

The IRA Rollover
Workbook:

**What you need
to know about
PTE 2020-02**





The Department of Labor has outlined new IRA Rollover requirements in its Prohibited Transaction Exemption 2020-02 (or PTE 2020-02), and this resource is designed as a basic guide to get you started with compliance.

PTE 2020-02 effectively adds more responsibility for you to act in your clients' best interests in doing IRA rollovers and other retirement account transactions where your advice is conflicted.

By giving the advice to roll over assets from a retirement plan to an IRA (as well as an IRA to IRA or a plan to another plan), you are giving investment advice as an ERISA fiduciary. This means that you need to comply with PTE 2020-02.

Here are the things you need to know:

What It Means to be a Fiduciary Under ERISA

The term "fiduciary" comes up multiple times under ERISA – the Employee Retirement Income Security Act of 1974.

Fiduciary status is important because it provides heightened protection to your clients when they're trusting you with their assets.

ERISA has the definition of fiduciary under Section 3(21): "A fiduciary is: (1) Anyone who makes decisions about managing the plan or its investments, such as selecting the investment choices for participants or hiring persons who provide services to the plan; (2) Anyone who makes decisions about administering the plan, such as determining eligibility of participants, providing benefits statements and ruling on benefits claims, or (3) Anyone who is paid to provide investment advice."

The last one is the one you need to focus on. The other two definitions are for employer or plan sponsors, as they are about having discretion over the administration of a plan or having discretion over the assets and moving around of the money.

But essentially, you end up being a fiduciary when you render investment advice for a fee.

Let's dive a little bit deeper. The question oftentimes ends up being: What is investment advice? Keep in mind that ERISA was passed in 1974, and the Department of Labor said we need some way to figure out what investment advice is. So they established a five-part test (which has historically

been quite controversial) that you're likely familiar with it. The five-part test determines who provides investment advice, which is part of the definition of who is a fiduciary under ERISA Section 3(21), which is important to know for PTE 2020-02:

So, a fiduciary is someone who, for a fee,

- 1 Renders advice or recommend securities;
- 2 On a regular basis;
- 3 Pursuant to mutual agreement;
- 4 Which serves as a primary basis for investment decisions; and
- 5 The advice is individualized for the particular needs of a plan or IRA.

This is not an either/or situation – all five of these elements must be met to be considered investment advice if you're getting a fee for that.

You're a Fiduciary – Why Do You Care?

So you're a fiduciary under ERISA; what does that mean and why do you care? It means you can't engage in prohibited transactions. But what is a prohibited transaction?

ERISA Section 404 outlines the duties that are required of you as a fiduciary. ERISA Section 406 outlines all the prohibited transactions – or things you are not allowed to do. And ERISA Section 408 gives you guidance on exemptions if you do something in Section 406.

Here is a quick explanation of each of these:

Section 404

- » You must follow the plan document
- » You must diversify investments
- » You can't pay more than reasonable fees
- » You can't have prohibited transactions
- » You have the duty of prudence, meaning you must follow a prudent process

- » You have a duty of loyalty, meaning you must act in the best interest of participants or clients (keeping in mind that is the financial best interest of clients and beneficiaries)

Section 406

- » You can't self-deal (meaning you can't sell or lease any property between the plan and party in interest)
- » You can't have conflicts of interest (keep in mind that if it looks, feels or smells like a conflict of interest, it probably is, and that means it's a prohibited transaction. This includes things like lending money or extending credit between the plan and party in interest)
- » You can't furnish goods, services or facilities between the plan and the party in interest
- » You can't transfer, or use for your own benefit, any assets of the plan
- » You can't acquire, on behalf of the plan, any employer security or employer property that violates ERISA Section 407

Parties in interest means you, the fiduciary, and any of your service providers.

It's important to note that 4975 of the Tax Code and ERISA Section 406 are essentially the same because if you have a prohibited transaction and you don't have an exemption under ERISA Section 408 or you haven't received a class exemption, then the penalties you get under the DOL come from the Tax Code because you'll get assessed a tax.

Basically, the big takeaways from this: You aren't allowed to have prohibited transactions and you must follow a prudent process. A rollover from a plan to an IRA creates a prohibited transaction because the advice from the ERISA fiduciary is conflicted; as such, you need to follow a prudent process, which might be foreign to someone who's never been an ERISA fiduciary. To help, we've outlined the steps to follow for PTE 2020-02 in the next section.

A Stepwise Approach for Developing Prudent Process for PTE 2020-02 Compliance

PTE 2020-02 applies in four scenarios: (1) in a rollover context from plan to IRA, (2) plan-to-plan transfers, (3) IRA-to-IRA transfers and (4) commission to fee, but the main one most advisers will be concerned about is plan-to-IRA rollovers.

The main questions to ask: Does the ERISA fiduciary standard apply, and if so, what does that mean in the context of plan-to-IRA transfers and what do I have to do?

Technically, PTE 2020-02 doesn't break up what you need to do into steps, but it can be helpful for you to see what you need to do in a stepwise format. So we offer these five steps for you to follow:

- 1 Identify a framework.** The first step of the process is always to establish the framework for review. For investments, that's always setting up the Investment Policy Statement (IPS) or other objectives (even though an IPS isn't required under ERISA). For PTE 2020-02, the framework is the worksheet/checklist/considerations that you will consistently evaluate for every client. You don't want to change the considerations depending on the client you are helping.
- 2 Gather relevant information.** Gather relevant information or that information you should know to be relevant. You're held to prudent expert standard, and you can't just say, "I didn't know." You're required to know. (See the worksheet titled Assessing What's Important to Your Clients for a practical application of this step and the checklist items regarding plan-related documents).
- 3 Objectively review, compare and analyze the relevant information.** Go over your relevant information again with an objective eye. Compare the information. Did you miss anything? (See

all items regarding comparing information in the worksheet titled "What PTE 2020-02 Requires in Plan-to-IRA Rollovers: Checklists" and the Pros and Cons exercise in the worksheet titled "Assessing What's Important to Your Clients.")

- 4 Make an informed decision that's well-reasoned.** Taking the client's needs and desires into account, make a decision that makes the most sense.
- 5 Document and revisit over time, if needed.** What information did you review and how did you make that comparison? Document everything to show your work so that you can incorporate it into the disclosures for your client. Revisit it periodically to ensure the decision still makes sense, if needed.

Do you remember math tests in school? You likely didn't get credit unless you showed the work you did to get to your answer. Think of the Department of Labor as your math teachers who need to see your work. You have to document how you came to certain recommendations or decisions and "show your work." Document your process in each of these steps above.

Keeping supporting documents and showing your work can justify that your recommendation was well-reasoned. For example, you can say something like, "We chose this Large Cap A fund because it was low-cost and met the needs this particular client desired. That's why we ruled out these three others that we considered."

What PTE 2020-02 Requires in Plan-to-IRA Rollovers: Checklists

There are four transaction types covered in the rule; however, we're only going to focus on plan-to-IRA rollover because it's going to be the most common. As advisers, you're generally not recommending someone move from one plan to another plan. It's more likely that you're helping your clients move from

a retirement plan to an IRA once they've accumulated enough assets.

This type of transaction is the most common and most complex, and it's important to keep in mind that there are complications beyond the scope of this resource. As such, we've put together a few checklists to help you with the basics.

First, when you're rolling over client assets from a 401(k) to an IRA, you're required to **follow impartial conduct standards**. Let's say you have a client with \$1 million in a 401(k) and you want to roll that over to an IRA. To make that recommendation or give investment advice, you need to do four things:

Did you ensure it's in the best interest of that investor? Meaning, did you meet your duty of care and duty of loyalty?

Did you do this for reasonable compensation?

Did you ensure there are no materially misleading statements?

Did you get the best price?

In terms of getting the best price, ensure you mark off the items on this checklist:

I compared all-in fees and expenses.

You don't have to get the lowest fees, but you have to be able to justify why your choice doesn't have to be the lowest fees, you have to be able to justify why you're going from a 10-basis point plan to 100-basis point IRA, for example, and you're going to have to document it.

I compared the available services in the plan to the available services in the IRA.

I compared the available investments or products in the plan to those in the IRA.

One way you can show you compared the two is to show that you found in

the plan there were only 20 available investment options, but thousands of options in the IRA, for example. Or you can show that the IRA allows you to use crypto, whereas the plan doesn't. You're essentially weighing one versus the other and documenting your findings.

I have relevant plan-related documents.

You want to make sure you have three categories of documents: (1) annual participant fee disclosure; (2) the quarterly participant fee disclosure (ensure you have the four most recent quarterly participant fee disclosures); and (3) summary plan description. Essentially, you're going to outline what you are proposing and compare it to the existing 401(k) plan in terms of fees and expenses, services and available investments (as well as other factors that may be relevant to the client).

Assessing What's Important to Your Clients

In making a recommendation for a client to roll over a plan to an IRA, you want to assess what's important to your client in several areas.

Rate whether the following are important to your clients. Put a + sign next to the ones that are important and a - sign next to the ones that are not important. Then go through and rank the ones that are most important to them. This will depend on the number of plus signs, and 1 will be the most important. Say they have only five plus signs, you can rank them as 1 being the most important and 5 being the least important:

Fees and Expenses

Services Available for the Plan

Investments that are Available

Whether the IRA has a Guaranteed Income Option

Tax Considerations

Distribution Considerations

Beneficiary Considerations

Other Unique Considerations

When we make tough decisions, oftentimes we'll create a pro/con list. If you're considering recommending a rollover from a plan to an IRA for your client, you can make a pro and con list with the information you've gleaned from above about what's most important to them. You can list the pros and cons of the IRA you've chosen for your client. You can print and use this in your documentation to show your work.

PROS

CONS

Documentation and Disclosures

Now, step four of your prudent process for an ERISA fiduciary is making your decision, and step five is documenting it. You're going to give the client your documentation, which includes your statement that you're a fiduciary, your disclosures (for example,

Form CRS) and your scope of services. The latter will include what services you're providing and fees you're charging.

Establishing Policies and Procedures

Note that while this resource is helpful jumping-off point to get to planning, you should always enlist help to comply with PTE 2020-02.

An advisor shouldn't attempt to comply with PTE 2020-02 all on their own. The rule requires that you have a level of oversight because you must have (1) policies and procedures in place; and (2) a review of policies and procedures.

Here are some things to keep in mind and include in developing your policies and procedures:

- » Did you provide a background on the fiduciary rule and PTE 2020-02?
- » Has your firm designated a supervisor?
- » Have you outlined general PTE 2020-02 procedures?
- » Have you established an outline of the required client documentation?
- » Have you outlined the penalties for not complying with PTE 2020-02?
- » Have you outlined your procedures for conducting an annual review and policies for what happens if you uncover any violations during annual review?
- » Do you have a list of the relevant technology you use to help you comply with PTE 2020-02?

Keep in mind that it's best to work with your coach or compliance professional to help you develop your policies and procedures.



CARSON
COACHING

Carson Coaching
14600 Branch St
Omaha, Nebraska 68154

carsongroup.com
888.321.0808
info@carsongroup.com