

# New PTEs Impact Broker's and Advisor's Relationship with Retirement Plans and IRAs and Also Impact Plan Sponsors and Fiduciaries

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While only the plan service providers, like brokers, are required to comply with the requirements of the revised and new prohibited transaction class exemptions contained in the package with the definition of fiduciary/conflict of interest final regulation package (the "PTEs"), plan fiduciaries and plan sponsors will need to understand the PTEs that may apply to their plans and what they will need to do because the PTEs will impact employers and plan fiduciaries as the result of the new disclosures, fiduciary obligations and the rights to access information about the transactions covered by the PTEs. The rights to access information will provide more information about the costs of particular transactions in the retirement plans to employees and employee organization which may bring more questions and challenges for employers.

In order for a plan fiduciary to be able to continue to make investments in securities, mutual fund shares and annuity contracts, plan fiduciaries and the vendors selling those investments to retirement plans will need to understand PTEs that will govern retirement plan and individual retirement account ("IRA") transactions occurring on or after April 10, 2017. The new PTEs were necessary due to the substantial broadening of the definition of an investment advice fiduciary and what constitutes a recommendation in the final package included in the "Conflict of Interest" regulation and the related PTEs. *The PTEs in the guidance package not only establish numerous new requirements to exempt certain common plan transactions, but they set new standards and procedures impacting the steps that must be completed to accomplish a rollover to an IRA from a retirement plan if advice is provided related to the distribution or rollover decision.*

In order to understand the impact of the Conflict of Interest/Fiduciary definition regulatory package, one must consider the impact of the changes in the Prohibited Transaction Exemptions applicable to the transactions amongst the "financial institutions" or "investment advice fiduciaries", the plans, participants and the organizations representing such participants in order to understand how their relationships will change and what the new limitations will mean to each of the parties' operations.

While the PTEs apply to the broker dealers, banks, and others qualifying as "financial institutions", *such entities compliance will likely result in plan sponsors and plan fiduciaries needing to provide additional information and documentation to participants seeking to process a rollover and will require those vendors to establish procedures to respond to inquiries from participants and representatives of employees proving compliance with the PTEs.* So understanding the PTEs requirements is important for plan sponsors and fiduciaries because the retirement plan vendors' PTE compliance will impact employers when making plan distributions. The vendors' PTE compliance will result in more information about the fees and expenses related to common transactions being available for review by participants, employee organizations as well as by plan fiduciaries. Plan fiduciaries and employers may want to anticipate additional questions from participants and employee organizations representing them about the plan's costs and expenses if the plan is operating under one of the PTEs providing for the availability of the additional information on PTE compliance. Historically, many brokers relied on a number of PTEs to receive compensation, directly or indirectly, for effecting securities transactions for the retirement plans for which they provided services, such as being the custodian of the assets, trustee, or record keeper and some of the methods of compensation were used to pay the retirement plan's record keeping or administration costs. The compensation included commissions on securities transactions, 12b-1 fees, revenue sharing and other fees.

In the past, the brokers relied upon PTE 75-1, I(a) and (b) to cover receipt of commissions on security sales and this was repealed for receipt of reasonable commissions on security sales effected for a benefit plan by a party providing services to the plan, such as a broker with custody of the plan assets or who provided investment advice to the plan. Effective for transactions occurring on an after April 10, 2017, this exemption is not available, but instead the Best Interest Contract

Exemption (“BICE”) can be utilized instead. Similarly, PTE 75-1, Part II(2) which had permitted certain fiduciaries to receive compensation from mutual fund transactions (commissions and other fees) was also revoked.

The continuing PTEs most likely to be utilized by brokers and other “financial institutions” with respect to the retirement plans they serve are PTE 75-1, V (loans to prevent failed securities transactions require new disclosures), PTE 86-128 originally issued primarily for commissions and other remuneration from securities sales and mutual fund share sales (limited by the amendment to apply only to commissions on sales of securities and mutual fund shares effected on and after April 10, 2017), and PTE 84-24 (historically covering insurance annuity sales and some mutual fund share sales, but after April 10, 2017 is limited to mutual fund shares by the Principal Underwriter and limited to apply to commissions from sales of only fixed rate annuities and no other types of annuities). In addition to the limitations, new conditions apply, new contract requirements exist and new reporting and disclosure requirements were added. Each PTE has its own requirements and this summary of the changes does not attempt or intend to cover all of the requirements of each of the PTEs because that is beyond the scope of this alert.

The BICE has numerous requirements that will impact not only agreements with plans and IRA holders, but also the internal policies and procedures of the “financial institution” regarding sale of securities and annuities, regarding advising individuals with respect to plan distributions and policies and programs for compensation of such individuals providing plan or IRA investment advice, or plan distribution advice. These requirements will require additional steps to be taken to open an IRA for a rollover if any “recommendation” is made to the IRA owner with respect to the distribution decision or the investment of the proceeds. Remember a “recommendation” is much broader under the conflict of interest regulation and can include providing a list of options.

In order for a broker, bank or similar advisor to be able to receive commissions or 12b-1 fees or revenue sharing on transactions after April 10, 2017 with respect to plans with whom they have some relationship, or in relation to advice on taking a rollover or distribution from a plan, such entities will generally need to comply with the BICE. In order for one of those entities to be able to extend a loan to a retirement plan to prevent a failed securities transaction (e.g., the order to purchase shares is filled at a price in excess of the dollars available for investment in the account) PTE 75-1, V as modified must be complied with for any loan to prevent a failed securities transaction.

The Principal Transaction Exemption (“Principal Transaction”) (e.g., for fulfilling a securities sale or purchase order from a plan out of the “financial institution’s” own inventory of securities) in certain circumstances may also need to be complied with by the financial institution.

While each PTE has its own requirements, the requirements for all of the most likely to be utilized PTEs mentioned above include requirements of notice to the account holder of the changes to the arrangement (and for the BICE and Principal Transaction, the notice of the changes can be provided and they will automatically be effective if no objection is made by the account holder within 30 days). Additional disclosures regarding the terms and fees related to the transaction, and disclosure of any “Material Conflicts of Interest” are also required. Documentation of the analysis of the prudence of the recommendation for the particular investor being advised (plan fiduciary or participant) and records of compliance with the satisfaction of the applicable PTE’s requirements for each transaction must be maintained for a period of six years. Such records of compliance must be accessible to the IRS and DoL, plan fiduciary, plan participants, an employer contributing to the plan, and an employee organization whose members are covered by the plan (i.e., the union whose members are participating in the plan). Since there will be more records available regarding the fees associated with transactions within the retirement plans, plan sponsors should expect more inquiries related to the plan fees, expenses and transactions.

Financial institutions with relationships to retirement plans (e.g., broker dealers who have custody of plan assets or who advise plan participants on taking distributions or rollovers from retirement plans) will also be impacted because they must comply with the BICE. They must provide investment advice to the individual interested in making a rollover from a retirement plan “with 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*” individual. While some brokers have stated that based on fees alone this means they will never be able to advise someone to

rollover funds; such a broad assumption may fail to consider the financial circumstances and needs of the individual and fail to individually tailor the advice which is part of the required consideration.

The BICE explicitly includes “the financial circumstances and needs of the” individual in the definition of what constitutes investment advice in the “Best Interest” of the individual; thus consideration of such circumstances and needs should be documented when developing a recommendation for an individual and included in the records supporting qualification of the recommendation and any resulting transaction for the BICE. For example, if the retirement plan in which the individual participated only permits lump sum distributions, then if this individual needs to rely upon the retirement account for funds during his retirement, he may need to rollover the funds to an IRA due to his financial circumstances and to continue to defer and minimize income taxes while still being able to access the funds for retirement. Thus, a rollover may be in his best interest even if it means moving to an account where the fees charged may or may not be higher. It may also be in an individual’s best interest to move to an IRA to obtain access to more diversified investments than those available in his retirement plan. The “Best Interest” will need to be analyzed and documented for each individual to support the application of the BICE to that individual’s rollover or distribution decision by the broker or agent (their firm) advising the individual.

Such an analysis will require any advisor seeking to advise a retiree on a rollover option to have access to information about the plan from which the distribution will be paid and about the fees and other expenses charged to the plan as well as about the individual’s other financial resources. The availability of different forms of distributions under the retirement plan will be part of the analysis of whether a rollover is in the best interest of the retiree based on the financial circumstances and needs of the retiree. *This means employers should anticipate receiving additional requests for plan documents or summary plan descriptions and about the plan’s investment choices and expenses and all the fees related to such investments or account that are charged to a participant’s account. The employer may anticipate that this information will be requested at the time an employee retires and contemplates a rollover or distribution, assuming the employee is utilizing a financial advisor who is utilizing the BICE. Employers may want to develop a standard mechanism for handling these requests in situations when a number of retirements are contemplated at the same time. Employer may want to develop a procedure for providing these electronically by requesting the retiring employee to consent to receive these disclosures electronically in order to accomplish these disclosures in the most cost effective manner.*

Since the vendors must maintain and provide records proving compliance with the PTEs, all plan sponsors will need to be ready to answer inquiries from the participants or employee representatives, including employee organizations, regarding the fees related to such transactions and the decisions on the recommendations made to cause such transactions to occur after April 10, 2017 when the rules begin to require maintenance of such information available for disclosure. While these record requests on the PTE compliance will go to the plan vendors (or the advisor on the rollover), the plan vendors (or IRA rollover advisor) will need to respond to them, but the plan fiduciary may ultimately face additional questions regarding their decisions on the recommendations and the fees and other payments paid to the vendor based on their decisions. *The plan fiduciary may want to consider reviewing the records obtained upon request under the PTEs periodically so that it is aware of what is being provided to others after the PTEs are in effect.*

*Retirement plan fiduciaries training materials and training on their responsibilities as a plan fiduciary should be updated to consider the impact of the new PTEs particularly with respect to reviewing the contract change notifications they will receive under the negative consent rules under the new or revised PTEs so that they are prepared for the inquiries that may follow later.* Some retirement plan record keepers have indicated that they contemplate sending the changes to their agreements under the negative consent procedure as early as the third calendar quarter of 2016, so plan fiduciaries should be made aware of these new obligations soon.

*In order for a broker or a bank to comply with all of the requirements for the BICE there are many steps that need to be completed. Since there is a sixty day time period within which a rollover must be deposited in an individual retirement account, retirees should consider not requesting a rollover distribution until they have their individual retirement account fully established and the paperwork completed.* Hopefully, they will be advised to not make a distribution or rollover request until after the individual retirement account is established so that they will not have adverse tax impacts or need to incur the costs to file a request for a waiver of the 60 day time limit with the IRS. Trustee to trustee transfers may be the

safest option to effect a rollover without running afoul of the time limit because such a transfer will not be processed until the receiving account is established.

Thank you for taking the time to consider these thoughts. No action should be taken solely based on the content of this alert as this alert cannot cover the full scope of any of any of the PTE's requirements.

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