

# PTE 2020-02 Retrospective Reviews

---

By Amber Allen and Craig Watanabe



**About the Authors:**

Amber Allen is VP and General Counsel with Fairview Investment Services, LLC. She is reached at [amber.allen@fairviewinvest.com](mailto:amber.allen@fairviewinvest.com).

Craig Watanabe is the Director of IA Compliance at DFPG Investments. He is reached at [cwatanabe@dfpg.com](mailto:cwatanabe@dfpg.com).

**T**itle I of the Employment Retirement Income Security Act of 1974, as amended (“ERISA”), and the Internal Revenue Code of 1986, as amended, prohibits parties providing fiduciary investment advice to IRA owners, plan participants, and sponsors, from receiving payments that create a conflict of interest unless the fiduciary complies with protective conditions set forth in a prohibited transaction exemption. PTE 2020-02 was adopted on December 18, 2020, as a prohibited transaction exemption for fiduciary advice provided to employee benefit plans and IRAs. To rely on the exemption, investment advisers (IAs) and broker dealers (BDs) may only make investment recommendations for IRA assets or an IRA rollover if such recommendations are in the best interest of the client and meet certain additional requirements. Among these other requirements explained in additional detail below, firms must conduct an annual retrospective review.

To provide perspective on the annual retrospective review for exemptive relief under PTE 2020-02 (“the exemption”), it is helpful for context to review a summary of all the sections of the exemption:

- Impartial Conduct Standards
  - Best Interest
  - Reasonable Compensation
  - Best Execution
  - No Misleading Statements
- Disclosure
- Policies and Procedures
- Annual Retrospective Review
- Self-Correction
- Principal Transactions
- Recordkeeping

The exemption went into full effect on July 1, 2022, and now that firms have had some experience with compliance, this article will address one of the next major challenges, the annual retrospective review which most firms will likely need to undertake in the first half of 2023.

## Requirements of the Retrospective Review

To satisfy the retrospective review requirement of the exemption, firms must conduct an annual retrospective review reasonably designed to assist in detecting and preventing violations of the Impartial Conduct Standards and the firm’s policies and procedures.

Per the Final Rule, “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 Department of Labor (“DOL”) issued a FAQ in April 2021 and response to Question 19 stated,

*“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 recordkeeping retention requirement for the exemption is six years, and the documents must be available for review by the DOL within 10 business days of a request. Notably, the six-year requirement does not conform with the retention requirements for either BDs or IAs as it is longer than both.

## Retirement Accounts and ERISA Testing Template

Included with this article is a Retirement Accounts and ERISA Testing Template which is available in the NSCP Resource Library. This template is divided into three sections:

- Solo-Participant Plans (IRAs, etc.)
- Employer-Sponsored Plans
- Senior Executive Certification

Also note there are three tabs:

- Testing
- Population
- Sample

## Integrating the Retrospective Review Requirement

Both BDs and IAs should already have a testing program and perform annual reviews. For most firms, it will make sense to integrate the Retrospective Review requirement into their existing testing and annual review process. However, the Retrospective Review requirement has two elements that do not conform with either FINRA or SEC Rules and expectations. First, as mentioned above, there is a six-year retention requirement for books and records related to PTE 2020-02. Typically, the retention requirement is three years for BDs and five years for IAs. Second, as described below, the Senior Executive certification has three prescribed elements modeled after FINRA Rule 3130<sup>1</sup>; however, the DOL declined to provide a safe harbor based on compliance with FINRA Rules. Under Rule 206(4)-7, IAs are required to perform an annual review although no written report is required. On March 10, 2022, the SEC proposed an amendment to 206(4)-7 that would require all SEC-registered investment advisers to document in writing the annual review of their compliance policies and procedures<sup>2</sup>; however, neither the current Rules nor the proposed amendment contain a Senior Executive certification requirement.

## Senior Executive Certification

The Final Rule specifies a “Senior Executive Officer” is the CEO, CCO, CFO, President, or one of the three most senior officers of the firm. The Senior Executive Officer must certify, within six-months of the end of the annual review period that:

- The officer reviewed the report;
- The firm has in place policies and procedures prudently designed to achieve compliance with the conditions of PTE 2020-02; and
- The firm has in place a prudent process to modify such policies and procedures as business, regulatory and legislative changes and events dictate, and to test the effectiveness of such policies and procedures on a periodic basis, the timing and extent of which is reasonably designed to ensure continuing compliance with the conditions of PTE 2020-02.

---

1. See “3130 Annual Certification of Compliance and Supervisory Processes”, FINRA Manual Rule 3130 available at: [3130. Annual Certification of Compliance and Supervisory Processes | FINRA.org](#).

2. See “Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews”, U.S. Securities and Exchange Commission Proposed Rule (March 10, 2022) available at: [Proposed rule: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews; Conformed to Federal Register version \(sec.gov\)](#).

Rows 32-39 of the testing template are formatted to memorialize the Senior Executive Certification and fulfill the PTE 2020-02 requirement.

## Review of Policies and Procedures

Arguably the most critical element of the policies and procedures is the scope. Row 12 of the testing template asks:

*“Test the scope of the policies to determine if they are reasonably designed to achieve compliance with the procedures. Due to the complexity of the Rule, some policies can lead to confusion as to when the procedures are applicable, so be sure to test for gaps. Does the scope of the policies appear to be reasonably designed and effective?”*

The scope of most policies will derive from the scope of the Rule, which was the impetus for the policies, in this case “covered transactions” under PTE 2020-02:

*“This exemption permits Financial Institutions and Investment Professionals, and their Affiliates and Related Entities, to engage in the following transactions, including as part of a rollover from a Plan to an IRA as defined in Code section 4975(e)(1)(B) or (C), as a result of the provision of investment advice within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B).”*

There are two significant challenges. First, as defined in PTE 2020-02 the scope is not at all intuitive. Second, the complexity of this definition can make it extremely difficult to determine when PTE 2020-02 is needed. *Do not underestimate the complexity of the definition of “covered transactions.”*

Well-written policies and procedures are simple, straightforward, and tailored to fit the firm’s business practices. There is a “Template Retirement Account and ERISA Policies and Procedures” in the NSCP Resource Library and the scope is defined as “whenever a retirement account is opened.” Granted, this is broader than the Rule; however, this definition is simple and straightforward. Your first task in the retrospective review is to review the written policies and procedures and pay particular attention to how the scope of your policies is defined. As with any policy template, firms should use the template as an example and should tailor the policies and procedures to reflect the firm’s business practices.

## Errors of Omission

When performing testing, it is important to understand where violations may occur. Compliance violations may occur in policy and procedure design, implementation, or execution.

The section above focused on policy and procedure design and preventing gaps in the policies and procedures. This section will address the execution of the policies and procedures, specifically errors of omission which occur in the execution of the policies and procedures.

There could be a situation in which there was a recommendation for an IRA transfer and for whatever reason the adviser did not comply with the requirements of the exemption including the disclosure requirement. These errors of omission can be difficult to detect. Firms should consider the types of errors of omission that may occur at their firm and tailor their compliance testing and training programs accordingly.

For example, an execution violation may occur if an IAR or BD does not realize that a recommendation falls within the scope of PTE 2020-02 and therefore fails to comply with the firm's policy. This error could have been prevented by a thorough training program. As an additional safeguard, testing should be conducted to quickly identify these types of exceptions. For example, periodically reviewing new retirement accounts to determine if the appropriate disclosures are on file would assist a firm in identifying these types of exceptions.

Consider the situation where the firm has implemented an automated solution to comply with the exemption. Most automated solutions are helpful; however, they are vulnerable to errors of omission. Even though most automated solutions have dashboards to facilitate the Retrospective Review, the program has no way to know if data has not been entered (an error of omission). Thus, even when using an automated solution, it is important to test and look for errors of omission. If a firm detects an error, it should determine whether PTE self-correction is available and comply with the four requirements, including documenting the violation and correction in the Retrospective Review.

## Best Interest Rationale

The PTE 2020-02 FAQ Question 15<sup>3</sup> asks, "What factors should financial institutions and investment professionals consider and document in their disclosure of the reasons that a rollover recommendation is in the retirement investor's best interest?"

The answer to Question 15, states:

*"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."*

The Best Interest Rationale requirement is challenging because the execution will inevitably require subjectivity, which presents problems with consistency and quality control. Imagine if a BD had a policy that when making recommendations the Registered Representatives must describe in writing why the recommendation was suitable. Or consider if an IA had a policy that when making recommendations the investment adviser representative must document how and why the fiduciary duty has been upheld. Because these policies would be difficult to execute and monitor, one could argue they are poor policies. This is the challenge with the Best Interest Rationale. Most firms have at least some freeform responses built into their procedures, so training is critical to achieve some semblance of consistency. There have been no enforcement cases for violations of PTE 2020-02 and ultimately, we will need to see how the exemption will be enforced.

---

3. See endnote 3.

*Alternatives to a Rollover.* The answer to Question 15 elaborates:

*“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.”*

Consider this when addressing Row 18 – “consideration of alternatives” in the Testing Template.

*Fees and Compensation.* The answer to Question 15 elaborates:

*“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.”*

This is the most challenging requirement of the exemption, and an automated solution is an attractive approach to addressing this problem. Conducting a side-by-side fee comparison manually is difficult even if the data is available. Note, the FAQ advises to obtain the 404a-5 disclosure or if not available, obtain data from Form 5500 filings or benchmarking data. However, for many firms, especially those with voluminous rollover recommendations, manual fee comparisons are high risk for inaccurate data and / or fee calculations. Here is an exercise to prove this point: pull a 404a-5, and a 5500 from the internet and calculate the fees in a side-by-side comparison. If you have difficulty doing so, reconsider a policy that requires your staff to do so.

*Documentation of Best Interest Analysis.* To satisfy the requirement to document the prudent analysis of why a rollover recommendation is in a retirement investor’s best interest, most firms incorporated a freeform response from the person who made the recommendation. Although there have been no enforcement cases from the DOL, Reg-BI has a similar documentation requirement, and the SEC announced its first enforcement of Reg-BI in June 2022<sup>4</sup>. In full disclosure, we do not know how the DOL will enforce PTE 2020-02; however, the SEC took a strict interpretation when enforcing the Care Obligation of Reg-BI.

4. See “SEC Charges Firm and Five Brokers with Violations of Reg-BI”, SEC Press Release 2022-110 (June 16, 2022) available at: [SEC.gov | SEC Charges Firm and Five Brokers with Violations of Reg BI](https://www.sec.gov/SEC-Charges-Firm-and-Five-Brokers-with-Violations-of-Reg-BI).

The litigation release highlighted eight clients, and, in each case, the Best Interest Rationale was cited as deficient. For example, in the findings for “Customer A” the release stated, “Customer is seeking a higher rate of interest from funds sitting in a bank savings at .05%. They will utilize the interest for supplemental income each month.” The SEC stated this is a reason why the recommendation was made but not why it was in the investor’s best interest. The SEC deemed the rationale to be “unreasonable, vague and generic” and the registered representative “did not exercise reasonable diligence, care, and skill to have a reasonable basis to believe the recommendation were in the customer’s best interest.” Many firms probably would have found the rationale for Customer A to be acceptable; however, this approach should be reconsidered. Given the subjectivity needed to comply with the Best Interest Rationale, the best solution may be to focus on training to achieve better outcomes.

## Sampling

PTE 2020-02 has an explicit testing requirement, “The firm has in place a prudent process to modify such policies and procedures as business, regulatory and legislative changes and events dictate, and to test the effectiveness of such policies and procedures on a periodic basis, the timing and extent of which is reasonably designed to ensure continuing compliance with the conditions of PTE 2020-02.”

Row 25 of the Testing Template is designed to comply with the testing requirement and asks, “Select a sample and perform testing. Were there any findings?” We will first address the three steps in selecting a sample for testing”

- Step 1 - Define the population
- Step 2 - Determine the sample size
- Step 3 - Decide upon a sampling methodology

*Define the population.* Make a list in the <Population> tab of the Testing Template of all retirement accounts opened during the review period. If the scope of your policy applies to all retirement accounts, you can move to the next step and determine the sample size. If your policy is narrower, you will need to cull the list and delete items from the population to which the policies do not apply.

*Determine the sample size.* This is a use case for a Sample Size Calculator which will apply statistical criteria to determine the sample size based on the following inputs:

- Population size
- Confidence level
- Margin of error

Sample size calculators are ubiquitous on the internet and a simple search will turn up many usable examples that are practically identical. The Confidence Level is the degree of confidence that the sample will be representative of the entire population. The Margin of Error is the plus or minus percentage of the Confidence Level.

For example, entering a population size of 1,000, confidence level of 80% and margin of error of 20% yields a sample size of 11 which is 1.1% of the population. There is no prescribed methodology, so you have a lot of latitude in selecting your sample size parameters. Generally, it is prudent to select a larger sample in the initial testing after a new policy is implemented, or if possible, test the entire population without sampling.



*Decide upon a sampling methodology.* There are four common sampling methodologies: random, periodic, transactional, and judgmental.

- Random sampling is accomplished with the aid of a random number generator to eliminate bias in the sample selection. An example of a random number generator is the RAND function in Excel.
- Periodic sampling means selecting every nth item. In the above example with a sample size of 11 out of 1,000 a periodic sample would select roughly every 100th item.
- Transactional sampling means samples are selected based on transactional criteria. For example, if the objective is to test only 401k to IRA rollovers, each time such a transaction occurs the transaction will be selected for testing.
- Judgmental testing is the method most often utilized. Subjective judgments are introduced to ensure a diverse sample. For example, the sample might include at least one transaction from each IAR or an even proportion from each custodian.

Once a sampling method is selected it will be applied to the <Population> and the sampled items copied to the <Sample> tab for testing in the Testing Template.

## Testing

Once the sampled items have been copied to the <Sample> tab, Columns F-L can be populated to memorialize compliance or non-compliance with each of the component requirements of the exemption. The testing columns should be reviewed and edited to align with your firm's policies and procedures.

Note: Testing is a skill, and some people are better at it than others. Take this into account if the testing is delegated to someone. For the initial testing, it might be advisable to have the most knowledgeable and experienced person on your staff perform the testing. This documentation can then be used as a training resource when additional staff (or vendors) perform the review.

## Follow Up

The results of your testing should inform your next steps, which could include more testing, updates to policies and procedures, updates to workflows/forms, training, or escalation of violative behavior. Finally, there is a self-correction provision within PTE 2020-02. Under the correction procedure, violations may be self-corrected 90 days after the firm learns or "reasonably should have learned" of the violation.<sup>5</sup>

## Conclusion

In Compliance, some tasks are "easy to say but hard to do." The PTE 2020-02 Retrospective Reviews fall into this category. This article and the Testing Template will hopefully, not only provide the know-how, but also the tools to accomplish the Retrospective Review. ■

---

5. See "PTE 2020-02 Improving Investment Advice for Workers & Retirees Frequently Asked Questions, Question 20" U.S. Department of Labor, Employee Benefits Security Administration (April 2021) available at: <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/faqs/new-fiduciary-advice-exemption>.



# Retirement Accounts and ERISA Testing Template

---

The Retirement Accounts and ERISA Testing Template is available for download. The authors have provided this tool to readers in a format that allows them to customize the document to best serve their needs.

[DOWNLOAD NOW](#)