CARLTON FIELDS

The DOL Fiduciary Rule: Charting a Course, Avoiding Collisions & Potential Litigation Q&A #3

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Q&As on Annuity Sales Practices, 'Investment Advice' and Litigation

For the past two months, we have written about potential litigation issues under the "revised temporary" DOL Rule involving the offer and sale of annuities in the IRA market. We continue that discussion here. As in the past, the answers below are limited to the Rule's impact during the "temporary" period, which, it appears, will now be extended to June 2019. This month, we address two issues. First, last month's carryover question on the potential class action exposure of the "financial institution" under the Rule, or of the life insurer itself (in addition to the agent or broker who the Rule would treat as a fiduciary). The second Q&A focuses on the steps necessary to protect against exposure in connection with advising on or effecting a transaction which involves either advice that a plan participant effect a distribution from an existing ERISA plan into an IRA or, similarly, a recommendation to move from one IRA to another. **Q. What is the potential that either the "financial institution" or the insurer, as well as the insurance agent/broker will face potential class action claims of a state law fiduciary breach during this "temporary" period of the Rule, and what is such a claim's likelihood of success? A.** Given the history of the plaintiff's bar regarding class actions against both insurers and their life insurance sales agents, it should be no surprise if such claims are made. But, of course, as we pointed out in our prior Q&As, any such claim would almost certainly be limited to a single state (given the potential differences among state laws), and perhaps more important, such a claim is likely to fail absent some particular conduct which permits the finding of a "special relationship" between the financial institution or the insurer and the purchaser of the annuity as well as all other putative class members. The history on such claims does not bode well for plaintiffs (see, e.g., last month's Q&A and the discussion of the Abbit decision.). **Q. What steps should financial institutions or insurers take to help prevent such class action claims from succeeding?** **A.** First and foremost, a robust disclosure of the product's features, and the conduct required of the purchaser to take advantage of such features is paramount. Secondarily, the proper "best interest" conduct of the sales agent should be supported by the financial institution and insurer, which should: (i) make clear in all of their written material and agent training material that each customer is unique, (ii) require sales practice standards which, step by step, illustrate to any third party review that the sale involved a careful analysis of each customer's unique position, and (iii) show that the particular product being offered is tailored to match the customer's current and future needs and obligations. Finally, it should be clear from the records of each sale that the agent/broker is making recommendations, not placing herself in a decision making role. **Q. What are the requirements for protecting against becoming a fiduciary under state law, as well as for adhering to the "best interest" standard under the Rule in conjunction with a transaction which involves either advice that a plan participant make a distribution from an existing ERISA plan into an IRA, or a recommendation to move from one IRA to another?** **A.** This is really two questions. First, what standards apply under the Rule and second, what issues arise in determining whether a recommendation to do either of the above might constitute fiduciary advice under state law. Assuming the sales agent or broker making such a recommendation will earn a commission or otherwise receive money for such advice, it will be a prohibited transaction under the Rule. During the transition period, whether relying on 84-24 or BICE, we know that the best interest standard will apply. The following steps should be taken:

> 1. First, obtain all necessary information from the plan participant or IRA owner. This will include all of the same information normally involved in the sale of an annuity — and more — particularly with a focus on the "retirement" needs inherent in a transfer from an ERISA plan, as well as presumably comparable needs regarding an existing IRA investment. For example, what are their financial profiles and risk tolerances; what are their short- and long-term needs; what obligations do they have; and what is their likely retirement duration? We need not spell out these categories here, but the agent/broker should have a clear record of having performed this function. Creating and retaining this record (and a record of the actions below) is crucial. 2. Obtain all necessary information relevant to a prudent and loyal decision making process:
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> > a. In the case of an ERISA pension plan, such information would include all benefit and expense information as well as information regarding past performance (and possibly projected future performance). In the case of an IRA to IRA transaction, such information would logically include all

> > relevant information as to the existing IRA — for example, the nature of the investment (e.g., mutual fund, annuity, other structured product), the existing investment's track record, and what expenses or commissions have been, or are being, incurred. b. Compare the information from the existing investment to the characteristics of the new investment.
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> > > i. What services are provided?
> > > ii. What are the "investment options?"
> > > iii. What are the costs/charges?
> > > iv. What is the track record of the new verses old IRA investment
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> > c. As the agent/broker adviser under the Rule, is the compensation "reasonable?"
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> 3. Make certain the client understands your role: you are an adviser attempting to act in your "best interest" and considering all of the factors mentioned above, not a decision maker who could be viewed as a fiduciary.[1]

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[1] For more detail and the DOL's analysis of these issues, see the DOL FAQ's and responses, particularly the January, 2017 version and note responses to FAQ's 3-7 and 13-22.

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