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Impact of the DOL Fiduciary Rule on Independent Insurance Agents

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Recommendations of annuities and life insurance to retirement plan participants and IRAs ("retirement investors") are fiduciary acts under the DOL's new fiduciary definition. This means that independent insurance agents need to engage in a prudent process in making those recommendations. It also means that, to collect their commissions, they will need to comply with conditions of Prohibited Transaction Exemption (PTE) 84-24. This Alert addresses the types of recommendations that are covered by the fiduciary rule, describes a prudent process and discusses the conditions independent insurance agents will need to meet.

Preliminary Note

The rules we discuss are in effect from now until the end of 2017 — this is referred to as the "transition period." (Note, however, that there is a possibility that the transition period will be extended, possibly for as long as a year.) At the end of the transition period, unless the rules are changed, PTE 84-24 will apply only to the sale of life insurance and fixed rate annuities, will exclude variable and fixed indexed annuities, and will require additional disclosures. We do not discuss the Best Interest Contract Exemption in this Alert because it is not, as a practical matter, available to independent insurance agents.

Covered Recommendations

The fiduciary rule applies to more than just recommendations to purchase annuities or insurance products. It also covers advice on investment strategies, selection of others to provide investment advice or management and, of particular importance to independent agents, recommendations on taking money out of a plan or IRA. Thus, for example, suggesting that an investor take money out of his IRA to purchase a life insurance policy would be fiduciary advice. The focus in this Alert, however, is on recommending the purchase of annuities or life insurance.

To comply with the rule, agents must make prudent recommendations.

Prudent Process

What does this mean? First, it does *not* require agents to guarantee a future outcome. But it does require agents to go through a thorough and well-documented series of steps. These steps —referred to as the “prudent process” — include:

- Gathering information that is relevant to the product being recommended and to the needs of the retirement investor;
- Assessing the information that has been gathered; and then
- Making an informed and reasoned recommendation that puts the interest of the retirement investor first.

To make this process a little more concrete, let’s look at recommending annuities. The DOL has provided a list of more than a dozen factors that agents should consider in recommending fixed indexed annuities. We won’t list them all here but generally, in recommending annuities, agents must consider:

- The financial stability of the insurance company;
- The terms and features of the annuity contract;
- The expenses of the contract and investments;
- The needs of the client for guaranteed income and the allocation of the client’s financial assets to the contract;
- The recommended contract features and options; and
- The ongoing services and monitoring offered by the agent.

The purpose of the analysis is to make sure that the recommended annuity is prudent for the retirement investors, both as a product and in light of the investor’s circumstances.

Prohibited Transaction Exemption

Even if an agent engages in a prudent process, ERISA and the Code say that a fiduciary may not use his authority to cause himself to receive compensation. This would make an agent’s receipt of a commission for recommending the purchase of an annuity impermissible. But the DOL has adopted an exemption, or exception, that allows prohibited compensation so long as specific conditions are met.

In the context of annuity and insurance sales, PTE 84-24 is available. It permits an agent to receive a “sales commission” if the following conditions are satisfied before the sale of the contract is completed:

- The agent observes “impartial conduct standards” (described later);
- The agent’s compensation is reasonable relative to the services provided;
- The agent makes written disclosure of his compensation, his relationship, if any, to the insurance carrier, any contractual limitations on his ability to recommend certain products, other costs of holding the contract, and his “material conflicts of interest” (described later); and
- The client acknowledges receipt of the disclosures in writing and specifically approves the transaction.

The “impartial conduct standards” require that the agent act in the best interest of the client and not make misleading statements in any information provided to the client. The best interest standard is, in most respects, the same as ERISA’s prudent process and duty of loyalty requirement, in that it requires the agent to act prudently and loyally. But under this standard, the agent must also take into account the client’s investment objectives, risk tolerance, financial circumstances and needs. Further, he must do so “without regard to the financial or other interests of” the agent. The client information that must be considered is similar to that required under state insurance suitability rules. The “without regard” requirement is generally understood to mean that the agent must put the client’s interests above his own.

Failure to disclose material conflicts of interest is considered to be misleading, hence the specific requirement to disclose. Examples of such disclosures include the obvious — if the client doesn’t buy the contract, the agent won’t receive a commission. It also includes disclosure of the less obvious — if the client does buy the contract, the agent may be eligible to receive certain employee benefits, such as contributions to a retirement plan and/or reimbursement or payment of expenses or other incentives (for simplicity, let’s call them add-ons) that may be viewed as compensation.

It is unclear whether the receipt of add-ons is permissible under PTE 84-24. The exemption permits an agent to receive “sales commissions,” but the term is not defined (at least in the version in effect during the transition period). And there is little guidance on whether various add-on items, such as trips and awards, are permissible or excluded. In adopting revisions to 84-24, the DOL said it had never intended for employee benefits for career agents to be impermissible. It also said that historically it had taken the position that other add-ons were not permitted, though the limited guidance on this issue can be read as contradictory. Thus, it appears that providing employee benefits for career agents entails little risk, while there is more risk if an agent receives other types of add-ons, unless they are considered to be part of the sales commission and disclosed as such.

Conclusion

Agents who recommend the sale of insurance and annuities to plans and IRAs act as fiduciaries. In making a recommendation, they must act prudently and in the interest of the client. This means they must engage in a prudent process. To receive a commission for the recommendation, agents must comply with the conditions of PTE 84-24, which include satisfying the impartial conduct standards, making sure their commission is reasonable, making certain written disclosures to the client — including material conflicts of interest — and obtaining client approval of the transaction in advance. They may also be subject to restrictions on other types of payments.

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