

DOL RELEASES FIRST FAQs RELATED TO NEW FIDUCIARY RULE

The Department of Labor (DOL) has released 34 FAQs providing additional guidance related to its final rule expanding the definition of an investment advice fiduciary (the Final Rule) for purposes of the Employee Retirement Income Act of 1974, as amended (ERISA). This first set of FAQs principally addresses issues under the complex of prohibited transaction exemptions (PTEs) issued or revised corollary to the final rule.

On October 26, 2016, DOL released [FAQs](#) primarily related to various PTEs adopted or amended in conjunction with the [Final Rule](#), which are summarized below. The FAQs also include a limited discussion of the circumstances in which such an exemption is required because an investment advice fiduciary, as defined in the Final Rule, is providing conflicted advice, i.e., generally, if the revenue received by the fiduciary or affiliates varies as a result of the advice given. In addition:

- DOL reiterated its prior finding that an applicability date of April 10, 2017, provides adequate time for retirement product and service providers to comply with the new requirements [preface to FAQ 1], apparently signaling a disinclination at this time to extend the applicability date.
- DOL noted that its initial posture after the applicability date generally will be to render compliance assistance in support of efforts to diligently and in good faith come into compliance with the new rules, rather than to cite violations and impose penalties. [FAQ 34]
 - » *Because DOL will not be solely responsible for enforcement of these rules, however, it is not a certainty that DOL's appropriate view will always be controlling.*

DOL is expected to issue additional sets of FAQs addressing other issues arising in connection with the Final Rule.

FAQ	PTE Addressed							Other Issues
	BICE	75-1	77-4	80-83	84-24	86-128	2016-02	
1	■							
2		■	■	■	■	■		
3	■							
4-5								■
6-20	■							
21-23	■				■			
24-30	■							
31							■	
32-33					■			
34								■

SCOPE OF FIDUCIARY INVESTMENT ADVICE DEFINITION

- Exemptive relief is not required if investment intermediaries merely execute transactions at the direction of a retirement investor, or provide a recommendation for which the fiduciary and its affiliates do not receive any direct or indirect compensation (broadly conceived). [FAQ 4]
- Advisers who are compensated on a level fee-for-service basis are giving conflicted advice that requires exemptive relief if they make a gating recommendation that, e.g., an investor roll out of a retirement plan to an IRA invested with that adviser, or switch an IRA from a commission-based account to a fixed percentage fee-based account. The level fee fiduciary exemption under the Best Interest Contract Exemption (BICE), PTE 2016-01, may be available in these circumstances, however, to address that conflict. Also, while the level fee received in the operation of the account does not create conflicts, “reverse churning,” among other circumstances, can give rise to a prohibited transaction not covered by an exemption. [FAQs 5, 13]
- DOL explained that the BICE bank networking arrangement exemption was limited to referrals only to non-affiliated financial institutions (e.g., broker-dealers, insurance companies and registered investment advisers) because referrals to affiliated institutions may not be fiduciary advice under the “hire me” rule. [FAQ 20]

BICE

Appropriately, the new BICE received the most attention in the FAQs. The BICE functionally is a compendium of several different exemptions, including the “full BIC” exemption (which requires a written contract for IRA investors that can be formed through negative consent for existing accounts, but does not require a written contract for ERISA plans), full BIC for proprietary products or third-party payments, the level fee fiduciary exemption, the bank networking arrangement exemption, the transition exemption, and the grandfather exemption.

DOL intends for the BICE to serve as the flagship relief particularly for advice to IRA owners, as FAQ 3 makes clear.

- As the flagship exemption, BICE broadly covers recommendations to retail investors with respect to all categories of assets, rollovers and selection of investment advisers or managers, including recommendations for which the fiduciary receives transaction-based or third-party compensation. [FAQ 3]
 - » *There are limits to the relief provided by the BICE, however, including those noted below.*
- While BICE is not available to resolve conflicts in the management of a discretionary account, it is available to resolve conflicts in a recommendation to roll over to or otherwise open that account, provided that the discretionary manager has no discretion over that particular transaction. [FAQs 6, 7, 8]
 - » *These FAQs elaborate the position first expressed in the [July technical corrections](#) to BICE.*
- Similarly, BICE is not available to resolve conflicted robo-advice (provided solely on that basis, without any personal interaction or advice from an individual adviser) unless it qualifies under the level fee fiduciary exemption. The computer model exemption of ERISA sections 408(b)(14) and 408(g) may in the alternative provide relief for conflicted robo-advice in certain circumstances. [FAQ 10]
- To use the BICE streamlined level fee fiduciary exemption, the recommended investment or account must provide the financial institution and adviser (and their affiliates) with only a level fee paid by the retirement investor; payments from third parties are not allowed, even if those payments are themselves level, nor are recommendations limited to proprietary products. [FAQ 18]
 - » *DOL may be taking an unnecessarily narrow view on this point. Third-party payments used to offset an investor’s level fee obligation to the adviser, for example, would not seem to raise policy or operational concerns.*
- The level fee exemption can be used for gating recommendations to open discretionary accounts, as noted above, as well as gating recommendations among commission-based accounts and/or level fee accounts at different price points, so long as the investor selects one of the level fee accounts. [FAQs 13, 15, 16, 17, 19]
 - » *Because the offering of commission-based or multiple level fee accounts is not disqualifying, this point is an important confirmation that greatly enhances the utility of the level fee fiduciary exemption.*

- The documentation requirement for rollover advice under the level fee fiduciary exemption requires the adviser and financial institution to make diligent and prudent efforts to obtain relevant information about the existing plan. If that information remains unavailable, rollover advice can be based on, e.g., the most recent Form 5500 for the plan or reliable industry benchmarks for fees and expenses under comparable plans, and the documentation should memorialize how the financial institution determined that alternative data was reasonable and the limitations of that data. [FAQ 14]
 - » *While this documentation is required only under the level fee fiduciary exemption, DOL suggested that any fiduciary providing rollover advice subject to the impartial conduct standards in PTEs consider the process reflected in that documentation.*
- The warranties under the full BIC exemption (whether a written BIC contract is required in the case of IRAs or not required in the case of ERISA plans) constrain the use of escalating commission grids for advisers. In DOL's judgment, certain compensation grids may cause advisers to make recommendations that are not in the best interest of retirement investors, including grids that:
 - Pass through differences in commissions among product manufacturers in a given product category;
 - Pay different commissions between even broad, reasonably designed product categories unless justified by neutral factors unrelated to product profitability or the financial interest of the financial institution or adviser;
 - Provide “large” increases between steps on the grid. DOL believes that several modest or gradual step increases are less likely to create misaligned incentives than a single large step increase;
 - Increase retroactively the commission paid for prior sales in that compensation cycle, upon attainment of a new step; or
 - Set unduly aggressive or unrealistic sales incentives.

Financial institutions making use of compensation grids should monitor adviser recommendations generally, and increase that monitoring at or near each incremental step on the grid. [FAQ 9]
- With respect to adviser recruitment programs, DOL opined that “front end” bonuses or awards tied to ongoing service by an adviser were consistent with the warranties under the full BIC, but that large or disproportionate “back end” bonuses or awards tied to the achievement of sales or asset targets on an “all or nothing” basis were not. [FAQ 12]
 - » *This is a more absolute statement on this point than anything in the preambles to the BICE.*
- DOL did allow relief under the full BIC for binding commitments to pay “back end” awards (e.g., a loan forgiveness program extending for a commercially reasonable time past the April 10, 2017, applicability date) entered into prior to the October 26 date of the FAQ if the firm (i) determines in good faith that it is contractually obligated to continue those awards, and (ii) adopts special and stringent procedures to oversee conflicts created by those awards. [FAQ 12]
- In contrast, BICE does not preclude firms and advisers from providing, to select investors, discounts from a standard pricing schedule that meets the reasonable compensation standard, so long as the discounts do not introduce conflicts of interest into the arrangement. [FAQ 11]
- Regarding the disclosure requirements under the full BIC exemption:
 - The requirement for the financial institution to post on its website a copy of the written contract applicable to the retirement investor can be satisfied by posting a model contract or (under the negative consent provision) a sample contract amendment containing all the governing terms, together with an acknowledgement that the financial institution is bound by the model document as to specified customers. [FAQs 24, 25]
 - The transaction disclosure only needs to be provided for purchase recommendations and not for any hold or sell recommendations. [FAQ 26]
 - The specific disclosure requested by the investor should disclose costs, fees and other compensation (e.g., third-party payments) as of the date of the *recommendation*, not the date of the investor's *request*. [FAQ 27]
 - » *These FAQs 24-27 are all helpful to the implementation of the full BIC exemption.*
- Insurance agents who are not licensed to offer other types of investments are not precluded from relying on BICE (or PTE 84-24), provided that limitation is disclosed to investors and the agent forgoes making a recommendation (and a sale) if an annuity or other insurance product would be imprudent in the circumstances of the particular retirement investor. [FAQ 21]

- Similarly, BICE does not preclude an insurance company from distributing its products through captive agents, independent agents or any other distribution channel. Under the full BIC exemption, the insurance company may act as the “financial institution” with oversight responsibility only for the recommendation and sale of its proprietary products, and would not serve as the “financial institution” for recommendations and transactions involving other insurers. As the “financial institution,” the insurance company must adopt procedures to safeguard the agent’s compliance with the impartial conduct standards when recommending those proprietary products, avoid improper incentives to recommend the products most profitable to the insurance company at the customer’s expense, and otherwise satisfy the conditions of the full BIC exemption. [FAQ 22]
 - DOL noted that it would be permissible for an insurance company taking this approach to bolster its compliance by contracting with an independent marketing organization (IMO) to ensure that agents working through that IMO satisfied the impartial conduct standards. [FAQ 22]
 - IMOs can continue to receive commissions and override payments under either BICE or PTE 84-24, if the conditions of the applicable exemption are met. [FAQ 23]
- For financial institutions that elect to utilize the transition relief under the BICE, during the transition period (April 10 through December 31, 2016), they must observe the impartial conduct standards (but not the warranties), acknowledge by notice their fiduciary status and disclose material conflicts, and designate a BICE conflicts officer. [FAQ 1]
- Finally, with respect to the BICE grandfather provision:
 - The grandfather rule applies to compensation received in connection with the purchase, holding, sale or exchange of investments acquired before the applicability date, but not for recommendations with respect to the investment of sale proceeds. [FAQ 30]
 - Grandfather relief is available for recommendations to continue systematic payment programs, but not for recommendations to make changes to such a program. For this purpose, systematic payment programs are those that operate automatically after the applicability date, and can include dividend reinvestment programs. [FAQ 28]
 - Grandfather relief remains available for ongoing compensation related to annuity deposits predating the applicability date, even if an additional deposit is made to the contract after the applicability date (which does not qualify for grandfathering). [FAQ 29]
 - » *While this is a helpful point, it may be difficult to operationalize and separate the treatment of annuity deposits before and after the applicability date.*

PTE 84-24

In addition to the FAQs discussing PTE 84-24 noted above:

- DOL agreed that PTE 82-24 covers rollovers into an annuity. [FAQ 32]
- The reasonable compensation standard in PTE 84-24, although worded somewhat differently, is identical in substance to that standard in BICE and will be interpreted in the same way. [FAQ 33]

PRINCIPAL TRANSACTION EXEMPTION

- DOL confirmed that the scope of “Principal Traded Assets” for which exemptive relief is provided can be expanded through the use of DOL’s individual prohibited transaction process. [FAQ 31]

OTHER EXEMPTIONS

- The new impartial conduct standards under PTEs 75-1, 77-4, 80-83, 83-1, 84-24 and 86-128 must be observed starting April 10, 2017. [FAQ 2]
- Under PTE 86-128, fiduciaries may rely on negative consent to transactions recommended on or after that date from IRA and non-ERISA plan investors who were customers of the fiduciary as of that date and received the requisite disclosures and consent termination form by that date. [FAQ 2]

Countdown to Applicability Date

-367 days	April 8	Final Rule published
-307 days	June 7	Effective Date – Final Rule officially became law
-277 days	July 7	Technical corrections to BICE, PTE 2016-02 released
-228 days	August 25	Hearing in DC litigation
-201 days	September 21	Hearing in Kansas litigation
-166 days	October 26	First FAQs issued
-144 days	November 17	Scheduled hearing in Texas litigation
Deadline	April 10, 2017	Applicability Date – Final Rule fully applicable; all PTE relief available, with limited transition provisions
+266 days	January 1, 2018	PTE relief subject to all conditions; transition provisions expire

SUTHERLAND'S INTERDISCIPLINARY DOL FIDUCIARY RULE COMPLIANCE TEAM

Sutherland's unique team of ERISA, insurance, securities, banking, investment management and litigation attorneys are working collaboratively to share industry knowledge and insight regarding DOL fiduciary rule compliance best practices.



FOR MORE INFORMATION

For resources and commentary regarding the Final Rule, visit Sutherland's www.dolfiduciaryrule.com.

- Text of and supporting materials for the Proposed and Final Rule
- Pleadings in the pending litigations challenging the Final Rule
- Articles, presentations and client alerts
- Videocasts about the Final Rule

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