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Memorandum

Department of Labor Releases Final Definition of ERISA Fiduciary and Related Conflict of Interest Rules: Groups Move to Challenge in Court

June 14, 2016

On April 6, 2016, the Department of Labor ("**DOL**") published a new final fiduciary rule under the Employee Retirement Income Security Act of 1974, as amended ("**ERISA**") and Section 4975 of the Internal Revenue Code of 1986, as amended ("**Code**"), together with two new and six amended ERISA prohibited transaction class exemptions, which address conflicts of interest that may occur in connection with retirement investment advice. The regulatory package is intended to address perceived conflicts of interest between retail retirement investors and the broker-dealers and financial advisers who provide services to retail retirement investors.

A lawsuit was filed by the U.S. Chamber of Commerce and eight other industry groups on June 1, 2016 challenging the final rule and the related exemptions. The complaint seeks to (1) have the final fiduciary rule and the related prohibited transaction class exemptions (or amendments thereto) vacated and (2) enjoin the DOL from implementing the final rule and the related exemptions (or amendments thereto) while the case proceeds.

The plaintiffs argue that the final fiduciary rule expands the scope and application of ERISA's definition of fiduciary beyond what is intended to be covered by the ERISA statute, regulating business relationships and forms of advice not intended to be covered by the statute. In particular, the complaint alleges that the DOL acted beyond the scope of its authority by regulating the financial services industry and providing enforcement rules that apply to Individual Retirement Accounts ("**IRAs**"). The plaintiffs argue that the fiduciary requirements and prohibited transaction rules that apply to IRAs are currently enforced under the Code through the imposition of excise taxes and through the Treasury Department's audit power, but absent the new final rule the DOL does not have any enforcement authority of its own with respect to IRAs.

Moreover, the crux of the plaintiffs' argument is the assertion that under the relevant Code provisions, IRA owners have no right to bring a cause of action against a fiduciary or to otherwise enforce the prohibited transaction rules that apply to IRAs. The complaint alleges that the DOL created a non-statutory cause of action by requiring ERISA investment advice fiduciaries to enter into enforceable written contracts with IRA owners that would provide the IRA owners with private rights of action (and specifically by conditioning the so-called "Best Interest Contract" or "BIC" exemption (discussed in detail in Section IV, below) on the non-waiver of IRA owners' rights to bring or participate in a class action). The complaint states that the "creation of a private right of action is an impermissible end-run around the remedial scheme enacted by Congress" and asserts that there is a "well-established principle that only Congress may create a private right of action." The DOL anticipated this argument, and essentially counter-argued in the preamble to the final rule that there is no required non-waiver under the rule. Rather, to rely on an exemption from the rule, one must follow the terms of the exemption, one of which is non-waiver.

The plaintiffs argue that "because the broad sweep of the [final rule] would prohibit many common forms of compensation, and because the fee-based compensation model that is permissible under the [final rule] is incompatible with certain investment products…the [final rule] forces financial and insurance firms and professionals into relying on the BIC exemption and thus effectively prohibits the enforcement of arbitration agreements containing class action waivers." The plaintiffs argue in part that the BIC exemption and the other prohibited transaction exemptions should be vacated, and because the final rule and the exemptions are integrally linked, the final rule needs to be vacated as well. They also make arguments regarding the insufficiency of the administrative process used in adopting the rule.

Separately, the National Association for Fixed Annuities filed its own challenge in federal district court on June 2, 2016 and has moved for a preliminary injunction, which will be heard on August 25, 2016. In addition, three more legal challenges were filed on June 8, 2016, by the American Council of Life Insurers, the Indexed Annuity Leadership Council and Market Synergy Group Inc.

I. Background

In general, the final rule treats persons who provide investment advice or recommendations for a fee or other compensation with respect to assets of an ERISA plan or an IRA as fiduciaries in a wider array of advice relationships than the existing rules did. The new rule substantially expands the group of persons and institutions who will be ERISA fiduciaries, and ERISA fiduciary status will now apply to investment advice given with respect to IRAs.

The new rule targets broker-dealers, investment advisers, mutual fund principal underwriters and insurance agents and brokers, among others. Each of these groups will need to revamp their operations in order to retain their existing commission or other variable compensation arrangements (or, alternatively, restructure compensation arrangements as level/fixed fee arrangements), as each group may need to comply with the

new Best Interest Contract exemption in order to maintain all existing forms of direct and indirect remuneration for what will now be treated as ERISA fiduciary investment advice. Businesses whose operations are subject to the expanded definition of investment advice fiduciary will need to carefully inventory and examine their operations and revenue practices in order to make sure that they comply with the new rule when it applies.

On May 12, 2015, we published a Memorandum alerting clients and friends to the proposed regulatory package that the DOL had published on April 20, 2015. For more information about last year's proposal, please read our May 12, 2015 Memorandum at the following link: http://www.stblaw.com/docs/default-source/memos/firmmemo_05_12_2015.pdf

While the effective date of the final regulations and new and revised class exemptions is June 7, 2016, in general, compliance with the new rule and class exemptions is not required until April 10, 2017 (or, in certain cases, until January 1, 2018), which is intended to provide adequate time for affected financial service organizations and other service providers to adjust to the fundamental change from non-fiduciary to fiduciary status.

The DOL has promised additional guidance releases beginning in the summer of 2016 to help clarify how the final rule and the related exemptions are intended to work.

Under the final rule, persons who were not previously considered ERISA fiduciaries and who provide certain types of advice, including investment recommendations, for a fee or other compensation, directly or indirectly, to IRA owners, ERISA plans, ERISA plan fiduciaries or to individual ERISA plan participants, may now be ERISA fiduciaries as a result of providing such advice.[1] The principal consequence of being deemed to be an ERISA fiduciary is that, in order to avoid engaging in a prohibited transaction and incurring liability as a result of the advice provided, restrictions are imposed on otherwise typical compensation arrangements, new operational procedures will need to be followed and additional disclosure will need to be provided. In the absence of a prohibited transaction exemption, receipt by an investment advice fiduciary of commissions, sales loads, 12b-1 fees, revenue sharing or similar variable compensation or transaction payments from third parties would violate the fiduciary/self-dealing provisions of ERISA, because the amount or timing of the fiduciary's compensation would be affected by the investment advice the fiduciary provides.

The final rule exempts from the ERISA investment fiduciary definition the investment advice given to financially sophisticated independent fiduciaries of certain ERISA plans and IRAs (see the "Seller's

[1] The new rule also applies to other tax-favored vehicles available under the Code, such as Health Savings Accounts (HSAs), Archer Medical Savings Accounts and Coverdell Education Savings Accounts, which are not specifically intended to be used for retirement savings.

Exemption" described more fully in Section III, below). One of the significant consequences of the final rule is that, assuming compliance, when applicable, with the Seller's Exemption, the expansion of those who are determined to be ERISA investment advice fiduciaries will primarily apply to those advising IRA owners, small ERISA plans or individual ERISA plan participants.

II. Highlights of Changes to Proposed Rule

As discussed below, the changes from the initial proposal are generally viewed to be favorable to the industry relative to the proposed rule, as the changes potentially expand the ability of intermediaries to preserve existing compensation structures for advice related to any asset class and reduce many of the administrative burdens that the industry generally believed made the proposed rule unworkable. However, compliance with the new rule may still require substantial changes in how those who advise IRA owners and individual ERISA plan participants conduct their businesses, and it is too early to know for sure how difficult or costly the required changes will be to implement.

Highlights of the changes to the proposed rule include:

- General communications such as private placement memoranda and/or general marketing materials should not constitute fiduciary investment advice;
- Expanded "Seller's Exemption" or "counterparty" exclusion that avoids fiduciary liability when the ERISA plan or IRA is represented by a sophisticated independent fiduciary;
- No limited list of assets as permitted investments under Best Interest Contract (BIC) exemption;
- BIC exemption can apply to more classes of retail retirement investors;
- New requirements that must be followed when moving clients to level fee arrangements;
- Requirement that principal underwriters of mutual funds comply with the BIC exemption when they or an affiliate are treated as investment advice fiduciaries under the new rule;
- No prior contract needed before investment advice is implemented when BIC exemption is being relied upon;
- No separate written contract required for advice given to ERISA plans or ERISA plan participants when BIC exemption is being relied upon (although a contract continues to be required for arrangements with IRAs);
- Negative consent permitted to authorize transition of existing customers to the BIC exemption (subject to certain conditions); and
- Simpler, more commercial disclosure requirements for compliance with the BIC exemption.

III. Final Rule

A. Revised Definition of Investment Advice Fiduciary

The new definition of investment advice "fiduciary" differs in some ways from the April 2015 proposal. Under the final rule, whether a "recommendation" has been made is a threshold issue that must be considered when determining whether investment advice has occurred. A person is an investment advice fiduciary if the person provides one of the following types of advice for a fee or other compensation, directly or indirectly, to an ERISA plan, plan fiduciary, plan participant or beneficiary or IRA or IRA owner:

- A recommendation as to the advisability of acquiring, holding, disposing of or exchanging securities or other investment property, or a recommendation as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred or distributed from the ERISA plan or IRA. The rule does not pick up advice relating to the purchase of health, disability or term life insurance, though it could relate to advice pertaining to investments and securities held by health or other welfare plans.
- A recommendation as to the management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, selection of *other* persons to provide investment advice or investment management services, selection of investment account arrangements (brokerage vs. advisory), or recommendations with respect to rollovers, transfers or distributions from an ERISA plan or IRA, including whether, in what amount, in what form and to what destination (such as a rollover), transfer or distribution should be made. A recommendation of oneself to provide investment advice or services is generally not by itself a recommendation for these purposes.

Unlike the proposed rule, the final rule does not include advice regarding appraisals or fairness opinions, though the DOL has indicated that later rulemaking may cover these topics.

In order for a recommendation to constitute fiduciary investment advice, the recommendation must be made either, directly or indirectly, by a person who represents or acknowledges that he, she or it is acting as a fiduciary within the meaning of ERISA or the Code, or the advice must be given under an agreement, arrangement or understanding that the advice is based on the particular needs of the recipient. Otherwise, the advice must be directed to a specific recipient or representative regarding the advisability of a particular investment or management decision about securities or other investment property of the ERISA plan or IRA.

Because the new rule focuses on recommendations about investments, it includes guidance on what actually is a "recommendation." At its core, a "recommendation" is a communication that, based on its content, context and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular investment action. The DOL notes in the preamble to the rule that "communications that require an adviser to comply with suitability requirements under applicable securities

or insurance laws will be viewed as recommendations." For example, if the communication were viewed as a "recommendation" under FINRA requirements, and thus must meet FINRA's requirement that the adviser have reasonable grounds for believing that the recommendation is suitable for the investor, the communication would also be treated as a recommendation for purposes of the final fiduciary rule.

The determination of whether a "recommendation" has been made is an objective inquiry, not a subjective one, but may be a challenging one. The more individually tailored the communication is to a specific recipient about, for example, a security, investment property or investment strategy, the more likely the communication will be viewed as a recommendation. The rule points out that a selective list of securities given to a particular recipient as appropriate for that investor would be a recommendation as to the advisability of acquiring securities, even if no recommendation is made with respect to any one security. The new rule says that discrete interactions and communications could be aggregated to constitute a recommendation, even if the individual interactions by themselves would not be a recommendation, and communications that begin from a computer program designed to help select or screen investments (or "robo-advice") could end up constituting recommendations under the expanded rule.

Private equity funds and their personnel will need to carefully review their procedures for communicating with IRA investors, as well as the content of what is said to IRA investors. ERISA plan investors and IRAs whose investments are made through an aggregator may likely be represented by an independent fiduciary. As discussed below, communications with such an independent fiduciary should be exempt from the final rule. However, direct communications and interactions with IRA owners could be construed as fiduciary investment advice under the final rule.

The final rule provides that a private equity fund can avoid being an investment advice fiduciary with respect to an ERISA plan, ERISA plan participants and IRA investors if the private equity fund satisfies the "Seller's Exemption," detailed below, or the fund makes certain that none of its written or other communications to ERISA plans, ERISA plan participants or IRA owners could be construed as recommendations or investment advice that would make the fund or any of its personnel an investment advice fiduciary. Because the final rule does not make 100% clear in all cases which communications could be construed as fiduciary investment advice and which would not, we recommend that funds aspire to both rely on the Seller's Exemption as often as possible, while also making every effort to avoid any communications with ERISA plans, ERISA plan participants and IRA owners that could be treated as investment advice or recommendations.

B. Exceptions to the Definition of "Recommendation"

The final rule enumerates four types of services that would not be investment advice recommendations:

- Platform of Investment Alternatives. Making available or even marketing a platform or similar mechanism that can be used by ERISA plan fiduciaries to select and monitor investment alternatives. Disclosure must make clear that the platform provider is not intending to give impartial investment advice or to advise in a fiduciary capacity. This exception does not apply to advice given to ERISA plan participants or beneficiaries or IRAs.
- Assistance in selecting and monitoring investment alternatives. Identifying investment alternatives that meet criteria that a plan fiduciary had set. The person who identifies the investment alternatives needs to disclose in writing whether he or she has a financial interest in any of the identified alternatives. "Request for Proposal" written responses that identify a limited sample set of alternatives based only on the size of the plan, the employer or existing alternatives would not be recommendations as long as the responses disclosed whether the responder has a financial interest in any of the alternatives, as would not the provision of objective data and comparisons with independent benchmarks.
- General Communications. Furnishing general communications that a reasonable person would not view as an investment recommendation is not a recommendation for purposes of the final rule. This includes general circulation newsletters, commentary in public broadcasts and reports prepared for general distribution. Only materials that, based on their content, context and presentation, would reasonably be viewed as suggesting that the recipient take an investment action would be construed as investment advice for purposes of this rule. General communications such as marketing materials and prospectuses are specifically identified in the new rule as examples of communications that are not considered investment recommendations. Accordingly, typical private placement memoranda and other general fund marketing materials prepared by fund sponsors (as opposed to materials prepared by those in the distribution channels who market directly to ERISA plans and IRAs) should not constitute fiduciary investment advice.
- Investment Education. Furnishing plan information, general financial, investment and retirement information, sample asset allocation models and interactive investment materials would generally not constitute investment recommendations for purposes of the final rule.

C. Persons Who Are Not Deemed Investment Advice Fiduciaries

The final rule does away with the "carve-outs" to the definition of fiduciary, which were included in the proposed rule. Rather, certain persons are not deemed to be investment advice fiduciaries with respect to certain transactions under the final rule and are excluded in that manner:

- "Seller's Exemption:" Transactions with independent fiduciaries with financial expertise. Persons providing advice with respect to certain arms-length transactions, such as the arm's-length sale, purchase, loan, exchange or other transaction related to the investment of securities or other investment property, to an ERISA plan fiduciary or an IRA fiduciary who is independent of the person providing the advice will not be deemed investment advice fiduciaries. The adviser relying on this exemption needs to know or

should reasonably believe that they are dealing with an independent fiduciary that is:

  - a bank as defined in section 202 of the Investment Advisers Act of 1940 (or similar institution that is subject to state or federal regulation and supervision);
  - an insurance carrier that is qualified in more than one state to perform the services of managing, acquiring and disposing of assets of a plan;
  - an investment adviser registered under the Investment Advisers Act of 1940 (or registered under the laws of the state where its office and principal place of business is);
  - a broker-dealer registered under the Securities Exchange Act of 1934; or
  - any independent fiduciary that holds, or has under management or control, total assets of at least $50 million.

- The adviser must know or reasonably believe that the independent fiduciary can evaluate investment risks independently;
- The adviser must inform the independent fiduciary that the adviser is not trying to give impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction, and the adviser must inform the independent fiduciary of the person's financial interests in the transaction;
- The adviser must know or reasonably believe that the independent fiduciary is a fiduciary under ERISA or the Code with respect to the transaction and the fiduciary is responsible for exercising independent judgment when evaluating the transaction; and
- The adviser cannot receive a fee or other compensation directly from the ERISA plan, ERISA plan participant, IRA or IRA owner for the provision of investment advice in connection with the transaction.

This exemption allows private equity funds to accept IRA investors who are represented by qualifying independent fiduciaries without risk that the private equity fund would be treated as providing fiduciary investment advice under the final rule. Those who act as aggregators in the private wealth channel and who satisfy the financial expertise and the assets under management requirements of the exemption can serve as independent fiduciaries for the IRAs that they are aggregating. As long as the private equity personnel are dealing directly with the aggregators and not the IRA owners, the private equity fund partners and personnel should not be treated as fiduciaries when giving advice to the aggregators.

- Swap Transactions. Persons providing advice to ERISA plans involved in swap transactions or swap-based transactions will not be deemed investment advice fiduciaries, as long as (1) the ERISA plan is represented by an independent fiduciary, (2) the swap dealer or security-based swap dealer is not acting as an adviser to the ERISA plan, (3) the adviser does not receive a fee or other compensation directly for such advice in connection with the transaction in question from the ERISA plan or its fiduciary, and (4) the ERISA plan's independent fiduciary provides certain written representations to the persons before the transaction is undertaken.

- Employees. Persons who are employees of an ERISA plan's plan sponsor, affiliate, fiduciary, employee organization or the ERISA plan itself will not be deemed investment advice fiduciaries when they advise the plan fiduciary or other employees (other than as participants), as long as the person providing the advice does not receive additional compensation beyond what he or she is normally paid for work for the employer. The employee may also provide advice to other employees who are plan participants without being deemed an investment advice fiduciary, as long as the person giving the advice does not receive a fee or extra compensation for the advice, the person's job responsibilities do not include giving investment advice or recommendations, and the person is not a registered investment adviser under federal or state securities or insurance laws, and the advice provided does not require the person to register under federal or state securities or insurance laws.

IV. New Prohibited Transaction Class Exemption: Best Interest Contract Exemption

A new DOL prohibited transaction class exemption, which is called the Best Interest Contract or "**BIC**" exemption, will permit financial advisors and institutions to preserve their existing compensation and fee arrangements when giving advice to IRA owners, ERISA plan participants and the non-independent fiduciaries of ERISA plans. The BIC exemption allows brokers, investment advisers, private wealth managers, mutual fund principal underwriters and insurance agents to receive compensation the amount and timing of which is affected by the investment advice the fiduciary provides. Generally, the BIC exemption requires that the financial institution agree to follow "Impartial Conduct Standards," give specific warranties, provide specific disclosures, and confirm that the investment professional and the financial institution are investment advice fiduciaries.

In a departure from the 2015 proposal, financial advisors and institutions are not limited in the types of investments or asset classes that they can recommend under the BIC exemption. They may recommend any asset, including non-traded business development companies, non-traded REITs, private equity fund interests and hedge fund interests, to their IRA and individual ERISA plan customers and rely on the BIC exemption to preserve their current fee structures. It should be noted, though, that in the preamble to the BIC exemption the DOL cautioned that it expects financial advisers and institutions to "exercise special care when assets are hard to value, illiquid, complex or particularly risky." The DOL cautioned that advisers need to follow "Impartial Conduct Standards" when making such recommendations, and that the financial institutions and advisers should be documenting the bases of their recommendations and the bases for their conclusions that Impartial Conduct Standards are satisfied.

The BIC exemption is generally not available for ERISA plans if the adviser, financial institution or any affiliate is the employer, named fiduciary or plan administrator with respect to the plan or the plan's participants. *The exemption is also not available if the adviser has or exercises any discretionary authority or control with respect to the transaction.* The exception does not apply to compensation received in

connection with "principal transactions," discussed in Section V, below. Finally, compensation received in connection with "robo-advice" computer-generated programs will not be covered by the BIC exemption, unless the special rule relating to level fee arrangements, described below, applies.

As a result of changes made to accommodate investment industry comments, the final BIC exemption seems to be more workable than the proposed exemption. Unlike the proposed exemption, advisers may rely on the BIC exemption when giving investment advice to the sponsors of small ERISA plans, as well as when the advice is given to individual plan participants or IRA owners. However, while many of the procedural and disclosure requirements have been softened, the BIC exemption still has a number of requirements, including:

- An enforceable written contract from the financial institution is required, but the contractual terms may be folded into an advisory or account agreement or other relevant paperwork. In a departure from the proposal, individual advisers need not also execute the written contract. In addition, a written contract is not required prior to providing advice to ERISA plans. Instead, the financial institution needs to provide a written statement of the financial institution's and adviser's fiduciary status before the recommended transaction is executed. However, in order for the exemption to be available to recommendations made prior to the contract's formation, the contract terms must cover the prior recommendations.
- Existing agreements with customers that intend to rely on the BIC exemption going forward may be amended by negative consent (as opposed to entering into new contracts) to implement the new terms required for compliance with the exemption. Affirmative consent from existing customers is not required, but no additional obligations, restrictions or liabilities may be imposed without receiving affirmative consent.
- The financial institution must acknowledge in writing that it and the advisers are acting as fiduciaries under ERISA or the Code, or both, with respect to the advice and recommendations given.
- The financial institution and the adviser must follow new "Impartial Conduct Standards," and the financial institution must give a warranty that the financial institution has adopted and will comply with written policies and procedures reasonably and prudently designed to insure that the Impartial Conduct Standards are in fact followed and that the financial institution has identified and documented material conflicts of interest and has adopted measures to keep material conflicts of interest from undermining the Impartial Conduct Standards. The Impartial Conduct Standards include requirements that the investment advice given is in the "Best Interest" of the "retirement investor," and the financial institution, the adviser and their affiliates and related entities may only receive compensation that is reasonable as determined under section 408(b)(2) of ERISA. Also, any statements by the financial institution or the adviser about investments, fees, compensation, material conflicts of interest and any other pertinent matters cannot be materially misleading when they are made.

- The financial institution and its affiliates and related entities cannot use quotas, appraisals, performance actions, bonuses, incentives, differential compensation or special awards that would reasonably be expected to cause advisers to make recommendations that are not in the best interest of an ERISA plan, ERISA plan participant or an IRA.
- Exculpatory provisions, limits on recoveries in breach of contract claims to amounts representing liquidated damages, provisions limiting the right of customers to participate in class actions and requirements to arbitrate in distant locations may not be included in the contract.
- Reliance on the BIC exemption generally requires disclosure that:
  - States the best interest standard of care owed;
  - Informs the retirement investor of the services provided;
  - Describes how services will be paid for;
  - Describes material conflicts of interest;
  - Discloses any fees or charges;
  - Identifies the types of compensation expected from third parties;
  - Offers (but need not provide without request) written copies of policies and procedures relating to the Impartial Conduct Standards and details of all costs, fees and compensation;
  - Discloses whether proprietary products are offered or third party payments are received;
  - Makes clear whether or not the adviser or financial institution will monitor the investment and recommend changes in the future;
  - Includes a link to the financial institution's website;
  - Gives notification that model contracts are updated quarterly and available on the website, and that the financial institution's description of its policies and procedures are available for free on the website; and
  - Provides contact information that the customer may use to present concerns about the substance of the advice or service he or she has received.
- Special substantive and disclosure requirements apply when the investment product being recommended is managed, issued or sponsored by the financial institution or any of its affiliates or when the adviser or financial institution receives payments, fees, compensation, consideration or other financial benefit from someone other than the ERISA plan, ERISA plan participant or IRA owner.
- Additional rules apply when the BIC exemption is used to cover purchases and sales of investment products from service providers or other parties in interest or disqualified persons to an ERISA plan or an IRA.
- The BIC exemption allows the continued receipt of compensation based on investment transactions that

occurred before April 10, 2017 as well as receipt of compensation for recommendations to maintain a systematic purchase program that was set before April 10, 2017. The BIC exemption also covers compensation received as a result of a recommendation to hold an investment that was entered into before April 10, 2017.

- Notice must be given to the DOL when a financial institution is relying on the BIC exemption, and special recordkeeping requirements apply when the BIC exemption is being used.
- Reliance on the BIC exemption may be confined to discrete transactions. Advisers may find that they need to rely on the BIC exemption for one discrete transaction, but that going forward the BIC exemption is not needed. Advisers can confine the scope of the advice to which the BIC exemption will apply.
- New Simplified Special BIC Requirements When Moving Clients to Level Fee Arrangements: The final BIC exemption contains more streamlined conditions in connection with moving clients to level fee arrangements. Advising an individual investor to move an ERISA plan account to an IRA or to move from commission-based fees to asset-based or flat fees will now require documentation of why the recommendation is in the best interest of the customer and will require enhanced disclosure showing the customer the difference in fees and expenses between the customer's current arrangement and the proposed new arrangement, and the benefits of moving to the new arrangement. Specifically, level fee fiduciaries must provide a written statement of fiduciary status; adhere to standards of fiduciary conduct; when recommending a rollover from an ERISA plan to an IRA, a rollover from another IRA or a switch from a commission-based account to a fee-based account, provide documentation of why the level fee arrangement was considered to be in the best interest of the "retirement investor"; and, if recommending rollovers from an ERISA plan, document their consideration of the retirement investor's alternatives to a rollover, including leaving the money in the current plan, if permitted. As a result, helping ERISA plan participants move their money from employer plans with limited investment choices to IRAs that can invest in private equity or other alternative investment funds, for example, will now involve a new level of compliance work and documentation and potentially increased liability.
- Bank Networking Arrangements. The final BIC exemption is also available to cover referral fees received by banks and bank employees, under "Bank Networking Arrangements," which are arrangements for the referral of retail nondeposit investment products that satisfy applicable federal banking, securities and insurance regulations, under which bank employees refer bank customers to (1) an unaffiliated investment adviser registered under the Investment Advisers Act of 1940 or under the laws of the state in which the adviser maintains its principal office and place of business, (2) an insurance company qualified to do business under the laws of a state, or (3) a broker or dealer registered under the Securities Exchange Act of 1934. The exemption provides relief for the receipt of compensation by an adviser who is a bank employee, and a financial institution that is a bank or similar financial institution under a Bank Networking Arrangement in connection with their provision of investment advice, but the investment advice must satisfy the Impartial Conduct Standards.

V. New Prohibited Transaction Exemption: Principal Transactions in Debt Securities

As was reflected in the April 2015 proposal, the DOL issued another new prohibited transaction class exemption that permits advisers and financial institutions to enter into principal transactions and riskless principal transactions with ERISA plans and IRAs with respect to certain specified investments (certain debt securities, certificates of deposit and unit investment trusts). A principal transaction is one in which an adviser or financial institution is buying from or selling to an ERISA plan, ERISA plan participant or IRA on behalf of the financial institution or one of its affiliates. A riskless principal transaction is one in which a financial institution buys or sells an asset for its own account in order to offset a contemporaneous, matching transaction with an ERISA plan, ERISA plan participant or IRA.

The exemption requires advisers and financial institutions to satisfy certain "Impartial Conduct Standards," including a "Best Interest" standard, in order to rely on the exemption. In addition, the financial institution must adopt certain policies and procedures and must make specific disclosures.

VI. Changes to Existing Prohibited Transaction Class Exemptions

In connection with the issuance of the new fiduciary rule and the issuance of the new prohibited transaction class exemptions, the DOL partially amended and partially repealed six existing prohibited transaction class exemptions that relate to investment advice, generally to require that investment advice given by fiduciaries follow the requirements of the BIC exemption and the Impartial Conduct Standards.

Prohibited Transaction Class Exemption 84-24 ("PTCE 84-24") historically allowed the principal underwriters of mutual funds to receive typical commissions and other fees in connection with an ERISA plan's or IRA's purchase of mutual fund shares. As revised, PTCE 84-24 will only cover commissions and sales loads paid by an ERISA plan in connection with the purchase (*but not sales*) of mutual fund shares from investment advice fiduciaries and other service providers. Investment advice fiduciaries to IRAs can no longer rely on PTCE 84-24 when engaging in covered transactions but must instead rely on the BIC Exemption, described above. Principal underwriters who are investment advice fiduciaries to an ERISA plan or IRA under the new fiduciary rule will need to rely on the BIC exemption to continue to receive 12b-1 fees, revenue sharing, administrative fees and marketing fees with respect to those ERISA plans or IRAs.

PTCE 84-24, which historically allowed insurance and annuity contracts to be sold to ERISA plans and IRAs and allowed agents and brokers to receive their typical commissions has also been amended so that the exemption will only cover sales of fixed rate annuity contracts which, in the DOL's view, guarantee a return of principal and a guaranteed minimum interest rate, and do not vary based on investment experience. Sales of variable annuities and indexed annuities, which the DOL views as products that take investment experience into account and which are complex products with "conflicted payment structures," will no longer be covered by PTCE 84-24 but must instead be covered by the BIC exemption.

PTCE 75-1 (Part V) has been amended to allow broker-dealers who will now be investment advice fiduciaries to receive compensation when they extend credit to ERISA plans and IRAs to avoid failed securities transactions by the ERISA plan or the IRA. There are special conditions that the broker-dealer must meet in order to rely on the revised exemption.

PTCE 86-128 generally allows certain fiduciaries to receive a fee from an ERISA plan or IRA for executing or effecting securities transactions as an agent both for the plan and the other party in the transaction. Exemptive relief also allows fiduciaries to receive commissions from ERISA plans or IRAs in connection with certain mutual fund transactions with ERISA plans and IRAs. Investment advice fiduciaries to IRAs can no longer rely on PTCE 86-128 when engaging in covered transactions but must instead rely on the BIC Exemption, described above.

Each of PTCEs 75-1(Parts III and IV), 77-4, 80-83 and 83-1 have been amended to incorporate the new Impartial Conduct Standards into each exemption. These standards require the affected fiduciaries to act in the best interest of ERISA plans and IRAs, charge no more than reasonable compensation and make no misleading statements to the ERISA plan or IRA when engaging in transactions that are covered by these exemptions.

In brief, PTCE 75-1(Part III) permits a fiduciary to cause an ERISA plan or an IRA to purchase securities from a member of an underwriting syndicate of which the fiduciary is a member, other than from the fiduciary. Part IV of PTCE 75-1 permits ERISA plans and IRAs to buy securities in principal transactions from a fiduciary who is a market-maker in those securities. PTCE 77-4 exempts an ERISA plan's or an IRA's purchase or sale of open-end mutual fund shares where the investment adviser for the mutual fund is also a fiduciary to the ERISA plan or IRA. PTCE 80-83 allows a fiduciary to cause an ERISA plan or an IRA to buy a security when the proceeds of the security may be used to retire or reduce indebtedness to the fiduciary or an affiliate. PTCE 83-1 permits an ERISA plan or an IRA to buy mortgage pool certificates when the sponsor, trustee or insurer of the mortgage pool is a fiduciary with respect to the ERISA plan or IRA assets that are invested in the certificates.

VII. Conclusion

The final rule and the related new and amended class exemptions raise substantial questions and issues relating to how financial institutions and investment professionals will service their clients going forward. Professionals who provide services to ERISA plans, ERISA plan participants and IRAs will need to inventory and analyze how, if at all, the new final rule affects their businesses and then plan carefully for meeting the April 10, 2017 compliance date, assuming the legal challenges are unsuccessful.

For further information regarding the Department of Labor final fiduciary rule, please contact a member of the Firm's Executive Compensation and Employee Benefits Practice Group.

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