

Perspectives

AN EXECUTIVE COMPENSATION, BENEFITS
& HUMAN RESOURCES LAW UPDATE



DOL Issues Final Investment Advice Fiduciary Rules

A LETTER TO OUR READERS...

Dear Reader:

This issue of *Perspectives* focuses on two recently issued U.S. Department of Labor final rules, each bearing on the activities that can confer ERISA fiduciary status on investment advisers. Many more categories of communication with investors will now be considered fiduciary in nature, and many more investment professionals will find themselves labeled as fiduciaries.

In April 2017, the “Fiduciary” rule will expand the definition of “investment advice” under ERISA, superseding a more than 40-year-old standard for determining under what circumstances a person or entity is treated as providing fiduciary investment advice to an ERISA-covered benefit plan.

Plan sponsors, IRA owners, and those who currently provide fiduciary or non-fiduciary investment-related advice to retirement plans and IRAs (including in the context of a potential rollover transaction) should review and obtain advice on the Final Rule to determine its application to current investment-related activities regarding the applicable plan or IRA.

Also taking effect in April 2017 will be the DOL’s concurrently published final “best interest contract” exemption (“Final BICE”), which will allow persons who are deemed to be “investment advice fiduciaries” to receive compensation for investment advice if certain conditions are met. The Rule will require more disclosure and acknowledgements of fiduciary status by advisors.

These requirements are numerous and specific and will impose additional burdens on investment advice fiduciaries who wish to rely on the exemption. The cost of complying with these requirements may lead to increases in investment advisory fees if ultimately passed along by investment advice fiduciaries to retirement investors.

We look forward to hearing your comments.

—Susan Serota

Leader, Executive Compensation & Benefits Practice

IN THIS EDITION...

DOL Releases the Final “Fiduciary” Rule

On April 6, 2016, the U.S. Department of Labor (DOL) released its long-awaited final rules on who is a fiduciary investment advisor under ERISA Section 3(21) to an employee benefit plan or individual retirement account (IRA) (Final Rule). The Final Rule significantly expands the scope of the types of communications that constitute fiduciary investment advice under ERISA and addresses conflicted advice provided to plans and IRAs. (p. 2)

DOL Releases Final Best Interest Contract Exemption

Also on April 6, 2016, the U.S. Department of Labor (“DOL”) published long-awaited final rules on who is a fiduciary under ERISA and the Code as a result of providing investment advice (“Fiduciary Rule”). The Fiduciary Rule extends fiduciary status to many investment professionals who have not previously been treated as fiduciaries and who, consequently, will be prohibited from receiving compensation for certain investment advice services unless a prohibited transaction exemption (“PTE” or “exemption”) exists. (p. 7)

DOL RELEASES THE FINAL “FIDUCIARY” RULE

by Susan P. Serota & Kathleen D. Bardunias

On April 6, 2016, the U.S. Department of Labor (DOL) released its long-awaited final rules on who is a fiduciary investment advisor under ERISA Section 3(21) to an employee benefit plan or individual retirement account (IRA) (Final Rule). The Final Rule significantly expands the scope of the types of communications that constitute fiduciary investment advice under ERISA and addresses conflicted advice provided to plans and IRAs. Accordingly, the Final Rule extends fiduciary status to many investment professionals who have not previously been treated as fiduciaries and who, consequently, will be prohibited from receiving compensation for certain investment advice services unless a prohibited transaction exemption (PTE) applies, such as the new “best interest contract” exemption (BICE). The Final Rule is expected to have a substantial impact on how investment-related services are provided to the retirement plan industry.

(For further details regarding the new “best interest contract” exemption (BICE), please see “DOL Releases Final Best Interest Contract Exemption,” page 7)

Background

The rulemaking process that resulted in the Final Rule began back in 2010 when the DOL issued its first set of proposed regulations regarding the definition of “investment advice” under ERISA 3(21). That initial proposal met with substantial criticism and the DOL quickly withdrew those proposed rules and did not issue repropounded rules on the subject until April 2015 (2015 Proposal). The 2015 Proposal underwent a thorough review and comment period during which the DOL (i) received thousands of comment letters, (ii) heard multiple days of testimony in public hearings, and (iii) engaged in hundreds of hours of discussion with affected players in the retirement industry. As a result of this review process, the DOL ultimately made certain changes to the Final Rule while ensuring that the DOL satisfied its primary goal to expand the types of communications that would be covered under the ERISA fiduciary rules, notably with respect to IRAs and rollover transactions. This Advisory summarizes the Final Rule.

Existing Definition of Fiduciary Investment Advice

In 1975, the DOL issued a five-part test in regulations under ERISA Section 3(21) to determine under what circumstances a person or entity is treated as providing fiduciary investment advice to an ERISA-covered benefit plan. (The Department of Treasury issued a virtually identical rule for purposes of plans, such as IRAs, subject to Code Section 4975.) This five-part test provides that for advice to constitute investment advice subject to the fiduciary rules, the adviser must (1) provide advice as to the value of securities or other property, (2) on a regular basis, (3) pursuant to a mutual agreement or understanding with the plan or plan fiduciary that (4) the advice will serve as a primary basis for investment decisions and (5) the advice is individualized to the particular needs of the plan or IRA.

At the time the five-part test was established, the vast majority of employer-sponsored retirement benefits were provided under defined-benefit pension plans, most defined-contribution plans were professionally managed and investment decisions were not participant-directed, and IRAs were newly authorized retirement investment devices. As the DOL noted throughout the rule-making process for the Final Rule, the changing landscape of retirement benefits from employer-managed defined-benefit pension plans to individual account plans (such as 401(k) plans and IRAs) where participants

DOL RELEASES THE FINAL “FIDUCIARY” RULE

are required to make investment decisions for their own accounts, meant that individuals have become “major consumers of investment advice that is paid for directly or indirectly.” Accordingly, the DOL’s view is that the five-part test no longer provides adequate fiduciary protections to these retirement investment advice “consumers” who are looking for expertise and non-conflicted advice from advisers.

New Definition of Fiduciary Investment Advice

The DOL generally adopted the same broad definition of “investment advice” as noted under the 2015 Proposal, but streamlined the applicable categories of “covered advice” (as described below) and provided further guidance about what types of communications will constitute a “recommendation” under the Final Rule. Specifically, the Final Rule provides that an adviser will be subject to ERISA fiduciary standards if the adviser provides directly to a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner (1) any one of the following types of advice described in the first column below (Covered Advice) in exchange for a fee or other direct or indirect compensation and (2) the adviser takes any one of the actions described in the second column below:

“Covered Advice” provided in exchange for a fee or direct or indirect compensation:	Adviser, directly or indirectly (e.g., through or together with any affiliate) does at least one of the following:
<p>A. A recommendation as to the advisability of acquiring, holding, disposing of, or exchanging securities or other investment property, or a recommendation of how securities or other investment property should be invested after the amounts are rolled over, transferred or otherwise distributed from a plan or IRA; or</p>	<p>A. Represents or acknowledges that it is acting as an fiduciary under ERISA or the Code with respect to the provision of the Covered Advice; or</p>
<p>B. A recommendation as to the management of securities or other investment property (including recommendations on investment policies, portfolio composition, selection of persons to provide investment advice or management services, or selection of types of investment arrangements); or</p>	<p>B. Provides the Covered Advice pursuant to a written or verbal agreement, arrangement or understanding that such advice is based on the particular needs of the recipient; or</p>
<p>C. A recommendation with respect to rollovers, transfers or distributions from a plan or IRA (including, whether, in what amount, in what form, and to what destination a rollover, transfer or distribution should be made).</p>	<p>C. Directs the advice to a specific recipient(s) regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the applicable plan or IRA.</p>

As noted in the chart above, each type of Covered Advice requires that a “recommendation” is made regarding the investment activity of the plan or IRA. The Final Rule defines a “recommendation” as 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 course of action.” As a result, any determination of whether an action or series of actions constitutes a “recommendation” under the Final Rule will require an objective facts and circumstances analysis regarding

DOL RELEASES THE FINAL “FIDUCIARY” RULE

the particular action or actions at issue. The DOL noted that the more individually tailored a communication is, the more likely it will be viewed as a recommendation, and that a communication initiated by a person or a computer program could be a recommendation.

Notably, this new definition removes from the original five-part test the requirements that the applicable advice be made “on a regular basis” and as the “primary basis for investment decisions.” As described above, the Final Rule can cover a single instance of advice provided that it is Covered Advice. In addition, the adviser only needs to acknowledge that its advice will be considered by the recipient in connection with investment decisions related to assets of an ERISA-covered plan or IRA.

The Final Rule clarified that “recommendations” regarding welfare plans, such as, disability, life or health insurance benefits, are not subject to the Final Rule so long as the welfare plan does not have an investment component. However, the DOL did not exclude health savings accounts (HSAs) from the Final Rule.

Activities That Are Not “Recommendations” under the Final Rule

The 2015 Proposal contained a number of activities that the DOL identified as “carve-outs” from the general fiduciary rule. The usage of the term “carve-out” was met with opposition and, in the Final Rule, the DOL eliminated the term “carve-out.” Instead, the DOL provided a set of activities which are excluded from fiduciary status under the Final Rule. The DOL does not consider these activities to be “recommendations” and, therefore, the activities cannot be Covered Advice under the general definition of “investment advice” described above. Accordingly, the following actions taken by an adviser are excluded from the fiduciary obligations under the Final Rule:

Exclusion	General Description
MARKETING INVESTMENT PLATFORMS	Excludes the marketing or offering of a “platform” of investment vehicles by certain service providers (e.g., recordkeepers and third-party administrators) to an ERISA-covered plan where the plan fiduciary selects the particular investment options or menu that will be made available to participants and the service provider discloses in writing that it is not intending to provide fiduciary advice.
SELECTION AND MONITORING ASSISTANCE	Excludes (i) identification of investment alternatives that meet objective criteria specified by the plan fiduciary (provided that the adviser disclose in writing any financial interest in the alternatives), (ii) identification of a sample set of investment alternatives based on the size of the employer or plan and the current investment alternatives under the plan in response to an RFP, or (iii) provision of objective financial data or comparisons to the plan fiduciary. Note: This exclusion does not apply to communications made to an IRA or IRA owner.
GENERAL COMMUNICATIONS	Directs the advice to a specific recipient(s) regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the applicable plan or IRA.

DOL RELEASES THE FINAL “FIDUCIARY” RULE

INVESTMENT OR RETIREMENT EDUCATION

Directs the advice to a specific recipient(s) regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the applicable plan or IRA.

The exclusions from fiduciary status described above are subject to certain rules and requirements as specified in the Final Rule.

Exceptions to the Final Rule

The Final Rule also includes an exception from fiduciary status for three types of activities that the DOL would, absent the exception, otherwise view as Covered Advice under the general rule. Accordingly, the DOL has expressly provided that these activities will not be considered fiduciary activities, unless the adviser acknowledges ERISA-fiduciary status in connection with the activity.

Exclusion	General Description of Exception
ADVICE TO PLAN FIDUCIARY WITH FINANCIAL EXPERTISE (LARGE PLAN EXCEPTION)	Advice (including provision of asset allocation models or other financial analysis tools) made to a plan fiduciary who is independent of the adviser in connection with an arm’s length sale, purchase, loan, exchange or other transaction related to the investment of securities or other investment property. Subject to other requirements, the adviser must know or reasonably believe that the independent fiduciary is (i) a U.S. bank or insurance company, (ii) a U.S.-registered investment adviser or broker-dealer, or (iii) a fiduciary that holds, or has management of at least \$50 million in assets.
SWAP TRANSACTION	Advice to an ERISA-covered employee benefit plan from swap dealer, major swap participant, major security-based swap participant or a swap clearing firm in connection with certain swap or security-based swap transactions under the Commodity Exchange Act or the Securities Exchange Act, provided that (i) the plan is represented by an independent fiduciary, (ii) in the case of a swap dealer or security based swap dealer, the person is not acting as an adviser to the plan in connection with the transaction, (iii) the person does not receive compensation from the plan or plan fiduciary for the provision of investment advice in connection with the transaction, and (iv) the plan fiduciary makes an advance written statement that it is not relying on the recommendation.
ADVICE FROM AN EMPLOYEE OF A PLAN SPONSOR	(i) Advice to a plan fiduciary or an employee (other than in his capacity as a participant in the plan) from an employee of the plan sponsor (or its affiliates), plan or plan fiduciary; or

DOL RELEASES THE FINAL “FIDUCIARY” RULE

ADVICE FROM AN EMPLOYEE OF A PLAN SPONSOR

(ii) Advice to a plan participant from an employee of the plan sponsor (or its affiliates), provided that the employee’s job responsibilities do not include providing investment advice, and the person is not registered or licensed under federal or state securities or insurance laws (and the advice given does not require such registration or licensing).

In either case, the employee providing the advice cannot receive direct or indirect compensation in connection with the advice other than his or her normal compensation as an employee of the plan sponsor.

The exceptions from fiduciary status described above are subject to certain rules and requirements as specified in the Final Rule.

Prohibited Transaction Class Exemptions

As previously mentioned, the Final Rule includes two new prohibited transaction class exemptions—the “Best Interest Contract Exemption” (BICE) and a new exemption for “principal transactions” as well as amendments to various existing class exemptions. These changes are intended to “allow, subject to appropriate safeguards, certain broker-dealers, insurance agents and others that act as investment advice fiduciaries to nevertheless continue to receive a variety of forms of compensation that would otherwise violate prohibited transaction rules and trigger excise taxes” under the Final Rule. (For further details about the BICE, please see *“DOL Releases Final Best Interest Contract Exemption,”* page 7.

Effective Date

The Final Rule is effective 60 days after publication in the Federal Register. However, the Final Rule (including certain conditions of the BICE) is not applicable until April 10, 2017, and, under available transition relief, other conditions of the BICE are not applicable until January 1, 2018. This means that the current five-part test for determining fiduciary status in the provision of investment advice under ERISA (as described above) will continue to apply until April 10, 2017.

Next Steps

Plan sponsors, IRA owners, and those who currently provide fiduciary or non-fiduciary investment-related advice to retirement plans and IRAs (including in the context of a potential rollover transaction) should carefully review the Final Rule to determine its application to current investment-related activities regarding the applicable plan or IRA. In addition, the DOL has indicated that it will continue to provide additional clarifying guidance regarding the Final Rule’s application and compliance assistance. ■



Susan P. Serota leads Pillsbury’s Executive Compensation & Benefits practice and is a member of the firm’s ERISA Litigation team. She may be contacted at susan.serota@pillsburylaw.com.



Kathleen D. Bardunias is a Counsel in Pillsbury’s Executive Compensation & Benefits Practice in the firm’s New York office. She may be contacted at kathleen.bardunias@pillsburylaw.com.

DOL RELEASES FINAL BEST INTEREST CONTRACT EXEMPTION

by Peter J. Hunt and Amber A. Ward

On April 6, 2016, the U.S. Department of Labor (“DOL”) published long-awaited final rules on who is a fiduciary under ERISA and the Code as a result of providing investment advice (“Fiduciary Rule”). The Fiduciary Rule extends fiduciary status to many investment professionals who have not previously been treated as fiduciaries and who, consequently, will be prohibited from receiving compensation for certain investment advice services unless a prohibited transaction exemption (“PTE” or “exemption”) exists. To compensate for this more expansive fiduciary standard, the DOL concurrently published a final “best interest contract” exemption (“Final BICE”) that would allow persons who are deemed to be “investment advice fiduciaries” to receive compensation for investment advice if certain conditions are met.

The DOL had previously issued a proposed best interest contract exemption on April 14, 2015 (“Proposed BICE”). The Final BICE generally follows the Proposed BICE, with a few key changes summarized below. The Final BICE is effective April 10, 2017, although full compliance with all of the exemption’s requirements will not be required until January 1, 2018.

Background

The Fiduciary Rule will treat certain persons who provide investment advice for a fee or other compensation to an employer-sponsored retirement plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner as fiduciaries (“investment advice fiduciaries”) under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”) or the Internal Revenue Code of 1986, as amended (“Code”). Please see “DOL Releases the Final ‘Fiduciary’ Rule,” page 2, for more information on persons who would qualify as investment advice fiduciaries under, and the categories of advice covered by, the Fiduciary Rule.

Investment advice fiduciaries are generally prohibited from receiving payments from third parties or from receiving compensation that varies depending on the particular investments made or recommended by the fiduciary. Unless a prohibited transaction exemption applies, investment advice fiduciaries are prohibited from receiving brokerage and insurance commissions, 12b-1 fees, revenue sharing payments and certain other types of compensation resulting from their investment advice to plan sponsors, plan participants and beneficiaries, and IRA owners.

Existing Definition of Fiduciary Investment Advice

The new PTE published with the Fiduciary Rule—the “best interest contract” exemption or “Final BICE”—would allow “advisors,” “financial institutions,” and their “affiliates and related entities” to receive compensation for investment advice provided to “retirement investors” that would otherwise be prohibited as a conflict of interest. The exemption seeks to promote investment advice that is in the best interests of retirement investors by requiring financial institutions and advisors to adhere to “impartial conduct standards” when providing advice regarding retirement investments. In addition, financial institutions must adopt policies and procedures designed to ensure that their individual advisors adhere to the impartial conduct standards; disclose important information relating to fees, compensation, and material conflicts of interest; and retain records demonstrating compliance with the exemption.

DOL RELEASES FINAL BEST INTEREST CONTRACT EXEMPTION

Notably, new carve outs in the Final BICE alleviate requirements for investment advice fiduciaries to enter into contracts with ERISA plan investors, allow fiduciaries to rely on negative consent amendments for existing client contracts, and permit fiduciaries who receive only a level fee in connection with advisory or investment management services to comply with more streamlined requirements designed to target the conflicts of interest associated with such services.

Consistent with the Proposed BICE, the U.S. Department of Labor (DOL) has provided in the Final BICE a principles-based approach that is intended to preserve existing beneficial business models and broadly permit investment advice fiduciaries to continue to rely on common fee practices. This represents a departure from the DOL's typical regulatory approach of creating highly prescriptive transaction-specific exemptions.

The Final BICE is limited to investment advice provided to (1) individual participants who can direct their own investments in 401(k) and 403(b) plans and other plans governed by ERISA, (2) IRA owners, and (3) "retail fiduciaries" of ERISA-governed plans or IRAs. Investment advice for such plans or persons not covered by the Final BICE may, however, be covered by other DOL exemptions.

A summary of the material aspects of the Final BICE follows below.

KEY DEFINITIONS

Advisers, Financial Institutions, and Their Affiliates and Related Entities

An "adviser" is an investment advice fiduciary of an employee benefit plan or IRA who:

- is an employee, independent contractor, agent, or registered representative of a financial institution; and
- satisfies the applicable federal and state regulatory and licensing requirements of insurance, banking, and securities laws covering the transaction.

A "financial institution" is the entity that

- employs the adviser or otherwise retains such individual as an independent contractor, agent, or registered representative; and
- is a registered investment adviser, bank, insurance company, or a registered broker-dealer.

An "affiliate" of an adviser or financial institution is any:

- person who is, directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the adviser or financial institution;
- officer, director, partner, employee, or relative of the adviser or financial institution; or
- corporation or partnership of which the adviser or financial institution is an officer, director or partner.

A "related entity" means any entity other than an affiliate in which the adviser or financial institution has an interest which may affect the exercise of its best judgement as a fiduciary.

Advisers, financial institutions and their affiliates and related entities are referred to in this Client Advisory as "investment advice fiduciaries."

DOL RELEASES FINAL BEST INTEREST CONTRACT EXEMPTION

Retirement Investor

A “retirement investor” is:

- a participant or beneficiary of an ERISA-governed, participant-directed individual account plan with authority to direct the investment of assets in his or her plan account or to take a distribution;
- a beneficial owner of an IRA acting on behalf of the IRA; or
- a “retail fiduciary” with respect to an ERISA-governed plan or an IRA. A “retail fiduciary” is defined as a fiduciary of an ERISA-governed plan or an IRA who holds, or has under management or control, less than \$50 million in assets, and is not a bank, insurance carrier, registered investment adviser or broker dealer. The Final BICE is more inclusive than the Proposed BICE, which had limited this category of retirement investors to plan sponsors of non-participant directed ERISA-governed plans with fewer than 100 participants.

COVERED TRANSACTIONS

The Final BICE permits investment advice fiduciaries to receive compensation for services performed in connection with the purchase, sale, or holding of the assets of a plan or IRA by retirement investors in accordance with the advice of the investment advice fiduciary. Unlike the Proposed BICE, which contained a list of certain asset classes covered by the PTE, the Final BICE covers all asset classes.

The exemption does not apply to the receipt of compensation in transactions involving the following:

- an ERISA-governed plan if the investment advice fiduciary is the employer of employees covered by the plan;
- an ERISA-governed plan if the advisor or financial institution (or an affiliate) is a named fiduciary or plan administrator that was selected to provide advice to the plan by a fiduciary who is not independent;
- a “principal transaction,” defined as a purchase or sale of certain investment products where the advisor or financial institution is purchasing or selling for the financial institution’s own account or the account of an affiliate. Sales of insurance or annuity contracts, mutual fund transactions and certain “riskless” transactions are not considered “principal transactions” for this purpose;
- investment advice that is generated solely by an interactive website in which computer software-based models or applications provide investment advice to retirement investors based on personal information each investor supplies through the website without any personal interaction or advice from an individual adviser; or
- an adviser who exercises any discretionary authority or discretionary control with respect to the recommended transaction.

IMPARTIAL CONDUCT STANDARDS AND CONTRACT REQUIREMENTS

The Final BICE requires investment advice fiduciaries to comply with impartial conduct standards to rely on the exemption. In addition, financial institutions must adopt anti-conflict policies and procedures that are designed to ensure that advisers adhere to the impartial conduct standards, and must disclose important information about the financial institutions’ services, applicable fees and compensation. These requirements are described in greater detail below.

DOL RELEASES FINAL BEST INTEREST CONTRACT EXEMPTION

Contract Requirements

Investment advice concerning an IRA or non-ERISA plan must be subject to a written contract that is enforceable by the retirement investors. Financial institutions must agree that they and their advisors will adhere to the impartial conduct standards and other requirements under the Final BICE discussed below. In a change from the Proposed BICE, ERISA plans are not subject to the written contract requirement, because the plan fiduciaries have substantial rights under ERISA to enforce proper fiduciary conduct by their outside investment advisors. Nevertheless, ERISA plan investors should consider modifying their written investment management agreements and other contracts with investment advice fiduciaries to incorporate the impartial conduct standards and warranties described below.

The Final BICE also simplifies the mechanics of contract formation for IRAs and non-ERISA plans by allowing contract terms to be incorporated into the Financial Institution's account opening documents for new customers, relying on a negative consent process for existing customers, requiring the financial institution to execute the contract rather than each individual investment adviser from whom the retirement investor may receive advice. In addition, the Final BICE permits contracts to be executed at the time of an advisor's recommendation rather than prior to such recommendations; however, the contract must cover advice rendered period to the execution of the contract in order for the exemption to apply to such advice and related compensation.

Fiduciary Status

The financial institution must affirmatively state in writing that the institution and its advisors are fiduciaries under ERISA or the Code, or both, and that they will adhere to impartial conduct standards.

Impartial Conduct Standards

The financial institution must affirmatively state that it and its advisors will adhere to the following standards, and they must actually comply with these standards:

- to provide investment advice that is in the "best interest of the retirement investor" under standards similar to the duties of prudence and loyalty under ERISA.
- to not recommend an asset if the total amount of compensation anticipated to be received exceeds reasonable compensation in relation to the total services provided to the retirement investor; and
- to not make any materially misleading statements about a recommended transaction, fees, "material conflicts of interest," and any other matters relevant to a retirement investor's investment decisions.

A "material conflict of interest" exists when an adviser or financial institution has a financial interest that could affect the exercise of its best judgment as a fiduciary in rendering investment advice to a retirement investor.

Warranties

The financial institution must affirmatively warrant that it:

- has adopted and will comply with written policies and procedures reasonably designed to mitigate the impact of material conflicts of interest and ensure that individual advisers adhere to the impartial conduct standards and, in formulating its policies and procedures, has identified any material conflicts of interest and adopted measures

DOL RELEASES FINAL BEST INTEREST CONTRACT EXEMPTION

to prevent the material conflicts of interest from causing violations of the impartial conduct standards; and

- will not use quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives to the extent they would encourage individual advisors to make recommendations that are not in the best interest of the retirement investor.

Disclosures

The Final BICE significantly expands upon the disclosure requirements that were included in the Proposed BICE. In the best interest contract or in a separate written disclosure provided to the retirement investor, the investment advice fiduciary must clearly and prominently:

- state the best interest standard of care owed by the financial institution and its advisers to the retirement investor; inform the retirement investor of the services being provided; and describe how the retirement investor will pay for the services;
- identify and disclose any material conflicts of interest; disclose any fees or charges the investment advice fiduciary imposes upon the retirement investor or the retirement investor's account; and state the types of compensation that the investment advice fiduciary expects to receive from third parties in connection with investments recommended to retirement investors;
- inform the retirement investor of its right to obtain copies of the policies and procedures that the financial institution has adopted to comply with the Final BICE, as well as complete information about all direct and indirect fees associated with recommended investment transactions, and describe how the retirement investor can obtain the information free of charge;
- include a link to the financial institution's web site as required by the Final BICE (see below for more information), and informs the retirement investor that: (1) model contract disclosures are maintained on the website, and (2) the financial institution's written descriptions of its policies and procedures adopted to comply with the Final BICE are available free of charge on the website;
- disclose whether the financial institution offers proprietary products or receives third-party payments with respect to any recommended investment transactions; and to the extent the financial institution or advisor limits investment recommendations, in whole or in part, to proprietary products or investments that generate third party payments, notify the retirement investor of such limitations;
- provide contact information (telephone and email) for a representative of the financial institution that the investor can use to express concerns about the advice or service received and, if applicable, a statement explaining that the retirement investor can research the financial institution and its advisors using FINRA's BrokerCheck database or the Investment Adviser Registration Depository (IARD), or other database maintained by a governmental agency or instrumentality, or self-regulatory organization; and
- describe whether or not the financial institution or adviser will monitor the retirement investor's investments and alert the retirement investor to any recommended change to those investments and, if so monitoring, the frequency with which the monitoring will occur and the reasons for which the retirement investor will be alerted.

The financial institution will not fail to satisfy the disclosure requirements of the Final BICE solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, provided the financial institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission.

DOL RELEASES FINAL BEST INTEREST CONTRACT EXEMPTION

Prohibited Contractual Provisions

Written contracts may not contain:

- exculpatory provisions disclaiming or otherwise limiting liability of the adviser or financial institution for a violation of the contract's terms;
- any provision requiring the retirement investor to agree to waive or qualify its right to bring or participate in a class action or other representative action in court in a dispute with the advisor or financial institution; or
- agreements to arbitrate or mediate individual claims in venues that are distant or that otherwise unreasonably limit the ability of retirement investors to assert the claims safeguarded by the Final BICE.

Level Fee Fiduciaries

The Final BICE includes new streamlined conditions for investment advice fiduciaries who qualify as "level fee fiduciaries." A financial institution or adviser is a level fee fiduciary if the only fee or compensation received by the financial institution, adviser or any affiliate in connection with the advisory or investment management services is a "level fee" that is disclosed in advance to the retirement investor. A "level fee" is a fee or compensation that is provided on the basis of a fixed percentage of the value of the assets or a set fee that does not vary with the particular investment recommended, rather than a commission or other transaction-based fee.

Level fee fiduciaries are required under the Final BICE to provide a written statement of fiduciary status to retirement investors, to comply with the impartial conduct standards, and in the case of a recommended rollover transaction or a recommended switch from a commission-based account to a level fee arrangement, to document the specific reason or reasons for the recommendation.

OTHER DISCLOSURE REQUIREMENTS

An advisor or financial institution must satisfy the following internet and transaction-based disclosure requirements for an investment recommendation to be covered by the final exemption.

Transaction Disclosures

The investment advice fiduciary must provide the retirement investor, before or at the same time as the execution of the recommended investment, the following disclosures, which must be stated clearly and prominently in a single written document.

- a statement of the best interest standard of care owed by the investment advice fiduciary to the retirement investor and a description of any material conflicts of interest;
- information regarding the retirement investor's right to obtain copies of policies and procedures adopted by the financial institution in accordance with the Final BICE, as well as specific disclosure of direct and indirect costs, fees, and other compensation relating to recommended transactions; and
- a link to the financial institution's website and informs the retirement investor that: (1) model contract disclosures are maintained on the website, and (2) the financial institution's written descriptions of its policies and procedures adopted to comply with the Final BICE are available free of charge on the website.

DOL RELEASES FINAL BEST INTEREST CONTRACT EXEMPTION

These transaction disclosures do not have to be repeated for subsequent recommendations by the investment advice fiduciary of the same investment product within one year of disclosures previously made to the retirement investor, unless there are material changes in the subject of the disclosures.

Web Disclosures

The financial institution must maintain a webpage, freely accessible to the public, which provides the following information:

- a discussion of the financial institution's business model and the material conflicts of interest associated with that business model;
- a schedule of typical account or contract fees and service charges;
- a model contract or other model notice of contractual terms;
- a written description of the financial institution's policies and procedures relating to conflict-mitigation and incentive practices;
- information regarding product manufacturers and other parties with whom the financial institution maintains arrangements that provide third party payments to either the financial institution or an adviser with respect to investment products or classes of investments recommended to retirement investors; and
- a description of the financial institution's compensation and incentive arrangements with advisers.

To the extent that the above information is provided in other disclosures made available to the public (such as a Form ADV, Part II filed with the SEC), the financial institution may post those disclosures to its website with an explanation that the information can be found in the disclosures and a link to where it can be found.

PROPRIETARY PRODUCTS AND THIRD PARTY PAYMENTS

The Final BICE includes specific standards for financial institutions that limit their offerings to proprietary products to insure that such institutions are satisfying the best interest conduct standards in the final exemption. The requirements include informing retirement investors of limitations placed on the universe of proprietary investments, as well as material conflicts of interest associated with the proprietary products and any third party payments. In addition, recommendations relating to the investments in the proprietary products must be prudent and the fees must be reasonable.

DOL NOTICE AND RECORDKEEPING

In order to rely on the exemption, the DOL would require financial institutions comply with the following notice and recordkeeping requirements:

- notify the DOL of its intention to rely on the exemption;
- maintain certain data for a period of six years from the date of the transaction subject to relief under the exemption; and
- maintain for a period of six years records necessary for the DOL or IRS to determine whether the conditions of the exemption have been met.

DOL RELEASES FINAL BEST INTEREST CONTRACT EXEMPTION

RELIEF FOR INSURANCE AND ANNUITY CONTRACTS

The exemption provides relief for the purchase of certain insurance or annuity contracts from an insurance company that has a preexisting fiduciary or other service relationship with a retirement investor. The transaction must be in the ordinary course of the insurance company's business, the insurance company's fees must be reasonable, and the terms of the purchase must be at least as favorable for the retirement investor as the terms generally available in an arm's length transaction with an unrelated party.

RELIEF FOR PREEXISTING TRANSACTIONS

The exemption also provides relief to investment advice fiduciaries for compensation received in connection with the purchase, sale or holding of investment property that was acquired before the effective date of the Fiduciary Rule and Final BICE (April 10, 2017) or acquired pursuant to a recommendation to continue to adhere to a systematic purchase program established before such date. Compensation received for investments of additional amounts in the previously acquired investment vehicle on or after April 10, 2017 is not eligible for this relief, except in limited circumstances.

IMPLICATIONS OF THE PROPOSED EXEMPTION

The Final BICE permits investment advice fiduciaries to continue receiving compensation in connection with investment advice provided to retirement investors under existing beneficial business models, provided certain requirements are met. These requirements, however, are numerous and specific and will impose additional burdens on investment advice fiduciaries who wish to rely on the exemption. The cost of complying with these requirements may lead to increases in investment advisory fees if ultimately passed along by investment advice fiduciaries to retirement investors.

The Fiduciary Rule and Final BICE, when implemented, may also lead to more "level fee" compensation arrangements and other arrangements under which the investment advice fiduciary's fees do not vary based on the particular investments being recommended. The DOL noted in the Final BICE that such arrangements would not ordinarily raise prohibited transaction considerations for the investment advice fiduciary. However, level fee fiduciaries could be subject to prohibited transaction restrictions when they recommend that a participant roll money out of a plan into an account that would generate fees for the fiduciary that it would not otherwise receive, or recommend that a retirement investor shift from a commission-based account to a level fee arrangement with the fiduciary. In such cases, the investment advice fiduciary would need to comply with the streamlined requirements for level fee fiduciaries under the Final BICE.

Sponsors and fiduciaries of ERISA-governed plans who wish to retain an investment advice fiduciary to advise participants on their plan investments would need to carefully review the agreements under which those services will be performed to determine if the compensation arrangements or other potential conflicts of interest require reliance on the "best interest contract" exemption. If so, then the plan fiduciaries would need to determine if the contract or other disclosures provided by the fiduciary meet the requirements of the exemption and to monitor the investment adviser's compliance with the exemption going forward. Failure of the plan fiduciaries to monitor compliance with the exemption could be viewed as a breach of fiduciary duty, in addition to giving rise to prohibited transaction sanctions.

Lastly, the "best interest" standard required of investment advice fiduciaries may be particularly important to IRA owners. Fiduciaries under ERISA are already subject to the duties of prudence and loyalty, whereas IRA fiduciaries are not necessarily subject to similar standards under the Code. Requiring a "best interest" standard to be incorporated into a contract between an IRA owner and investment advice fiduciary would provide IRA owners with greater protections,

DOL RELEASES FINAL BEST INTEREST CONTRACT EXEMPTION

including a private right of action if the fiduciary does not comply with the prescribed standards. This depends, of course, on the willingness of investment advisers to adopt contracts and procedures complying with the new rules. Some investment advisers may conclude that they would rather exit the business of advising IRAs than comply with the new rules. ■



Peter J. Hunt is a partner in Pillsbury's Executive Compensation & Benefits practice in the firm's New York office. He may be contacted at peter.hunt@pillsburylaw.com.

Amber A. Ward is a Senior Associate in Pillsbury's Executive Compensation & Benefits practice in the firm's San Francisco office. She may be contacted at amber.ward@pillsburylaw.com.

For more information, please contact:

New York

Susan P. Serota
212.858.1125
susan.serota@pillsburylaw.com

Peter J. Hunt
212.858.1139
peter.hunt@pillsburylaw.com

Washington, DC

Howard L. Clemons
703.770.7997
howard.clemons@pillsburylaw.com

San Diego North County

Marcus Wu
858.509.4030
marcus.wu@pillsburylaw.com

San Francisco

Christine L. Richardson
415.983.1826
crichardson@pillsburylaw.com

Los Angeles

Mark Jones
213.488.7337
mark.jones@pillsburylaw.com

Editor

Susan P. Serota

Editorial Staff

Kathleen D. Bardunias

For mailing list inquiries, please email
executivecomp@pillsburylaw.com

Pillsbury Winthrop Shaw Pittman LLP | 1540 Broadway | New York, NY 10036 | 877.323.4171 | pillsburylaw.com

ADVERTISING MATERIALS. This may be considered advertising under the rules of some states. The hiring of a lawyer is an important decision that should not be based solely upon advertisements. Furthermore, prior results, like those described in this brochure, cannot and do not guarantee or predict a similar outcome with respect to any future matter, including yours, that we or any lawyer may be retained to handle. Not all photos used portray actual firm clients. The information presented is only of a general nature, intended simply as background material, is current only as of its indicated date, omits many details and special rules and accordingly cannot be regarded as legal or tax advice.

The information presented is not intended to constitute a complete analysis of all tax considerations. Internal Revenue Service regulations generally provide that, for the purpose of avoiding United States federal tax penalties, a taxpayer may rely only on formal written opinions meeting specific regulatory requirements. The information presented does not meet those requirements. Accordingly, the information presented was not intended or written to be used, and a taxpayer cannot use it, for the purpose of avoiding United States federal or other tax penalties or for the purpose of promoting, marketing or recommending to another party any tax-related matters. © 2016 Pillsbury Winthrop Shaw Pittman LLP. All rights reserved.