that client beginning July 1, 2022. DOL has not provided specific guidance about this critical piece, which encompasses all of the factors considered in the analysis. Because the document

exposes the advisor to potential liability, many focus on precisely what is required and otherwise adopt a “less is more” approach.

- **Advisors face an annual obligation to look back: Retrospective review.** Another key requirement is a retrospective review that must be conducted at least annually, looking at whether the policies and procedures and requirements put in place are working. Advisors are required to document both the methodology of the review and the results in a written report to be certified by a senior executive officer. DOL is also looking for advisory firms to have a proven policy in place to modify the policies and procedures as legislative and regulator changes dictate.

Figure 1: Meeting DOL Requirements for Recommending Rollovers: A Summary



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Broadridge Fi360 Solutions solves for the most common challenges advisors face in complying with the DOL exemption requirements.

Decision Optimizer synthesizes the DOL rules into a tool that facilitates workflow and analysis, while also enabling documentation and supervision. Key elements include:

- **Helps to conduct the information gathering and analysis.** One frequent challenge is the difficulty in gathering information about the plan. When actual client data is unavailable, the tool seamlessly screens publicly available information to calculate an applicable benchmark cost.

Another feature is a configurable framework to conduct the critical analysis of the factors that go into the recommendation, specific to the client. This

method enables the advisor to measure each factor in terms of how important it is to the client and the degree of difference between the plan and the IRA in meeting the client's needs. These calculations are combined to build an overall score for the recommendation, which is backed by rigorous analysis.

- **Facilitates documentation and retrospective review.** To provide the rollover playback to the client, Decision Optimizer combines a visual representation of the critical analysis it enabled with the client attestation.

This solution further creates a dashboard that offers supervisors real-time access across all advisors to the underlying data, enabling alerts for any noncompliance. These underlying data factors also provide the building blocks for the required compliance review.

Figure 2: Decision Optimizer's Customizable Decision Framework

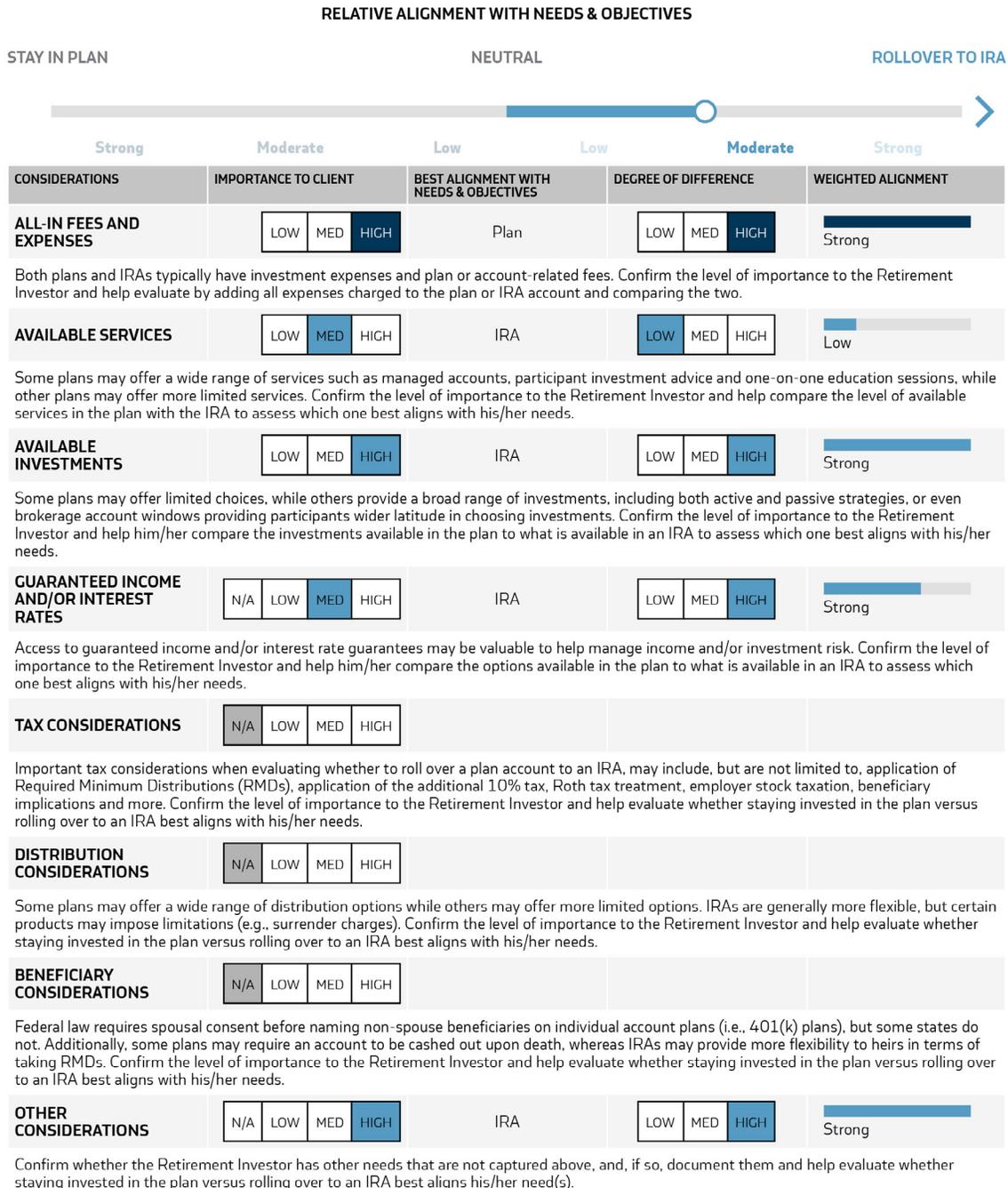
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Figure 3 Building the Rollover Playback for the Client with Decision Optimizer

PLAN TO IRA ANALYSIS

Analysis completed on 02/11/2022. Report generated on 02/11/2022. Analysis ID: 929.

Client Name: Sample



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BIOGRAPHIES

John Faustino

Head of Fiduciary Education and Training, Broadridge

John is Head of Broadridge Fi360 Solutions. In this role, he's responsible for strategy and leading day to day operations. John started at Fi360 in 2016 as chief product and strategy officer. Prior to Fi360, he spent over 14 years at Morningstar where he led global teams responsible for technology-based wealth and retirement plan solutions. Early in his career, John worked for Brinson Partners as portfolio administrator for large wealth and retirement accounts and served as an officer on a closed-end bond fund.

In addition to his industry experience, John has a BS in Finance from the University of Illinois, MS in Decision Sciences from the London School of Economics, MBA from the University of Chicago's Booth School of Business, and MSIT from Northwestern University.

Jason Roberts

CEO, Pension Resource Institute & Retirement Law Group

Jason is the founder and CEO of Pension Resource Institute, LLC (PRI). The firm helps banks, broker-dealers, and registered investment advisors implement and maintain profitable strategies for serving retirement investors. PRI was founded on the idea that compliance with retirement regulations should be accessible and affordable.

In addition to his role as CEO of PRI, Jason is the founder and managing partner of Retirement Law Group (RLG), a firm serving plan sponsors, investment professionals, and service providers in all aspects of retirement-related products and services. RLG's network of leading ERISA, tax, and securities lawyers

is available to assist clients on a project, flat fee, or hourly basis. Prior to founding PRI and RLG, Jason was a partner and co-chair of the Financial Services Group at a leading ERISA law firm and the head of the Investment Fiduciary practice for a national securities law firm.

Jason has published numerous articles focusing on ERISA and securities compliance and fiduciary best practices and is a frequent speaker at retirement plan and financial industry conferences. He is a contributing author and faculty member for the Practicing Law Institute. Jason has been repeatedly recognized as one of the "100 Most Influential in Defined Contribution" by the 401(k) Wire and a "Rising Star" by *SuperLawyers Magazine* and was selected by *InvestmentNews* as one of the Top 40 Advisors and Associated Professionals under 40. *The Wall Street Journal* also tapped Jason for its "Ask the Experts" series answering readers' questions relating to the DOL Fiduciary Regulation.

Jason received his B.S.B.A. in Finance & Banking from the University of Missouri and his J.D. from UCLA Law School.

Dave Palascak

Senior Director, Product Management, Broadridge

As the leader of Broadridge Fi360 Solutions product management, Dave is responsible for the strategic roadmap and overall success of Fi360's software offerings. Dave started with Fi360 in 2003 and was the visionary behind the widely used Fi360 Toolkit for Advisors.

In addition to holding the AIF® and CFA Designations, Dave has a bachelor's degree in finance from the University of Pittsburgh and is Level 3 certified by Pragmatic Marketing, Inc.