




OCTOBER 25, 2021

# PROHIBITED TRANSACTION EXEMPTION

## 2020-02

*HERE WE GO AGAIN...., INCLUDING AN EXTENSION TO 1-31-2022*

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## Executive Summary

Here we go again.... The DOL has released a new prohibited transaction exemption (PTE) that will replace current guidance which allows banks, registered investment advisers and other financial firms to make certain recommendations and receive certain types of compensation related to qualified plans and individual retirement plans (IRA). The exemption is establish to address three types of prohibited transactions.

1. Compensation: Under the exemption, your firm can receive a wide variety of payments that would otherwise violate the prohibited transaction rules, including, but not limited to, commissions, 12b-1 fees, trailing commissions, sales loads, mark-ups and mark-downs, and revenue sharing payments from investment providers or third parties.
2. IRA Rollovers: The exemption's relief extends to prohibited transactions arising as a result of investment advice to roll over assets from a Plan to an IRA offered by our firm.
3. Principal Transactions: The exemption also allows your firm to engage in principal transactions with Plans and IRAs. A principal transaction occurs when your firm purchases or sells certain investments from its own account to the Retirement Investor.

For most firms the primary impact of this new PTE will be on IRA rollovers and transfers. As with all PTE's the means are very specific by which your firm may utilize the exemption to conduct an otherwise prohibited transaction.

The new PTE requires specific disclosure to be provided to retirement investors, requires specific policies and procedures, including Impartial Conduct Standards, and introduces a novel requirement for an annual "retrospective compliance review". This White Paper provides a brief description of the primary considerations arising from this new PTE.

## PTE 2020-02

On December 18, 2020, the Department of Labor (DOL) adopted PTE 2020-02, a new prohibited transaction exemption under ERISA and the Internal Revenue Code (IRC) for investment advice fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs).

Under ERISA and the IRC, financial service providers, *specifically including banks and registered investment advisers*, providing fiduciary investment advice to plan sponsors, plan participants, and IRA owners may not receive certain compensation, may not provide rollover recommendations and may not engage in principal transactions unless they comply with protective conditions in a prohibited transaction exemption. A principal transaction occurs when your firm purchases or sells certain investments from its own account to the Retirement Investor.

*For most firms, the primary need for the protections of PTE 2020-02 arises from IRA rollover and IRA transfer advice.*

## Rollovers

A fundamental question for your firm is whether the mere recommendation that a participant rollover their retirement plan balance to your firm's IRA offerings is considered “fiduciary investment advice” and thus in need of the protections of PTE 2020-02. In large part the question is answered by whether the rollover advice is given as part of a “regular basis” of advice. The DOL has provided three examples to help define “regular basis”:

1. If in conjunction with the rollover advice your firm expects to advise or manage the assets in the IRA account, then the rollover advice would be the start of an advice relationship that satisfies the regular basis requirement. Meeting the requirements of PTE 2020-02 would be needed in this situation.
2. Additionally where advice to roll over plan assets is provided to the participant by a firm who is already providing advice on other assets of the participant then the rollover advice would meet the regular basis component. PTE 2020-02 would be needed in this situation.

3. Thus, only a single, discrete instance of advice to roll over assets from an employee benefit plan to a *self-directed IRA* without any other current or intended relationship would appear to avoid the regular basis prong of the “investment advice” test. *Note that the burden to prove that there is no preexisting or ongoing relationship will be on your firm.*

From the PTE’s terms and the DOL’s related guidance it is abundantly clear that any firm that recommends IRA rollovers or transfers to the firms advice or managed account offering must meet the compliance requirements of PTE 2020-02

## Compliance Requirements

Firms relying on the exemption must address each of the following requirements:

1. acknowledge their fiduciary status in writing
2. disclose their services and material conflicts of interest,
3. adhere to Impartial Conduct Standards requiring that they:
  - a. 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”),
  - b. 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),
  - c. charge no more than reasonable compensation;
  - d. comply with federal securities laws regarding “best execution,” and
  - e. avoid making misleading statements about investment transactions and other relevant matters,
4. 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;
5. document and disclose the specific reasons that any rollover recommendations are in the retirement investor’s best interest; and, *(non-enforcement date for this item has been extended to June 30, 2022)*
6. conduct an annual retrospective compliance review.

## Compliance Date

The Department of Labor announce on Monday October 25th, that it is extending the enforcement date for PTE 2020-02 from December 20, 2021 to January 31, 2022. The 41 day extension will provide additional time to prepare for the PTE 2020-02 requirements.

Also the DOL is extending the time line for the documentation of the reasons for the rollover recommendations from December 20, 2021 to June 30, 2022. Note that this is the only requirement under PTE 2020-02 that is being extended to June 30th. Thus, your organization now has until January 31 to update your policies, procedures, customer disclosure forms and to develop an annual retrospective review process.

PTE 2020-02 became effective on February 16, 2021. However, as a matter of enforcement policy the DOL has stated that the original December 20, 2021 non-enforcement date is extended to January 31, 2021. The DOL has stated it will not challenge fiduciary breaches or prohibited transactions with respect to investment advice fiduciaries who are *working diligently and in good faith* to comply with the impartial conduct standards until January 31, 2022

## Enforcement

It is critical to remember that the federal banking regulators and the Securities and Exchange Commission will refer firms who have run afoul of ERISA or the Internal Revenue Code, including related PTE's, to the DOL for enforcement actions. Thus, not only could failure to adhere to ERISA and any necessary PTE, lead to examination findings but could also lead to direct enforcement action by the DOL.

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Pohl Consulting and Training has developed a suite of products designed to assist your firm in meeting the specific terms of PTE 2020-02.

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