New Fiduciary Advice Exemption: PTE 2020-02
Improving Investment Advice for Workers & Retirees
Frequently Asked Questions

U.S. Department of Labor
Employee Benefits Security Administration
April 2021

Under Title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA), and the Internal Revenue Code of 1986, as amended (the Code), parties providing fiduciary investment advice to plan sponsors, plan participants, and IRA owners may not receive payments creating conflicts of interest, unless they comply with protective conditions in a prohibited transaction exemption.

On December 18, 2020, the Department adopted PTE 2020-02, *Improving Investment Advice for Workers & Retirees*, a new prohibited transaction exemption under ERISA and the Code for investment advice fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs). Investment advice fiduciaries who rely on the exemption must render advice that is in their plan and IRA customers' best interest in order to receive compensation that would otherwise be prohibited in the absence of an exemption, including commissions, 12b-1 fees, revenue sharing, and mark-ups and mark-downs in certain principal transactions.[1] The exemption expressly covers prohibited transactions resulting from both rollover advice and advice on how to invest assets within a plan or IRA.

The Department's adoption of PTE 2020-02 followed a series of actions regarding the regulation of investment advice. In 2016, the Department issued a regulation that updated a 1975 regulation determining who is an investment advice fiduciary. At the same time, the Department also granted new associated prohibited transaction class exemptions and amended certain pre-existing class exemptions. The U.S. Court of Appeals for the Fifth Circuit subsequently vacated that rulemaking,[2] including both the rule defining fiduciary advice and the new and amended exemptions. Following the Fifth Circuit's opinion, the Department issued Field Assistance Bulletin (FAB) 2018-02, a temporary enforcement policy providing prohibited transaction relief to investment advice fiduciaries.[3] In the FAB, the Department stated it would not pursue prohibited transaction claims against investment advice fiduciaries who worked diligently and in

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[1] On June 5, 2019, the SEC finalized a regulatory package relating to conduct standards for SEC-regulated broker-dealers and investment advisers. The package included Regulation Best Interest which also establishes a best interest standard applicable to broker-dealers when making a recommendation of any securities transaction or investment strategy involving securities to retail customers. 84 FR 33318 (July 12, 2019). In addition, the SEC issued an interpretation of the fiduciary conduct standards applicable to investment advisers under the Investment Advisers Act of 1940. 84 FR 33669 (July 12, 2019). While the best interest standard set forth in PTE 2020-02 is broadly consistent with the SEC regulatory package, these *Frequently Asked Questions* are limited to questions concerning PTE 2020-02. Specific questions concerning the SEC regulatory package should be directed to the SEC.
[2] Chamber of Commerce of the United States v. U.S. Department of Labor, 885 F.3d 360 (5th Cir. 2018).
[3] Available at *www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-02*.

good faith to comply with "Impartial Conduct Standards" for transactions that would have been exempt under the new exemptions, or treat the fiduciaries as violating the applicable prohibited transaction rules. The Impartial Conduct Standards have three components: a best interest standard, a reasonable compensation standard, and a requirement to make no misleading statements about investment transactions and other relevant matters.

The Department proposed PTE 2020-02 on July 7, 2020. On that same date, the Department issued a technical amendment to the Code of Federal Regulations, which restored the text of the 1975 regulation defining an investment advice fiduciary under ERISA and the Code. The 1975 regulation established a five-part test, discussed in greater detail below, for status as an investment advice fiduciary. In addition, the Department clarified the availability of exemptions that had been amended as part of the 2016 rulemaking on their pre-amendment terms.

The following FAQs provide guidance on PTE 2020-02 and information on the Department's next steps in its regulation of investment advice. The guidance is limited to application of federal retirement laws to advice concerning investments in ERISA-covered plans and plans covered by Code section 4975 (such as IRAs).

Background

Q1. Why did the Department grant PTE 2020-02?

PTE 2020-02 is designed to promote investment advice that is in the best interest of retirement investors (*e.g.*, plan participants and beneficiaries, and IRA owners). The exemption conditions emphasize mitigating conflicts of interest and ensuring retirement investors are receiving advice that is prudent and loyal. The exemption offers a compliance option to investment advisers, broker-dealers, banks, and insurance companies (financial institutions) and their employees, agents, and representatives (investment professionals) that is broader and more flexible than pre-existing prohibited transaction exemptions. In particular, the exemption expressly provides relief for a variety of transactions and compensation that may not have been covered by prior exemptions. The preamble to the new exemption makes clear that the 1975 fiduciary regulation can extend to advice to roll assets out of a plan to an IRA and the exemption provides relief for prohibited transactions resulting from such advice.

An important aim of the exemption is to make sure that fiduciary advice providers adhere to stringent standards designed to ensure that their investment recommendations reflect the best interest of plan and IRA investors. In addition to other requirements, financial institutions and investment professionals relying on the exemption must:

- acknowledge their fiduciary status in writing,
- disclose their services and material conflicts of interest,
- adhere to Impartial Conduct Standards requiring that they

    - investigate and evaluate investments, provide advice, and exercise sound judgment in the same way that knowledgeable and impartial professionals would (i.e., their recommendations must be "prudent"),

    - act with undivided loyalty to retirement investors when making recommendations (in other words, they must never place their own interests ahead of the interests of the retirement investor, or subordinate the retirement investor's interests to their own),

    - charge no more than reasonable compensation and comply with federal securities laws regarding "best execution," and

    - avoid making misleading statements about investment transactions and other relevant matters,

- adopt policies and procedures prudently designed to ensure compliance with the Impartial Conduct Standards and to mitigate conflicts of interest that could otherwise cause violations of those standards;

- document and disclose the specific reasons that any rollover recommendations are in the retirement investor's best interest; and

- conduct an annual retrospective compliance review.

The exemption also includes an eligibility provision that precludes financial institutions and investment professionals from relying on the exemption for 10 years after conviction for specified crimes, or if they have engaged in systematic or intentional violation of the exemption's conditions or provided materially misleading information to the Department in relation to their conduct under the exemption.

PTE 2020-02's preamble includes an interpretation of when recommendations to roll over assets from an employee benefit plan to an IRA will be considered fiduciary investment advice. Rollover recommendations are a primary concern of the Department, as financial services providers often have a strong economic incentive to recommend that retirement investors roll assets out of ERISA-protected plans into one of their institution's IRAs. The decision to roll over assets from a plan to an IRA is often the single most important financial decision a plan participant makes, involving a lifetime of retirement savings. In the preamble to PTE 2020-02, the Department reiterated the conclusion it had reached in its 2016 rulemaking that the Deseret Letter, Advisory Opinion 2005-23A, was incorrect in its conclusion that the 1975 fiduciary rule did not extend to rollover advice. Advice to roll assets out of a plan is advice as to the sale, withdrawal, or transfer of plan assets and, therefore, is covered as fiduciary advice to the extent that the other conditions of the 1975 fiduciary advice definition are satisfied.

Compliance Dates

Q2. Did PTE 2020-02 become effective as scheduled, on February 16, 2021?

Yes. PTE 2020-02 became effective on February 16, 2021. The Department considered whether to delay the exemption's effective date, pursuant to the memorandum from Ronald A. Klain, Assistant to the President and Chief of Staff, entitled "Regulatory Freeze Pending Review," and concluded that PTE 2020-02 should go into effect as scheduled.

The exemption includes conditions that will result in more protection of retirement investors, including retirement investors receiving fiduciary investment advice on rollover transactions, as compared to FAB 2018-02. The Department believes that financial institutions and investment professionals providing fiduciary investment advice on rollover transactions may choose to implement and strictly adhere to the exemption's protective conditions because it provides a single exemption, which is broadly available for a wide range of transactions and, in many cases, may provide relief that is not otherwise available from the patchwork of other more limited exemptions covering disparate advice transactions with disparate conditions.

While the Department intends to revisit PTE 2020-02 and other exemptions relating to advice, the Department believes that core components of PTE 2020-02, including the Impartial Conduct Standards and the requirement for strong policies and procedures, are fundamental investor protections which should not be delayed while the Department considers additional protections or clarifications.

Q3. Is the Department withdrawing Field Assistance Bulletin 2018-02 at this time?

No. FAB 2018-02 will remain in place until December 20, 2021. This date is unchanged from the period set forth in PTE 2020-02.

Q4. Is the Department delaying the application of its interpretation related to rollover recommendations?

No. The preamble to PTE 2020-02 stated that, as a matter of enforcement policy, the Department would not pursue claims for breaches of fiduciary duty or prohibited transactions for the period between 2005 (when the Deseret Letter was issued) and February 16, 2021, or treat parties as violating the prohibited transaction rules, based on rollover recommendations that would have been considered non-fiduciary conduct under the reasoning of the Deseret Letter. The Department will respect this enforcement policy, but is not extending it. Rollover recommendations are a primary concern of the Department because of their extraordinary importance to retirement investors. Having disavowed the Deseret Letter both in its 2016 rulemaking and its 2020 exemption, the Department does not believe additional extensions are warranted or protective of plan participants' interests in sound advice.

Q5. Will the Department take more actions relating to the regulation of fiduciary investment advice?

The Department is reviewing issues of fact, law, and policy related to PTE 2020-02, and more generally, its regulation of fiduciary investment advice. The Department anticipates taking further regulatory and sub-regulatory actions, as appropriate, including amending the investment advice fiduciary regulation, amending PTE 2020-02, and amending or revoking some of the other existing class exemptions available to investment advice fiduciaries. Regulatory actions will be preceded by notice and an opportunity for public comment. Additionally, although future actions are under consideration to improve the exemption, the Department believes that core components of PTE 2020-02, including the Impartial Conduct Standards and the requirement for strong policies and procedures, are fundamental investor protections which should not be delayed while the Department considers additional protections or clarifications.

Definition of fiduciary investment advice

Q6. How does ERISA define fiduciary investment advice?

Under ERISA's statutory text, a firm or investment professional provides fiduciary investment advice to the extent she "renders investment advice for a fee or other compensation, direct or indirect, with respect to any money or other property of such plan, or has any authority or responsibility to do so."

In 1975, the Department issued a regulation that adopted a five-part test for determining when recommendations count as investment advice. Under this 1975 regulation, the person making the recommendation must:

1) Render advice to the plan, plan fiduciary, or IRA owner 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.

All parts of the 1975 test must be satisfied for a firm or investment professional to be an investment advice fiduciary when making a recommendation.

Q7. When is advice to roll over assets from an employee benefit plan to an IRA considered to be a on a "regular basis"?

A single, discrete instance of advice to roll over assets from an employee benefit plan to an IRA would not meet the regular basis prong of the 1975 test. However, advice to roll over plan assets can also occur as part of an ongoing relationship or as the beginning of an intended future ongoing relationship that an individual has with an investment advice provider. When the investment advice provider has been giving advice to the individual about investing in, purchasing, or selling securities or other financial instruments through tax-advantaged retirement vehicles subject to ERISA or the Code, the advice to roll assets out of the employee benefit plan is part of an ongoing advice relationship that satisfies the regular basis prong. Similarly, when the investment advice provider has not previously provided advice but expects to regularly make investment recommendations regarding the IRA as part of an ongoing relationship, the advice to roll assets out of an employee benefit plan into an IRA would be the start of an advice relationship that satisfies the regular basis requirement. The 1975 test extends to the entire advice relationship and does not exclude the first instance of advice, such as a recommendation to roll plan assets to an IRA, in an ongoing advice relationship.

Q8. Can an investment advice provider avoid fiduciary status with a fine print disclaimer, such as that there is no "mutual agreement, arrangement, or understanding" that the advice will serve as "a primary basis for investment decisions," even if other factors suggest otherwise?

Written statements disclaiming a "mutual" understanding or forbidding reliance on the advice as "a primary basis for investment decisions" may be considered in determining whether a mutual understanding exists, but such statements will not be determinative. Boilerplate disclaimers are insufficient to defeat the test, when the parties have a mutual understanding that the adviser is making an individualized recommendation upon which the investor can be expected to rely in making the investment decision. When firms and investment professionals hold themselves out in their oral communications, marketing materials, or interactions with retirement investors as making individualized recommendations that the investor can rely upon to make an investment decision that is in the best interest of the investor, and the investor, accordingly, relies upon the recommendation to make an investment decision, the 1975 test's requirement for a "mutual agreement, arrangement, or understanding" is satisfied. In applying the 1975 test, the Department intends to consider the *reasonable* understandings of the parties based on the totality of the circumstances. Firms and investment professionals cannot use written disclaimers to undermine reasonable investor understandings. Similarly, written statements disclaiming other parts of the 1975 test will not be determinative of fiduciary status.

Q9. Does PTE 2020-02 provide prohibited transaction relief for rollover recommendations?

Yes, the exemption provides relief for rollover recommendations that result in prohibited transactions, so long as the exemption conditions are satisfied. In addition to the other conditions, financial institutions must document and disclose in writing the specific reasons that a rollover recommendation is in the retirement investor's best interest. In doing so, financial institutions should consider the retirement investor's alternatives to a rollover, such as leaving the money in an employer's plan and taking advantage of the investment options available in that plan, including available options other than those reflected in the retirement investor's current plan holdings. Financial institutions and investment professionals are expected to make diligent and prudent efforts to obtain information about the existing employee benefit plan and the participant's interests in it. See Q15 for more information on the factors to consider in connection with rollover recommendations.

Compliance with PTE 2020-02

Q10. What is required to comply with PTE 2020-02?

PTE 2020-02 conditions prohibited transaction relief on financial institutions (SEC- and state-registered investment advisers, broker-dealers, banks, and insurance companies) and their investment professionals (employees, agents, and representatives) providing advice in accordance with the Impartial Conduct Standards. Financial institutions must also acknowledge in writing their and their investment professionals' fiduciary status under Title I of ERISA and the Internal Revenue Code, as applicable, when providing investment advice to the retirement investor, and they must describe in writing the services to be provided and the financial institutions' and investment professionals' material conflicts of interest. Financial institutions must document the reasons that a rollover recommendation is in the best interest of the retirement investor and provide that documentation to the retirement investor. Financial institutions must adopt policies and procedures prudently designed to ensure compliance with the Impartial Conduct Standards and that mitigate conflicts of interest, and must conduct an annual retrospective review of compliance.

To ensure that financial institutions provide reasonable oversight of investment professionals and adopt a culture of compliance, financial institutions and investment professionals will be ineligible to rely on the exemption if, within the previous 10 years, they were convicted of certain crimes arising out of their provision of investment advice to retirement investors. They will also be ineligible if they engaged in systematic or intentional violation of the exemption's conditions or provided materially misleading information to the Department in relation to their conduct under the exemption.

Q11. What are the Impartial Conduct Standards?

The Impartial Conduct Standards are consumer protection standards that ensure that financial institutions and investment professionals adhere to fiduciary norms and basic standards of fair dealing. The standards specifically require financial institutions and investment professionals to:

- Give advice that is in the "best interest" of the retirement investor. This best interest standard has two chief components: prudence and loyalty;
    - Under the prudence standard, the advice must meet a professional standard of care as specified in the text of the exemption;

- Under the loyalty standard, advice providers may not place their own interests ahead of the interests of the retirement investor, or subordinate the retirement investor's interests to their own;

- Charge no more than reasonable compensation and comply with federal securities laws regarding "best execution"; and

- Make no misleading statements about investment transactions and other relevant matters.

Q12. Does the best interest standard prevent financial institutions and investment professionals from receiving payment for their advice?

No. The best interest standard allows investment professionals and financial institutions to provide investment advice despite having a financial interest in the transaction, such as receiving payment, so long as they do not place their own interests ahead of the interests of the retirement investor or subordinate the retirement investor's interests to their own. Under this standard, *the advice must be based on the interests of the customer, rather than the competing financial interest of the investment professional or financial institution*. This means, for example, that in choosing between two investments equally available to the investor, it is not permissible for the investment professional to advise investing in the one that is worse for the retirement investor because it is better for the investment professional's or the financial institution's bottom line. The requirements of PTE 2020-02 are intended to work with a wide variety of payment structures.

Q13. Why did the Department require financial institutions and investment professionals to provide retirement investor customers with a written acknowledgement of their status as fiduciaries under Title I of ERISA and the Code?

The written fiduciary acknowledgment is designed to ensure that the fiduciary nature of the relationship under Title I of ERISA and/or the Code is clear to the financial institution and investment professional, as well as the retirement investor, at the time of the recommended investment transaction. This requirement reflects the Department's view that parties wishing to take advantage of the broad prohibited transaction relief in the new exemption should make a conscious up-front determination that they are acting as fiduciaries; tell their retirement investor customers that they are rendering advice as fiduciaries; and, based on their decision to act as fiduciaries, implement and follow the exemption's conditions. In assessing compliance with this condition, the Department expects financial institutions and investment professionals to be clear about their fiduciary status with respect to any transaction for which they are relying on the exemption. Ambiguous statements of fiduciary status that would leave a reasonable investor unsure of whether any particular recommendation is rendered in a fiduciary capacity under Title I of ERISA or the Code are insufficient.

To assist financial institutions and investment professionals in complying with this condition of the exemption, the exemption preamble included the following model language that will satisfy the fiduciary acknowledgment requirement:

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.

Under this special rule's provisions, we must:

- *Meet a professional standard of care when making investment recommendations (give prudent advice);*
- *Never put our financial interests ahead of yours when making recommendations (give loyal advice);*
- *Avoid misleading statements about conflicts of interest, fees, and investments;*
- *Follow policies and procedures designed to ensure that we give advice that is in your best interest;*
- *Charge no more than is reasonable for our services; and*
- *Give you basic information about conflicts of interest.*

Q14. What information about conflicts of interest must be disclosed to retirement investors?

Before engaging in a transaction under the exemption, a financial institution must give its retirement investor customer a written description of the financial institution's and investment professional's material conflicts of interest arising out of the services and any recommended investment transaction. The disclosure must be accurate and not misleading in all material respects. Financial institutions must disclose, for example, conflicts associated with proprietary products, payments from third parties, and compensation arrangements for both the financial institution and individual investment professional. Disclosures with material omissions will be considered inaccurate and will not satisfy the exemption.

To satisfy the exemption, this disclosure cannot be merely a "check-the-box" activity. The disclosure should be designed to allow a reasonable person to assess the scope and severity of the financial institution's and investment professional's conflicts of interest. Financial institutions must engage in a careful analysis to identify their material conflicts so that they and their investment professionals can provide meaningful information that retirement investors need to make decisions about their investments. The disclosure requirement is principles-based and intended to allow flexibility to apply to a wide variety of business models and practices.

Q15. What factors should financial institutions and investment professionals consider and document in their disclosure of the reasons that a rollover recommendation is in a retirement investor's best interest?

Financial institutions and investment professionals must consider and document their prudent analysis of why a rollover recommendation is in a retirement investor's best interest. For recommendations to roll over assets from an employee benefit plan to an IRA, the relevant factors include but are not limited to:

- the alternatives to a rollover, including leaving the money in the investor's employer's plan, if permitted;
- the fees and expenses associated with both the plan and the IRA;
- whether the employer pays for some or all of the plan's administrative expenses; and
- the different levels of services and investments available under the plan and the IRA.

When considering the alternatives to a rollover, the financial institution and investment professional generally should not focus solely on the retirement investor's existing investment allocation, without any consideration of other investment options in the plan. For rollovers from another IRA or from a commission-based account to a fee-based arrangement, a prudent recommendation would include consideration and documentation of the services under the new arrangement. As relevant, the analysis should include consideration of factors such as the long-term impact of any increased costs; why the rollover is appropriate notwithstanding any additional costs; and the impact of economically significant investment features such as surrender schedules and index annuity cap and participation rates.

To satisfy the documentation requirement for rollovers from an employee benefit plan to an IRA, investment professionals and financial institutions should make diligent and prudent efforts to obtain information about the existing employee benefit plan and the participant's interests in it. In general, such information should be readily available as a result of Department regulations mandating disclosure of plan-related information to the plan's participants (*see* 29 CFR 2550.404a-5). If the retirement investor won't 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 financial institution and 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.

Q16. The exemption requires financial institutions' policies and procedures to 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. What should financial institutions do to meet this standard of mitigation?

Financial institutions intending to rely on PTE 2020-02 must identify and carefully focus on the conflicts of interest associated with their business models and practices that create incentives for the financial institution or investment professional to place their interests ahead of the retirement investor's interest. Financial institutions' policies and procedures must be prudently designed to, among other things, protect retirement investors from recommendations to make excessive trades, to buy investment products, annuities, or riders that are not in the investor's best interest, or to allocate excessive amounts to illiquid or risky investments. The policies and procedures should themselves be reviewed and updated to ensure they stay effective and up to date.

Under the exemption's mitigation standard, it is important that financial institutions eliminate or mitigate incentives that are misaligned with the interests of their customers and that they adopt and implement effective oversight structures. In determining whether the exemption's standard for policies and procedures is met, the Department examines the financial institution's conflict mitigation and supervisory oversight as a whole. The conflict mitigation requirement in the policies and procedures condition is not limited to conflicts of investment professionals and extends to the financial institution's own interests, including interests in proprietary products and limited menus of investment options that generate third party payments (e.g., revenue sharing arrangements). As the Department stated in the preamble of PTE 2020-02, financial institutions must comply with the standards of the exemption to obtain relief from the prohibited transaction rules. There is no safe harbor based solely on compliance with other regulators' standards.

Investment professional conflicts. Financial institutions must take special care in developing and monitoring compensation systems to ensure that their investment professionals satisfy the fundamental obligation to provide advice that is in the retirement investor's best interest. By carefully designing their compensation structures, financial institutions can avoid incentive structures that a reasonable person would view as creating incentives for investment professionals to place their interests ahead of the interest of the retirement investor. Accordingly, financial institutions must be careful not to use quotas, bonuses, prizes, or performance standards as incentives that a reasonable person would conclude are likely to encourage investment professionals to make recommendations that are not in retirement investors' best interest. The financial institution should aim to eliminate such conflicts to the extent possible, not create them.

The Department recognizes that firms cannot eliminate all conflicts of interest, however, and the exemption accordingly stresses the importance of mitigating such conflicts. For example, a firm could ensure level compensation for recommendations to invest in assets that fall within reasonably defined investment categories (e.g., mutual funds), and exercise heightened supervision as between investment categories (e.g., between mutual funds and fixed annuities) to the extent that it is not possible for the institution to eliminate conflicts of interest between these categories. As much as possible, firms should carefully design differences in compensation between categories to avoid incentives that place the interest of the firm or investment professional ahead of the financial interests of the customer. Under this approach, financial institutions would avoid compensation that is likely to incentivize investment professionals to recommend one investment product over another comparable product based on the greater compensation to them or their financial institutions.

Financial institutions' policies and procedures must also include supervisory oversight of investment recommendations, particularly in areas in which differential compensation remains. In addition, financial institutions' policies and procedures could provide for increased monitoring of investment professional recommendations at or near compensation thresholds, recommendations at key liquidity events for investors (e.g., rollovers), and recommendations of investments that are particularly prone to conflicts of interest, such as proprietary products and principal-traded assets. However, in many circumstances, supervisory oversight is not an effective substitute for meaningful mitigation or elimination of dangerous compensation incentives.

Financial institution conflicts. Financial institutions' policies and procedures also should address and mitigate financial institutions' own conflicts of interest, including by establishing or enhancing the review process for determining which investment products may be recommended to retirement investors. This review process should include procedures for identifying and mitigating the financial institutions' conflicts of interest associated with investment products or, alternatively, declining to recommend a product if the financial institution cannot effectively mitigate associated conflicts of interest sufficiently to promote compliance with the Impartial Conduct Standards.

Q17. Are there special considerations for financial institutions that use payout grids in implementing the exemption's required policies and procedures?

If a financial institution wants to determine investment professional compensation through a payout grid, it should consider the following factors in developing its approach.

- Financial institutions should carefully review the amounts used as the basis for calculating investment professionals' compensation to avoid simply passing along firm-level conflicts to their investment professionals. If, for example, investment professionals are paid a fixed percentage of the commission generated for the financial institution, this may transmit firm-level conflicts to the investment professional, who is effectively rewarded for preferentially recommending those investments that generate the greatest compensation for the firm. The overarching goal should be to avoid incentive structures that encourage investment professionals to make recommendations inconsistent with the Impartial Conduct Standards. Accordingly, firms should work to align the interests of their investment professionals and retirement investors, and to root out misaligned incentives to the extent possible.

- Grids with one or several modest or gradual increases are less likely to create impermissible incentives than grids characterized by large increases. Firms should be very careful about structures that disproportionately increase compensation at specified thresholds. These structures can undermine the best interest standard and create incentives for investment professionals to make recommendations based on their own financial interest, rather than the retirement investor's interest in sound advice.

- As the investment professional reaches a threshold on the grid, any resulting increase in compensation rate should generally be prospective – the new rate should apply only to new investments made once the threshold is reached. If the consequence of reaching a threshold is not only a higher compensation rate for new transactions, but also retroactive application of an increased rate of pay for past investments, the grid is likely to create acute conflicts of interest. Retroactivity magnifies the investment professional's conflict of interest with respect to investment recommendations and increases the incentive to make the sales necessary to cross the threshold regardless of the investor's interest. The danger is particularly great when the sales necessary to cross the threshold would generate compensation for the investment professional that are disproportionate to the compensation the professional would normally receive for recommendations that are not at the threshold.

- As discussed in Q16, financial institutions employing escalating grids should establish a system to monitor and supervise investment professional recommendations, both at or near compensation thresholds and at a greater distance. Financial institutions should ensure that the thresholds do not create undue sales incentives. Aggressive thresholds can create incentives to make investment recommendations that are contrary to the retirement investor's interest.

Financial institutions should carefully assess their compensation practices for potential conflicts of interest and work to avoid structures that undermine investment professionals' incentives to comply with the best interest standard. To be prudent and loyal, fiduciaries should design compensation structures that minimize the dangers associated with conflicts of interest, as opposed to designing structures that create or reinforce conflicts of interest that run contrary to the interests of the investor.

Q18. How can insurance industry financial institutions comply with the exemption?

The Department is aware that insurance companies often sell insurance products and fixed (including indexed) annuities through different distribution channels than broker-dealers and registered investment advisers. While some insurance agents are employees of an insurance company, other insurance agents are independent, and work with multiple insurance companies. PTE 2020-02 applies to all these business models.

When an independent insurance agent recommends an annuity under the exemption, the agent and the financial institution (e.g., the insurance company) must satisfy the exemption's conditions, including the fiduciary acknowledgement and the Impartial Conduct Standards with respect to that transaction. In such cases, the insurance company must ensure that it has adopted policies and procedures to ensure compliance with the Impartial Conduct Standards and to avoid incentives that place the firm's or agent's interests ahead of the interests of retirement investors.

While the independent agent may recommend products issued by a variety of insurance companies, PTE 2020-02 does not require insurance companies to exercise supervisory responsibility with respect to the practices of unrelated and unaffiliated insurance companies. When an insurance company is the supervisory financial institution for purposes of the exemption, its obligation is simply to ensure that the insurer, its affiliates, and related parties meet the exemption's terms with respect to the insurance company's annuity which is the subject of the transaction.

Under the exemption, the insurance company must:

- adopt and implement prudent supervisory and review mechanisms to safeguard the agent's compliance with the Impartial Conduct Standards when recommending the insurance company's products;

- avoid improper incentives to preferentially recommend the products, riders, and annuity features that are most lucrative for the insurance company at the customer's expense;

- ensure that the agent receives no more than reasonable compensation for its services in connection with the transaction (e.g., by monitoring market prices and benchmarks for the insurance company's products, services, and agent compensation); and

- adhere to the disclosure and other conditions set forth in the exemptions.

The insurance company's responsibility is to oversee the recommendation and sale of its products, not recommendations and transactions involving other insurance companies. If the insurance company adheres to these principles, it should be able to comply with the exemption, regardless of whether it chooses to market its products through a captive sales force, independent agents, or other channels.

Insurance companies could also comply with the exemption by creating oversight and compliance systems through contracts with insurance intermediaries such as independent marketing organizations (IMOs), field marketing organizations (FMOs) or brokerage general agencies (BGAs). As one possible approach, an insurance intermediary could eliminate compensation incentives across all the insurance companies that work with the insurance intermediary, assisting each of the insurance companies with their independent obligations under the exemption. This might involve the insurance intermediary's review of documentation prepared by insurance agents to comply with the exemption, as may be required by the insurance company, or the use of third-party industry comparisons available in the marketplace to help independent insurance agents recommend products that are prudent for their retirement investor customers.[4]

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[4] In addition to relying on PTE 2002-02 for relief from prohibited transactions, insurers and agents may also rely on PTE 84-24, which provides relief for a smaller range of compensation practices, including the insurance agent's receipt of a sales commission from an insurance company and the insurance company's receipt of compensation and other consideration in connection with annuity sales, provided the conditions of the exemption are satisfied.

Q19. What is the exemption's annual retrospective review requirement, and what is its purpose?

Financial institutions must conduct an annual retrospective review that is reasonably designed to assist them in detecting and preventing violations of, and achieving compliance with, the Impartial Conduct Standards and their policies and procedures. The methodology and results of the retrospective review must be reduced to a written report that is provided to one of the financial institution's senior executive officers, who must then make certain certifications related to their review of the report. The financial institution must retain the report, certification, and supporting data for six years and provide these documents to the Department within 10 business days of a request.

The Department expects financial institutions to use the results of the review to find more effective ways to help ensure that investment professionals are providing investment advice in accordance with the Impartial Conduct Standards and to correct any deficiencies in existing policies and procedures. Senior executive officers should carefully review the report before making the required certifications, so that they can make the certifications with confidence. Making the certifications without carefully reviewing the report would constitute a violation of the exemption. This ensures that the financial institution, through an appropriate senior executive officer, is fully accountable for the retrospective review. The requirement that financial institutions make their report of their retrospective review available to the Department within 10 business days upon request ensures that the Department retains an appropriate level of oversight over exemption compliance.

Q20. Is there any way for financial institutions to correct violations of the exemption?

Yes, PTE 2020-02 contains a correction procedure for financial institutions to correct certain violations. Financial institutions can correct violations of the exemption within 90 days after the financial institution learns, or reasonably should have learned, of the violation. If the violation did not result in investment losses to the retirement investor or the financial institution made the retirement investor whole for any resulting losses, the financial institution can correct the violation and notify the Department within 30 days of correction. The financial institution must notify the persons responsible for conducting the retrospective review described in Q19 of the violation and correction, and the violation and correction must be specifically set forth in the written report of the retrospective review.

Q21. How will the Department enforce compliance with the exemption?

The Department has investigative and interpretive authority with respect to exemption compliance. For plans covered by ERISA Title I, the Department will investigate for compliance with the exemption and enforce the Title I protections. In addition, participants, beneficiaries, and fiduciaries of these plans have a statutory cause of action under Section 502 of ERISA for fiduciary breaches and prohibited transactions. For IRAs and other non-Title I plans, the Department has interpretive authority to determine whether the exemption conditions have been satisfied and transmits information to the IRS for enforcement of the excise tax. In marked contrast to the 2016 rulemaking, the new exemption does not impose contract or warranty requirements on the financial institutions or investment professionals responsible for compliance. The exemption also does not expand retirement investors' ability to enforce their rights in court or create any new legal claims beyond those in Title I of ERISA and the Code.

The exemption also includes several provisions intended to support and incentivize compliance. In addition to the annual retrospective review and self-correction discussed in previous FAQs, the exemption also encourages compliance by setting forth circumstances under which financial institutions and investment professionals can become ineligible to rely on the exemption for a period of 10 years. Parties can become ineligible following conviction for specified crimes, or if they have engaged in systematic or intentional violation of the exemption's conditions or provided materially misleading information to the Department in relation to their conduct under the exemption.