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DOL Finalizes The ERISA Fiduciary Regulation -- What It Means For Your Business

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In the face of controversy and following thousands of comments from market participants and lawmakers, the Department of Labor ("DOL") has finalized sweeping changes to the definition of "fiduciary" under the Employee Retirement Income Security Act of 1974 ("ERISA") that will impact broad categories of market participants that provide investment advice. On April 6, 2016, the DOL issued Definition of the Term "Fiduciary"; Conflict of Interest Rule - Retirement Investment[1] ("Fiduciary Rule") which will have the effect of greatly expanding the number of market participants that will be deemed ERISA fiduciaries and profoundly changing the provision of services to private sector employee benefit plans, primarily 401(k) plans and individual retirement accounts ("IRAs"). The DOL also issued new Prohibited Transaction Class Exemptions ("PTEs"), notably including the Best Interest Contract Exemption ("BIC Exemption") and amendments to existing PTEs (together with the Fiduciary Rule, the "Package").

The DOL has demonstrated remarkable persistence in finalizing a comprehensive change to the fiduciary definition. The DOL first proposed to change the definition of fiduciary in October 2010. In light of a heated public debate among lawmakers, the DOL withdrew its 2010 proposal and issued the reproposal in April 2015 with the strong support of the Obama White House.[2] Although it has only been one year since the DOL issued the reproposal, which was facilitated by expedited review by the Office of Management and Budget ("OMB"), DOL's success in issuing the Fiduciary Rule has been nearly six years in the making. In the coming months, Congress will likely conduct significant oversight of the DOL and may pursue legislation to blunt the Fiduciary Rule or prevent the DOL from implementing or enforcing the Fiduciary Rule, though the prospects of such efforts are unclear.

I. Overview and Changes

The definition of "fiduciary" is of utmost importance in the retirement space. ERISA fiduciaries are subject to many duties and responsibilities, including duties of prudence and loyalty, and strict prohibited transaction restrictions. Violations of a fiduciary's duties can have severe consequences.

Consequently, the Fiduciary Rule will have a significant effect on various industries. The types of businesses impacted include:

- Broker-dealers
- Investment managers

[1] Published in the Federal Register on April 8, 2016, 81 Fed. Reg. 20946 (Apr. 8, 2016).

[2] "DOL Re-Proposes Rule to make Brokers, Others, ERISA Fiduciaries", April 27, 2015, *available at* http://www.klgates.com/dol-re-proposes-rule-to-make-brokers-others-erisa-fiduciaries-04-27-2015/.

- Fund complexes
- Insurance companies
- 401(k) recordkeepers
- Consultants
- Plan sponsors

The Fiduciary Rule reflects some important changes and clarifications to the April 2015 proposal. While these changes address a number of significant concerns, certain ambiguities and issues, as well as significant and costly compliance challenges, remain. We summarize some of the most significant changes below.

Fiduciary Rule Changes

1. *The Fiduciary Standard* – The DOL added language nominally intended to raise the threshold for determining when a fiduciary "recommendation" has occurred. The DOL provided a number of "examples" of communications that are not fiduciary recommendations, including materials for general distribution, educational communications, and the provision of non-individualized platforms of investment options. The DOL also clarified that a person can market one's own services without triggering fiduciary status.
2. *Removal of Appraisals* – The Fiduciary Rule does not cover appraisals or other statements of value. The DOL has reserved appraisals for a future rulemaking.
3. *Asset Allocation Models* – While the proposal would have made the identification of specific investment alternatives in asset allocation models fiduciary investment advice, the Fiduciary Rule allows this as education in the context of ERISA plans (but not IRAs), subject to conditions.
4. *Transactions with Independent Fiduciaries with Financial Expertise* – The DOL reworked the proposal's "seller's carve-out" into a new exception from the Fiduciary Rule, allowing recommendations to independent fiduciaries of ERISA plans or IRAs if the fiduciary is a bank, insurance carrier, registered investment adviser, broker-dealer, or holds or has under management or control assets of at least $50 million, subject to certain representations and other conditions.

Best Interest Contract Exemption Changes

1. *Contracts* – The DOL modified the written contract requirement. A written contract is only required for IRAs and other plans not subject to Title I of ERISA. The contract can be entered into at the same time as the execution of the recommended transaction. The parties to the contract are the client and the financial institution -- individual advisers from whom the client receives advice do not need to be a party to the contract. For existing clients, contracts can be amended through negative consent.
2. *Compliance Burden* - The DOL made certain changes intended to ease the compliance burden associated with the BIC Exemption. A requirement to collect and retain specified data relating to the financial institution's inflows, outflows, holdings and returns for retirement investments has been eliminated. A requirement to disclose projections of the total cost of an investment at the point of sale over 1, 5

and 10 year periods as well as the annual disclosure requirement has also been eliminated. Detailed customer specific information has to be disclosed only upon request.

3. *Applicability Date and Transition* - Some requirements are applicable as of April 10, 2017 and the remaining requirements are applicable at the end of a "transition period", which is January 1, 2018. Some arrangements do not need to comply with any requirements of the BIC Exemption because of an expanded grandfathering clause for compensation received in connection with advice relating to securities or other property acquired before April 2017.
4. *Specific Assets* - The BIC Exemption provides relief for all categories of fiduciary recommendations covered by the Fiduciary Rule, including advice on rollovers, distributions, and services as well as with respect to any asset, rather than a limited list of specific assets.
5. *Level Fee Fiduciaries* - The BIC Exemption includes streamlined conditions when the only fee or compensation received by a financial institution, adviser and any affiliate in connection with advisory or investment management services is a level fee that is disclosed to the client.

See below for further discussion of these changes and other aspects of the Fiduciary Rule, as well as the implications for plan sponsors, financial services firms and other service providers.

The new definition of fiduciary investment advice will become applicable April 10, 2017. As discussed above, the DOL has adopted a phased implementation of the Best Interest Contract Exemption. Firms will have one year to comply with some requirements, and it will not go into full effect until January 1, 2018. In light of the adoption of the final Fiduciary Rule, each market participant that has become an ERISA fiduciary under the Rule, or who interacts with plan service providers that are now fiduciaries, must:

- Determine how the Fiduciary Rule effects the market participant's business and compensation structure, both directly and indirectly;
- Make strategic decisions on how to best position its business and ensure compliance with the Fiduciary Rule; and
- Implement corresponding changes to business models.

II. Background

The retirement space has changed dramatically since President Gerald Ford signed ERISA into law in 1974. At that time, 401(k) plans did not exist and IRAs were new. Defined benefit pension plans, where employers are primarily responsible for investment decisions and funding benefits, dominated the retirement landscape. Today, 401(k) plans and other individually directed retirement accounts, such as IRAs, have largely replaced defined benefit plans as the main retirement savings vehicles for private sector workers.[3]

[3] In recent years, a large number of sponsors of defined benefit plans have closed plans to new participants, frozen participant benefits, shrunk plans through lump-sum payments or simply terminated plans.

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401(k) plan participants and IRA owners face challenges in managing their retirement assets without external advice. A high level of financial literacy is needed to understand the confluence of matters that are relevant for financial decision making and retirement planning, including expectations regarding prospective survival probabilities, discount rates, investment returns, earnings, Social Security benefits, tax consequences and inflation. A decision such as whether to roll over assets from a retirement plan into an IRA can be one of the most important financial decisions a person makes. In preparing the Fiduciary Rule, the DOL expressed special concern for protecting individual plan participants and IRA owners from "conflicted advice" in a world that now places greater responsibility for investment decisions on the individuals' shoulders.

Supporters of the Fiduciary Rule argued that it is necessary to protect individuals from conflicted advice, which the DOL views generally as advice provided in any situation where the broker or other service provider/adviser may be more concerned about fees generated by directing the individual into particular products than what is in the plan participant's or IRA owner's best interest.

The Fiduciary Rule's opponents raised administrative concerns and argued that the Fiduciary Rule would have severe unintended consequences. Those making such arguments say the Securities and Exchange Commission ("SEC"), not the DOL, should be responsible for determining the appropriate standard for investment advice providers, regardless of whether the client is subject to ERISA and, at a minimum, the DOL should have collaborated more with the SEC in its rulemaking effort.[4] Opponents argued that unintended consequences would include less access to personalized investment guidance and certain products, particularly for those investors with small accounts.

III. Fiduciary Rule

The first step to evaluating the impact of the Fiduciary Rule and the related regulatory package comes down to one question – Who is now a fiduciary? As discussed above, fiduciary status comes with a lot of strings attached. The potentially onerous duties and restrictions in ERISA are why many service providers previously sought to avoid fiduciary status. As explained below, methods such service providers used will, in many cases, no longer be an option.

Under ERISA Section 3(21), a person can become an ERISA fiduciary "to the extent" he or she (a) exercises discretionary authority or discretionary control with respect to management of a plan or its assets or having discretionary authority over the administration of a plan (*discretionary fiduciaries*) or (b) renders non-discretionary investment advice to a plan for a fee or other compensation or has any authority or responsibility to do so (*investment advice fiduciaries*).[5] In 1975, the DOL issued regulations that defined the scope of the investment advice fiduciary definition.[6] Under those regulations, for advice to constitute fiduciary investment advice, each of the following five elements had to be satisfied:

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[4] See, Majority Staff Report of the Committee on Homeland Security and Governmental Affairs United States Senate, "The Labor Department's Fiduciary Rule: How a Flawed Process Could Hurt Retirement Savers" (Feb. 24, 2016).

[5] Internal Revenue Code § 4975(e)(3) defines "fiduciary" for purposes of the prohibited transaction excise tax rules in the same fashion.

[6] 29 C.F.R. § 2510.3-21(c)

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1. Render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property;
2. On a regular basis;
3. Pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary that;
4. The advice will serve as a primary basis for investment decisions with respect to plan assets and that;
5. The advice will be individualized based on the particular needs of the plan.

As the retirement space changed over the years, the DOL expressed concern that some service providers that should be ERISA fiduciaries constructed their business models to eliminate one or more of the five elements. This allowed these service providers to avoid fiduciary status and the associated responsibilities. For example, some advisers asked their clients to sign an agreement that included an acknowledgement that there is no "mutual agreement" that the advice serves as "a primary basis for investment decisions" -- no matter how much the client actually relied upon the advice. In addition, because advice had to be "on a regular basis," one time advice (as is often the case for rollovers) would not meet the definition. According to the DOL, the original regulation erected "a multi-part series of technical impediments to fiduciary responsibility."

To address these concerns, the DOL replaced the five-part test, notably eliminating the regular basis, primary basis, and mutuality requirements and specifically expanding the types of advice that trigger fiduciary status. Under the Fiduciary Rule, advice to a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner for a fee or other compensation, direct or indirect, is fiduciary investment advice if both (A) and (B) below are met.

(A)

Advice that falls into one of the following categories:

- Investment recommendations

  Recommendations regarding acquiring, holding, disposing of, or exchanging, securities or other investment property, including recommendations about how property should be invested after a rollover

- Investment management recommendations

  Recommendations regarding the management of investment property, the selection of other persons to

(B)

An advice provider that either:

- Represents or acknowledges that it is acting as a fiduciary under ERISA or the Internal Revenue Code ("Code") OR
- (1) Renders the advice pursuant to an agreement, arrangement, or understanding that the advice is based on the particular investment needs of the advice recipient OR (2) directs the advice to a specific advice recipient regarding the advisability of a particular investment or management decision regarding plan assets

provide investment advice or management services, the selection of investment account arrangements, and recommendations regarding rollovers, transfers, or distributions

Under the Fiduciary Rule, the threshold question is whether an advice provider made a "recommendation"[7] with respect to the covered conduct. The definition of recommendation broadly includes statements that would reasonably be viewed as "suggestions" to take (or refrain from taking) a particular course of action. While, in the preamble, the DOL likened a recommendation to a "call to action"[8] and has added language apparently intended to narrow the breadth of the term, it is as yet unclear how high or low a bar the "recommendation" threshold will be.

With respect to investment management recommendations, the Fiduciary Rule provides that only a recommendation of "other persons" (and not one's self) is fiduciary investment advice. Therefore, a person can have a "hire me" discussion with a prospective client, "touting" the quality of his or her own advisory or management services without triggering fiduciary status. This is a nuanced line, however – the DOL indicates this exception does not extend to any investment recommendations the adviser makes in connection with its "hire me" presentation. Therefore, if the adviser recommends that an investor rollover into its product or invest in a particular fund, that advice is given in a fiduciary capacity.

The Fiduciary Rule contains a number of "examples" of communications which generally are not recommendations and therefore are not fiduciary in nature. These examples effectively may serve as safe harbors from fiduciary status.

a. Platform providers (with selection and monitoring)

A platform provider may sell an "off the rack" platform of investment alternatives to an independent fiduciary of an ERISA plan without being deemed to provide fiduciary investment advice. This safe harbor allows the marketing of a non-individualized platform, or similar mechanism, through which the plan fiduciary may select or monitor investment alternatives (including qualified default investment alternatives) into which plan participants can direct the assets held in their individual accounts, provided the platform provider discloses in writing to the plan fiduciary that the provider is not undertaking to provide impartial investment advice or advice in a fiduciary capacity. A platform provider can also

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[7] Under the Fiduciary Rule, "recommendation" means "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." The Fiduciary Rule further attempts to clarify that "[t]he determination of whether a 'recommendation' has been made is an objective rather than subjective inquiry. In addition, the more individually tailored the communication is to a specific advice recipient or recipients about, for example, a security, investment property, or investment strategy, the more likely the communication will be viewed as a recommendation. Providing a selective list of securities to a particular advice 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. Furthermore, a series of actions, directly or indirectly (e.g., through or together with any affiliate), that may not constitute a recommendation when viewed individually may amount to a recommendation when considered in the aggregate. It also makes no difference whether the communication was initiated by a person or a computer software program." 81 Fed. Reg. at 20966, 20972

[8] 81 Fed. Reg. at 20948 (Apr. 8, 2016).

assist the plan fiduciary with identifying investment alternatives that meet objective criteria specified by the plan fiduciary (if the platform provider discloses in writing the precise nature of any financial interest in the identified investment alternatives) and providing objective financial data and comparisons with independent benchmarks. In addition, in a response to a request for information, RFP, or similar solicitation by or on behalf of a plan, a platform provider can identify a limited or sample set of investment alternatives based on certain limited criteria (and disclosing any financial interest).

Note that the platform provider provision is not available with respect to IRAs or other non-ERISA retirement plans, or with respect to plan participants (who may be investing through brokerage windows). In these cases, there is no separate independent fiduciary that interacts with the platform provider, which the DOL views as a necessary protection for the exclusion.

b. General Communications

Another example of communications which generally are not recommendations and therefore are not fiduciary in nature are general communications that a reasonable person would not view as investment recommendations, including newsletters, commentary in talk shows, remarks and presentations in widely attended speeches and conferences, research or news reports prepared for general distribution, general marketing materials, general market data including data on market performance, market indices, or trading volumes, price quotes, performance reports, or prospectuses.

c. Education

The Fiduciary Rule generally re-adopts the DOL's long-standing view that investment "education" is not fiduciary investment advice. The types of activities constituting education under the Fiduciary Rule, such as basic information about the plan; general financial, investment, and retirement information; asset allocation models; and interactive investment materials generally match up with those listed in Interpretive Bulletin 96-1 (which is superseded). Importantly, while the April 2015 proposal would have made the use of asset allocation models that identify specific investment alternatives fiduciary investment advice, the Fiduciary Rule allows this specific identification as non-fiduciary education within the context of an ERISA plan if the alternative: (i) is available under the plan as a designated investment alternative subject to oversight by a plan fiduciary independent from the person who developed or markets the investment alternative and the model; (ii) identifies all the other designated investment alternatives available under the plan that have similar risk and return characteristics, if any; and (iii) is accompanied by a statement indicating that those other designated investment alternatives have similar risk and return characteristics and identifying where information on those investment alternatives may be obtained. In the DOL's view, its concern about potential "steering" to particular options through use of asset allocation models can be effectively constrained by use of a pre-approved menu of alternatives. However, in the IRA context, presentation of asset allocation models identifying specific investment alternatives would not fit within the education safe harbor.

The final Fiduciary Rule also retains certain exceptions for activities the DOL believes are not fiduciary in nature, as discussed below. If an exception applies, the person who would

otherwise be considered a fiduciary by reason of providing investment advice would not be a fiduciary.[9]

d. Transactions with independent fiduciaries with financial expertise

This reworking of the April 2015 proposal's "seller's carve-out" allows the provision of advice by a person to an independent fiduciary of a plan or IRA (including a fiduciary to a plan assets investment vehicle) with respect to an arm's length sale, purchase, loan, exchange, or other transaction if the person:

- Knows or reasonably believes that the independent fiduciary is:
  - A State or Federally regulated bank or similar institution
  - An insurance carrier qualified under the laws of more than one state to perform plan asset management services
  - An SEC registered investment adviser, or an investment adviser registered under the laws of the State in which it maintains its principal office and place of business
  - A registered broker-dealer
  - Any independent fiduciary that holds, or has under management or control, total assets of at least $50 million
- Knows or reasonably believes that the independent fiduciary is capable of evaluating investment risks independently, both in general and with regard to the particular transactions and investment strategies
- Fairly informs the independent fiduciary that the person is not providing impartial or fiduciary investment advice and of the existence and nature of the person's financial interests in the transaction
- Knows or reasonably believes that the independent fiduciary is a fiduciary under ERISA or the Code or both and is responsible for exercising independent judgement in evaluating the transaction and
- Does not receive a direct fee or other compensation for the provision of investment advice (as opposed to other services) in connection with the transaction.

e. Swap and security-based swap transactions

Advice to independent plan fiduciaries of ERISA plans by swap dealers, major swap participants, or swap clearing firms, in connection with a swap that is regulated under the Securities Exchange Act of 1934 or the Commodity Exchange Act is generally excluded from the fiduciary definition, provided the swap counterparty or clearing firm obtains written representations that the plan fiduciary is exercising independent judgment and understands that the swap dealer or other listed market participant is not undertaking to provide impartial investment advice or give advice in a fiduciary capacity.

[9] The exceptions are not available if one represents that it is acting as an ERISA fiduciary.

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f. Employees

The Fiduciary Rule does not cover statements or recommendations provided to a plan fiduciary, or to another employee (other than in his or her capacity as a participant or beneficiary of an employee benefit plan), of an ERISA plan by an employee of the plan, plan fiduciary, plan sponsor, an affiliate of the plan sponsor, or employee organization, acting in her or her capacity as employee, if the employee receives only his or her normal compensation.

The Fiduciary Rule also does not cover advice by an employee to another employee, even in his or her capacity as a participant or beneficiary of the plan, provided the person's job responsibilities do not involve providing investment advice or investment recommendations, the person is not registered or licensed under federal or state securities or insurance law, the advice he or she provides does not require the person to be registered or licensed under federal or state securities or insurance laws, and the person receives only his or her normal compensation. This addition is intended to address circumstances where an employee, such as an HR employee, may make a recommendation that, albeit unintentional, technically may be treated as "fiduciary advice" in performing his or her normal duties.

g. Execution of securities transactions

A broker will not be deemed a fiduciary solely because the broker executes transactions in securities following specific directions of an independent plan fiduciary or IRA owner where no advice is provided. This continues the rule under existing DOL regulations.

IV. Best Interest Contract Exemption

The Package includes a new PTE - the BIC Exemption, which effectively allows advisers to continue to be compensated for "conflicted advice," provided certain conditions are met. This exemption will play an important role in shaping advisory services in the retail retirement space. While the BIC Exemption contains numerous requirements, we expect that many firms will have to invest the time and resources to comply with the exemption's terms, or consider other options to avoid prohibited transactions.[10]

The BIC Exemption allows registered investment advisers and broker-dealers that are ERISA fiduciaries on account of providing investment advice to retirement clients to be compensated in ways that would otherwise constitute a prohibited transaction. The exemption is intended to be helpful for firms that, as new fiduciaries under the Fiduciary Rule, wish to continue their existing compensation structures, which would be impermissible without the exemption. These structures may include the receipt of:

- 12b-1 fees
- Brokerage commissions
- Sales loads
- Revenue sharing payments

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[10] For example, see the independent financial expert approach described in DOL Advisory Opinion 2001-09A, known as the "SunAmerica Letter"; the complete offset method described in DOL Advisory Opinion 97-15A, known as the "Frost Letter"; and the statutory exemption for investment advice to plan participants in ERISA Section 408(b)(14) and 408(g), as implemented by DOL Regulation Section 2550.408g-1 & 2.

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In crafting the BIC Exemption, the DOL indicated that it sought to balance protecting retirement accounts from conflicts of interest with not being too disruptive of existing business models. To do this, the DOL used a principles-based approach to exempt a variety of transactions and compensation models from the prohibited transaction restrictions as long as certain conduct standards are adhered to. This is a departure from the DOL's normal approach of granting highly prescriptive transaction specific exemptions. The idea is that a principles-based approach should be a more flexible mechanism for firms to determine the best way to serve clients, rather than having the DOL dictate precisely what service providers must do. However, the subjectivity inherent in that approach may make it more difficult for firms to be comfortable they are complying with all of the BIC Exemption's requirements, particularly since the burden of demonstrating compliance falls upon the party claiming the exemption.[11]

When making strategic decisions regarding business models for retail retirement clients, such as plan participants and IRA owners, investment advice fiduciaries should carefully review the BIC Exemption's requirements to understand the costs and burdens of compliance. The requirements include:

- *Written Contract* - Only for IRAs and other plans not covered by Title I of ERISA; include an acknowledgment regarding fiduciary status; certain types of contractual provisions are impermissible
- *Impartial Conduct Standards* - Advice must be in the client's best interest and compensation to individual advisers must be structured to avoid incentives that would cause advisers to make recommendations not in a client's best interest; policies and procedures are needed (see Attachment A)
- *Disclosures* - Information about material conflicts of interest; costs
- *Rights of Action* - After January 1, 2018, IRA owners will have a private, contract-based, right of action to enforce the standard of care under this exemption. While contracts may require arbitration for individual claims, contracts cannot restrict the right to bring a class action. Contracts may limit damages to "make whole" amounts, however.

The BIC Exemption has streamlined conditions for financial institutions that are "level fee fiduciaries."[12] A financial institution and adviser are level fee fiduciaries if the only fees or compensation received by the financial institution, adviser and any affiliate in connection with advisory or investment management services is a "level fee" that is disclosed in advance to the client. 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. The DOL included this concept in the exemption because it believes fewer protections are necessary in situations where the prohibited transaction is relatively discrete and the provision of advice thereafter generally does not involve a prohibited transaction.

The relief for level fee fiduciaries will be helpful for firms that recommend a switch from a commission-based account to a fee-based account where the client is charged a fixed percentage of assets under management on an ongoing basis. The relief will also be helpful

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[11] See 81 Fed. Reg. at 21033 (Apr. 8, 2016).

[12] Section II(h) of the BIC Exemption.

for firms that recommend a rollover from a plan into a fee-based IRA. In both cases, the level fee fiduciary must document the reasons why the level fee arrangement was considered to be in the best interest of the client.

As part of the BIC Exemption, the DOL added an exemption for the purchase and sale of investment products, including insurance and annuity contracts, from financial institutions that are service providers to the plan or IRA, subject to certain conditions. The exemption generally requires that the transaction be effected by the financial institution in its ordinary course of business and on arm's length terms, and that the compensation received by the financial institution and its affiliates and related entities is reasonable.

As discussed below, the traditional exemption for insurance and annuity contracts transactions, PTE 84-24, will no longer be available for investment advice fiduciaries in connection with transactions involving variable or indexed annuity contracts or other annuity contracts that would constitute "securities" under federal securities laws. Such fiduciaries would have to rely on this part of the BIC Exemption.

Firms seeking to rely on the BIC Exemption do not need to immediately comply with all of its requirements.[13] Some requirements are effective as of the BIC Exemption's "applicability date", which is April 10, 2017, and the remaining requirements apply at the end of a "transition period", which is January 1, 2018.[14] By the applicability date, financial institutions need to provide a disclosure to clients that includes a statement that the financial institution and adviser are ERISA fiduciaries and describes any material conflicts of interest.

Some arrangements do not need to comply with any requirements of the BIC Exemption because of a grandfathering clause.[15] In order to be grandfathered, compensation must be on account of advice in connection with securities or other property that was acquired before the "applicability date" or that was acquired pursuant to a recommendation to continue to adhere to a systematic purchase program established before the applicability date. This relief potentially reduces disruption to firms that did not consider themselves ERISA fiduciaries before the Fiduciary Rule. As with many components of the BIC Exemption, the grandfather provisions include nuances that should be carefully understood to ensure compliance. For example, relief ends when the agreement pursuant to which such compensation is received is up for renewal after the applicability date. Further, relief is not available for advice about additional amounts invested in a previously acquired investment vehicle, such as additional contributions to a variable annuity. However, additions made as a result of a systematic purchase program established before April 10, 2017 will continue to be grandfathered.

Observations

- *Compensation.* The BIC Exemption specifically states that differential compensation is permissible, subject to policies and procedures designed to prevent advisers from

[13] Section IX of the BIC Exemption.

[14] The preamble to the final regulation provides that the issuance date serves as the date on which the BIC Exemption is intended to take effect for purposes of the Congressional Review Act ("CRA"). Under the CRA, the earliest date a major rule can become effective is 60 days after it is submitted to Congress or published in the Federal Register unless other provisions of the law apply. Consequently, DOL made explicit in the preamble that, for CRA purposes, the BIC Exemption will take effect on the earliest possible date of June 7, 2016, though the "applicability" (compliance) dates are later.

[15] Section VII of the BIC Exemption.

acting on conflicts of interest to the detriment of the client. Compensation structures should be designed to avoid a misalignment of the interests of advisers and their retirement clients. For example, different compensation based on "neutral factors" such as the difference in time and analysis necessary to provide prudent advice with respect to different types of investments is permissible. According to the DOL, "The [BIC Exemption's] goal is not to wring out every potential conflict, no matter how slight, but rather to ensure that Financial Institutions and Advisers put Retirement Investors interests first, take care to minimize incentives to act contrary to investors' interests and carefully police those conflicts that remain."[16]

- *Rollovers*. Under the Fiduciary Rule, providing advice to take a distribution or to roll over assets from a plan or IRA for a fee is fiduciary advice.[17] Since advisers stand to earn compensation as a result of a rollover that they would not be able to earn if the money remains invested in an ERISA plan, a prohibited transaction exemption is needed to engage in this activity. The BIC Exemption is a prohibited transaction exemption that advisers should consider. "Level Fee Fiduciaries" may find their streamlined requirements make the BIC Exemption an appealing approach.[18]
- *Proprietary products*. Recommendations may be restricted to proprietary products (or products that generate third party payments). The BIC Exemption includes a specific test for satisfying the best interest standard in this situation.[19] The test includes the following requirements: (i) prominent disclosure of the limited universe of investments and the inclusion of proprietary products, (ii) documentation of a reasonable determination that the limitations and conflicts of interest will not cause advisers to recommend imprudent investments, and (iii) incentives such as bonuses, contests, special awards and differential compensation are not used to cause an adviser to make imprudent recommendations. While these requirements are extensive, the DOL has made it clear that such platforms are permissible.

V. Other New Prohibited Transaction Exemptions and Amendments to Existing Prohibited Transaction Exemptions

a. Principal Transactions

The DOL adopted a new exemption that allows an individual investment advice fiduciary (an "adviser") and the firm that employs or otherwise contracts with the adviser (a "financial institution") to engage in principal transactions, including "riskless principal" transactions, involving the purchase of certain assets (including certain debt securities, certificates of deposit, interests in a unit investment trust or investments permitted to be purchased under an individual exemption), with plans, participant and beneficiary accounts, and IRAs ("retirement investors"). Note that, the assets that may be *sold* in a principal transaction are

[16] 81 Fed. Reg. at 21037 (Apr. 8, 2016).

[17] Advisers can educate plan participants on the various distribution options that are available without becoming an ERISA fiduciary. See Section III for a detailed description.

[18] It should be noted, however, that advisers including investment recommendations as part of the marketing of their services may well be considered fiduciary advisers under the Fiduciary Rule. In such case, advisers seeking to be hired by new clients, and thereby obtain asset-based level fees that would result from being hired, would need to rely on an exemption -- probably the BIC Exemption -- in order to do so.

[19] Section IV of the BIC Exemption.

broader than the assets that may be *purchased* in a principal transaction under the exemption.

To safeguard the interests of retirement investors, the exemption requires the financial institution to acknowledge fiduciary status affirmatively in writing with respect to any investment advice regarding principal transactions or riskless principal transactions and to commit to adhere to “impartial conduct standards” when providing investment advice regarding the principal transaction to the plan fiduciary with authority to make investment decisions for the retirement investor, including providing advice that is in the best interest of the retirement investor. (For IRAs and non-ERISA plans, the exemption requires this written commitment to be in an enforceable contract with the customer; there is no contract requirement for ERISA plans.) The financial institution is required to warrant that it has adopted (and will comply with) policies and procedures designed to ensure that individual advisers adhere to the impartial conduct standards and to prevent material conflicts of interest from causing violations of the impartial conduct standards. The retirement investor is required to consent to the principal transactions or riskless principal transactions following disclosure of the material conflicts of interest associated with such transactions. (For existing customers, this consent can be negative consent.) Financial institutions relying on the new exemption are subject to ongoing disclosure and recordkeeping requirements.

b. Prohibited Transaction Exemption 75-1, Part V

The amendment to PTE 75-1, Part V, allows investment advice fiduciaries that are broker-dealers to receive compensation when they lend money or otherwise extend credit to plans or IRAs to avoid the failure of a purchase or sale of a security. The exemption contains conditions that the broker-dealer lending money or otherwise extending credit must satisfy in order to take advantage of the exemption. In particular, the potential failure of the securities transaction may not be caused by the fiduciary or an affiliate, and the terms of the extension of credit must be at least as favorable to the plan or IRA as terms available in an arm's length transaction between unaffiliated parties. Certain written disclosures must be made to the plan or IRA prior to the extension of credit, in particular, with respect to the rate of interest or other fees charged for the loan or other extension of credit. Fiduciaries relying on the exemption are subject to recordkeeping requirements.

c. Prohibited Transaction Exemption 84-24

PTE 84-24 historically provided relief for certain parties to receive commissions when plans and IRAs purchased insurance and annuity contracts and shares in an investment company registered under the Investment Company Act of 1940 (a mutual fund).

In connection with the adoption of the Fiduciary Rule, PTE 84-24 has been amended and partially revoked. As amended, PTE 84-24 generally permits certain fiduciaries and other service providers to receive commissions in connection with the purchase of insurance contracts and “Fixed Rate Annuity Contracts”[20] by plans and IRAs, as well as the purchase

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[20] A Fixed Rate Annuity Contract is a fixed annuity contract issued by an insurance company that is either an immediate annuity contract or a deferred annuity contract that (i) satisfies applicable state standard nonforfeiture laws at the time of issue, or (ii) in the case of a group fixed annuity, guarantees return of principal net of reasonable compensation and provides a guaranteed declared minimum interest rate in accordance with the rates specified in the standard nonforfeiture laws in that state that are applicable to individual annuities; in either case, the benefits of which do not vary, in part or in whole, based on the investment experience of a separate account or accounts maintained by the insurer or the investment

of mutual fund shares by plans. The amendment revokes relief for compensation received in connection with plan and IRA purchases of annuity contracts that do not satisfy the definition of a Fixed Rate Annuity and revokes the exemption for compensation received in connection with purchases of mutual fund shares by IRAs. As amended, the exemption requires fiduciaries engaging in transactions covered by the exemption to adhere to “impartial conduct standards,” including acting in the best interest of the plans and IRAs when providing advice.

PTE 84-24 is no longer available for investment advice fiduciaries in connection with transactions involving variable or indexed annuity contracts or other annuity contracts that would constitute “securities” under federal securities laws. Such fiduciaries would have to rely on the BIC Exemption. Although numerous insurance companies opposed this change, in the DOL’s view, it was necessary to protect customers from the significant investment risk inherent in these products.

d. Prohibited Transaction Exemption 86-128 and 75-1

PTE 86-128 historically provided an exemption for certain fiduciaries and their affiliates to receive a fee from a plan or IRA for effecting or executing securities transactions as an agent on behalf of the plan or IRA. It also allows a fiduciary to act in an “agency cross transaction” (that is, to act as an agent both for the plan or IRA and for another party) and receive reasonable compensation from the other party. The exemption generally requires compliance with certain conditions such as advance disclosures to and approval by an independent fiduciary, although such conditions historically did not apply to transactions involving IRAs.

The amendment to PTE 86-128 requires fiduciaries relying on the exemption to adhere to the “impartial conduct standards,” including acting in the best interest of the plans and IRAs when providing advice, and defines the types of payments that are permitted under the exemption. The amendment restricts relief under this exemption to “investment management fiduciaries” (IRA fiduciaries that have discretionary authority or control over the management of the IRA’s assets) and imposes the exemption’s conditions on investment management fiduciaries when they engage in transactions with IRAs. The amended exemption requires investment management fiduciaries to IRAs relying on the amended exemption to make the disclosures and obtain the approvals that were historically required under the exemption with respect to other types of plans. The amendment revokes relief for “investment advice fiduciaries” (fiduciaries who provide investment advice to IRAs). Relief for investment advice fiduciaries to IRAs is now contained in the BIC Exemption described above.

The amendment to PTE 86-128 also adds an exemption for certain fiduciaries to act as principal (as opposed to agent for a third party) in selling mutual fund shares to plans and IRAs and to receive commissions for doing so. An exemption for these transactions was previously available in PTE 75-1, Part II(2), which has been revoked.

Several additional changes have been adopted with respect to PTE 75-1. Parts I(b) and (c) of PTE 75-1 have also been revoked. These provisions of PTE 75-1 provided relief for certain non-fiduciary services to plans and IRAs. The DOL indicated that persons who seek to engage in these transactions should look to the existing statutory exemptions provided in

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experience of an index or investment model. A Fixed Rate Annuity Contract does not include a variable annuity or an indexed annuity or similar annuity.

ERISA Section 408(b)(2) and the regulations thereunder, and Code Section 4975(d)(2), for relief.

The remaining exemption of PTE 75-1, Part II (for principal transactions with non-fiduciary parties in interest) has been amended to revise the recordkeeping requirement of that exemption.

e. Impartial Conduct Standards Amendments to Prohibited Transaction Exemptions 75-1, Part III; 75-1, Part IV; 77-4; 80-83 and 83-1

The prohibited transaction exemptions set forth below have been amended to incorporate the "impartial conduct standards" found in the BIC Exemption (although without requiring that such standards specifically be included in a written contract.)

- PTE 75-1, Part III, which permits a fiduciary to cause a plan or IRA to purchase securities from a member of an underwriting syndicate other than the fiduciary, when the fiduciary is also a member of the syndicate;
- PTE 75-1, Part IV, which permits a plan or IRA to purchase securities in a principal transaction from fiduciary market makers;
- PTE 77-4, which provides relief for a plan's or IRA's purchase or sale of shares in an open-end investment company advised by a plan fiduciary;
- PTE 80-83, which provides relief for a fiduciary causing a plan or IRA to purchase a security when the proceeds of the securities issuance may be used by the issuer to retire or reduce indebtedness to the fiduciary or an affiliate; and
- PTE 83-1, which provides relief for the sale of certificates in an initial issuance of certificates, by the sponsor of a mortgage pool to a plan or IRA, when the sponsor, trustee or insurer of the mortgage pool is a fiduciary with respect to the plan or IRA assets invested in such certificates.

VI. Implications of the Fiduciary Rule

The Fiduciary Rule has wide ranging consequences that impact market participants and market dynamics. These consequences and suggested action items are highlighted in the discussion below.

a. Brokers

The Package significantly impacts brokers and their registered representatives. To the extent brokers (or their representatives) are recommending investment products to their retail retirement clients, they will be subject to the more stringent fiduciary standard under the Fiduciary Rule in addition to the "suitability" standard under which brokers currently operate. If brokers and their representatives are fiduciaries under the Fiduciary Rule, they will be unable to receive traditional types of transaction-based fees, such as commissions, or other types of compensation common in the marketplace, such as 12b-1 fees and revenue sharing payments, unless an exemption to the fiduciary prohibited transaction restrictions applies.

To the extent brokers are providing advice to institutional retirement clients, the "transactions with independent fiduciaries with financial expertise" exception from the Fiduciary Rule may be useful, if its conditions are met. If brokers are providing advice to retail retirement clients, however, many will need to rely on the BIC Exemption in order to continue to receive fees

that would otherwise be prohibited, or take another approach to address or avoid prohibited transactions. Compliance with the BIC Exemption involves certain compliance burdens as discussed above and may severely impact the types of compensation structures brokers can use to pay their registered representatives.

These changes may expedite several trends in the retirement space:

- Automated advice becoming more prevalent, especially for smaller clients
- Lower cost products such as passive strategies replacing higher cost active strategies
- Fee-based compensation arrangements replacing commission-based arrangements

As brokers are a primary distribution channel to plans and IRAs for many investment products, any direct impact on brokers and any changes brokers make to their operations will reverberate on the issuers and manufacturers of such products.

One of the areas most impacted by the Package is IRA rollovers. Every year millions of workers change jobs.[21] Those that participate in a 401(k) plan must decide what to do with their account balance. The choices are:

- Leave the balance in the former employer's plan[22]
- Roll the balance over to a new employer's plan, if permitted under the terms of the plan
- Roll over to an IRA
- Cash-out (*i.e.*, take a taxable distribution)

Workers often get information on these options from a broker. The DOL had previously taken the position that, generally, it is not fiduciary advice for a broker to recommend plan distribution options, even if the recommendation included how the distribution should be invested.[23] Under the Fiduciary Rule, a recommendation that a plan participant roll over his or her account balance to an IRA is fiduciary investment advice.

The exceptions and safe harbors from the Fiduciary Rule have limited usefulness in the IRA rollover context. The exception for "transactions with independent fiduciaries with financial expertise" does not apply to conversations that take place directly between the broker and IRA owners or 401(k) plan participants. Similarly, although a broker can inform plan participants of certain distribution information as part of an "educational" communication, the information cannot include recommendations as to specific investment products or managers without becoming fiduciary investment advice.[24]

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[21] In 2013, 38 percent of workers left their jobs. U.S. Bureau of Labor Statistics, Job Openings and Labor Turnover Survey.

[22] Plans are not required to permit former employees to leave funds in the plan, if the balance is less than $5,000 or the participant attains the later of age 62 or normal retirement age.

[23] DOL Advisory Opinion 2005-23A (Dec. 7, 2005).

[24] Note, however, a "Level Fee Fiduciary" can recommend a rollover subject to certain streamlined conditions under the BIC Exemption.

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Action Items:

1. *Brokers should consider whether they are willing to act as a fiduciary, subject to ERISA's fiduciary standards and prohibited transaction restrictions, or whether their business can be restructured to avoid providing fiduciary "recommendations" under the Fiduciary Rule. Before acting as a fiduciary, brokers should consider the impact on:*
   - *Training of personnel*
   - *Adequacy of written policies and procedures*
   - *Compensation models (commission, fee-based) and other activities that could constitute a conflict of interest*
   - *Increased liability due to contractual right of action by IRAs*
   - *Insurance coverage*
   - *Legal advice needed*
2. *If a broker will be a fiduciary under the Fiduciary Rule, it must consider whether and when it will need to comply with the BIC Exemption or another prohibited transaction exemption (such as ERISA Section 408(b)(14)) or how to implement another approach to avoid prohibited transactions. It should consider the costs and difficulty of compliance with such exemption or approach, including potential changes to compensation models or product offerings.*

b. Investment Managers

The Fiduciary Rule may have implications for investment managers, including those who are already ERISA fiduciaries on account of having discretion over "plan assets" (as a result of having separate account clients subject to Section 4975 of the Code or managing funds treated as "plan assets") and those who manage funds that are not considered "plan assets."[25] Fund managers should see the section below discussing impacts on "Fund Complexes."

Whether or not an investment manager is considered a fiduciary with respect to investing plans, the Package may have an impact on an investment manager's distribution channels. There may be increased scrutiny of investment managers' products by distributors who were not previously considered fiduciaries with respect to plans or IRA investors as a result of the distributor's new fiduciary duties. In addition, because the investment manager and the distributor both are fiduciaries, ERISA's "co-fiduciary liability" provisions will be relevant.[26] Finally, compensation arrangements with distributors may also be impacted by the Package, as described further in the section above regarding impacts on brokers.

There will also be impacts on consultants that recommend investment managers to retirement investors, as further described below in the section regarding "Consultants."

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[25] Managers of certain vehicles are not ERISA fiduciaries. For example, mutual fund managers are not deemed to be ERISA fiduciaries in connection with managing the mutual fund. Similarly certain private fund managers are not ERISA fiduciaries in connection with their management of such funds if investment by ERISA investors and plans subject to Section 4975 of the Code (such as IRAs) in the fund is not "significant" (they are below a certain threshold).

[26] See ERISA Section 405.

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As discussed elsewhere herein, there will be broad impacts on the retirement space, including increased pressure for lower fee products, that should be taken into consideration by investment managers seeking to do business with retirement investors.

Action Items*:*

1. *Investment managers should take an inventory of each prohibited transaction exemption relied upon and determine whether any of the prohibited transactions have been amended, as described above. If any of the manager's exemptions have been amended, the manager should determine what changes should be made to its policies and procedures to ensure continue adherence to the requirements of the exemption.*
2. *Investment managers should work with their distribution partners that work with retirement clients to determine how they intend to avoid prohibited transactions. There may be changes to the relationship with distributors such as funds or share classes sold and compensation practices.*
3. *Investment managers should consider the Fiduciary Rule's impact on the retirement space when making strategic business decisions.*

c. Fund Complexes

The Package has the potential to drastically alter the landscape of both registered and non-registered investment companies by impacting the array of funds offered by product sponsors. Actively-managed funds with higher fees (and poorer performance) may likely see assets decline, which may result in only a few, high-quality actively-managed funds. The Package also has the potential to alter the fees charged by funds. Passive funds with lower fees are already responsible for a substantial amount of assets under management, and financial advisers subject to a fiduciary duty may likely continue this trend. Funds are allowed to have varying management fees; however, fund sponsors and investment advisers may feel pressure to not only lower fees, but also level them across the board in an effort to take "cost" out of the equation. Plan sponsors and distributors may aim to only put funds on their platform that have management fees that are within a uniform range.

One of the most significant changes to the Package was the DOL's decision not to proceed with the limited definition of "Asset" under the BIC Exemption. Many interpreted the BIC Exemption, as proposed, to limit investments in retirement accounts to certain highly liquid, transparent, and traditional investments. The proposed limited definition of Asset was seen as an attempt by the DOL to substitute its judgment for that of financial advisers by providing a legal list of permissible investments. The final BIC Exemption does not include a definition of Asset and thus does not limit the types of investments that can be recommended by financial advisers, including less traditional or more complex products. The DOL noted, however, that its elimination of the proposed definition of Asset does not mean that it is no longer concerned about the risks and characteristics associated with these products, such as complexity, lack of liquidity and transparency, high fees and commissions, and tax treatment.

A small, yet important change was the DOL's clarifications that the BIC Exemption's exclusion of principal transactions does not include "riskless principal transactions," where a broker matches substantially identical third-party purchase and sale orders. Without further clarification, the exclusion of principal transactions may have excluded certain funds such as unit investment trusts ("UITs") from being able to use the BIC Exemption, as such funds are

generally purchased from the fund sponsor on a principal basis. However, the BIC Exemption now provides that excluded principal transactions do not include such "riskless principal" transactions to fill orders placed by investors. The DOL also confirmed that UITs are included within the types of investments that can be recommended under the Principal Transactions Exemption.

The Fiduciary Rule provides some clarification regarding the boundaries between principal underwriters that act solely as fund wholesalers and financial advisers that communicate directly with investors. If a fund wholesaler complies with the "transactions with independent fiduciaries with financial expertise" exception, it can avoid fiduciary status in connection with such communications.

Action items:

1. *The DOL stated that the "[f]inancial [i]nstitutions responsible for overseeing recommendations of these investments must give special attention to the policies and procedures surrounding such investments…." Accordingly, financial institutions should undertake sufficient due diligence when vetting less traditional products before adding them to their platforms. These financial institutions also should consider undertaking ongoing due diligence of these funds to ensure they remain an appropriate investments for their clients.*
2. *Distributors that wholesale shares of funds should ensure that that they comply with the "transactions with independent fiduciaries with financial expertise" exception. Funds also should consider how their shares will be sold.*
3. *Fund complexes and their service providers should revise existing documents, including private placement memoranda and subscription agreements to reflect the new definition of fiduciary investment advice and draft new model language to include in future documents.*

d. Insurance Companies

According to industry estimates, about half of annuity sales are to retirement accounts. The new regulatory regime has direct implications for distribution of these products as most advisers will become ERISA fiduciaries. In addition, the new regulatory regime has direct and indirect implications for manufacturers of insurance products.

A threshold question for many insurance companies is whether they are now ERISA fiduciaries. Even manufacturers without affiliated distribution raised concerns regarding this matter. The concern arises because state insurance law requires insurance products be sold through state licensed agents that are appointed by the insurance company. Some companies are concerned that this "appointment" of an agent, who may be acting as an ERISA fiduciary, could cause the manufacturer to itself be an ERISA fiduciary.

The appointment of an independent agent to sell a manufacturer's product should not in itself cause the manufacturer to become an ERISA fiduciary because the manufacturer does not play a role in providing a recommendation to the purchaser. Rather, it is merely adhering to a state law requirement. Further, the exception for transactions with independent fiduciaries with financial expertise may apply in certain situations.

As ERISA fiduciaries, insurance advisers will need to avoid conflicts of interest or adhere to a prohibited transaction exemption, such as the BIC Exemption. Either approach will have

implications for manufacturers. One of the requirements of the BIC Exemption is that the adviser must act in the best interest of the client. This will cause advisers to more closely scrutinize fees, putting downward pressure on products that typically have higher fees, such as variable annuities. If fees are too high, advisers may have a difficult time demonstrating that the recommendation was in the client's best interest.

Some advisers will switch to fee-based compensation arrangements to avoid the BIC exemption's onerous requirements.[27] These advisers will need products that can be sold to these clients, such as no-load annuities. Regardless of whether an adviser can receive commission through reliance on a prohibited transaction exemption or an adviser receives an asset-based fee, insurance companies will need to develop products that can be sold in an environment with an even greater focus on disclosure and low fees.

Acton Items:

1. *Insurance companies should closely coordinate with their distribution partners as they adapt to the new regulatory regime. Manufacturing, compensation practices and wholesaling activities will ultimately be impacted*
2. *Manufacturers may want to consider developing product that is suitable for fee-based accounts*

e. 401(k) Recordkeepers

Most recordkeepers are not currently ERISA fiduciaries and would like to avoid such status, especially in connection with selecting and monitoring a plan's investment menu. Recordkeepers should determine whether they need to make changes to their services to avoid being covered by the Fiduciary Rule.

The Fiduciary Rule contains helpful guidance for what the DOL refers to as "platform providers" -- firms that offer a platform or selection of investment alternatives to participant directed individual account plans and plan fiduciaries of these plans who choose the specific investment alternatives that will be made available to plan participants. The many recordkeepers that offer investment products or are affiliated with investment providers (along side of the traditional recordkeeping services of posting payroll contributions, plan payments, earnings and adjustments, participant communications and compliance testing) can avoid becoming ERISA fiduciaries in connection with the investment options as long as a plan fiduciary independent of the recordkeeper (e.g., a consultant or the plan's internal pension committee) is responsible for choosing the specific investments to be made available and the recordkeeper discloses in writing to the plan fiduciary that the recordkeeper is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity.

Recordkeepers could also become fiduciaries under the Fiduciary Rule through other activities. These activities may, in certain circumstances, include:

- Participant communications - Plan participants receive various types of plan-related communications. Some plans have been moving to more personalized communications in an effort to better engage participants.

[27] However, see also footnote 18 above.

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- Call center operation - Recordkeepers commonly operate call centers to provide assistance to plan participants. Plan participants often contact the call center when deciding what to do with their account balance when leaving employment.
- Responding to plan sponsor data requests - Plan sponsors often ask recordkeepers for data about participant behavior such as how participant accounts are invested, loans, timing of withdrawals and timing of increases in deferrals. There is a risk in some cases that such communications could rise to the level of an investment or investment management "recommendation" to plan sponsors.

Action items:

1. *Recordkeepers should consider making the necessary disclosure required to be a "platform provider." Doing so will help avoid conflicts of interest associated with investment menus that include proprietary products.*
2. *Recordkeepers should evaluate their activities in connection with other activities such as participant communications, call centers and responding to plan sponsor data requests to determine whether these activities could potentially cause the recordkeeper to be an ERISA fiduciary. If any such activity results in fiduciary status, the recordkeeper should determine whether it wants to modify its practices to avoid such status.*
3. *Recordkeepers with an IRA business may want to evaluate pricing using new assumptions around rollover retention. See Section III for a detailed discussion of the Fiduciary Rule's implications for IRA rollovers.*

f. Consultants

Consultants offer several types of service levels when assisting plans with matters such as asset allocation and investment manager selection and monitoring. A consultant may have discretion over such matters, in which case the consultant has been and continues to be an ERISA fiduciary. More frequently, consultants do not have discretion. Such consultants generally will include those acting as an ERISA fiduciary and those not acting as an ERISA fiduciary.

Consultants acting as an ERISA fiduciary typically acknowledge fiduciary status in a written contract with the plan. On the other hand, consultants not acting as an ERISA fiduciary typically have a contract that includes a representation, warranty or acknowledgement that at least one of the five elements of the old five-part test is not met. For example, a consulting agreement may include a client acknowledgement that there is no "mutual understanding" that the consultant's advice will serve "as a primary basis" for investment decisions. In addition, some consultants that provide a single report to a client take the position that the report does not constitute fiduciary advice because advice is not being provided on a "regular basis." Now that the five-part test has been replaced with an expansive definition of investment advice fiduciary, it is difficult to envision a situation where a consultant is not acting as an ERISA fiduciary.

Action items:

1. *A consultant that is newly an ERISA fiduciary should review its business model and compensation structure to make sure prohibited transactions are avoided. For example, a fiduciary generally cannot recommend that a plan hire an affiliated*

investment manager or receive compensation from third parties in connection with the provision of advice.

2. *A consultant with fiduciary status for the first time should analyze whether its process and policies and procedures are adequate. For example, a consultant may need to obtain more detailed or more frequent client information to be able to act in the client's best interest.*

g. Plan Sponsors

Plan sponsors hire an array of service providers for their retirement plans. Several types of service providers may make changes to their business models because of the Package. Plan sponsors have a responsibility to understand the impact of any such changes on their pension and 401(k) plans, including whether compensation arrangements continue to be "reasonable."

As discussed above, among the service providers that may be impacted by the Package are consultants and 401(k) recordkeepers. Plans often use consultants to assist with matters such as determining an asset allocation and selecting and monitoring investment managers. Some consultants have discretion over these matters. More frequently, consultants provide advice, which may or may not be ERISA fiduciary advice. Under the new expansive definition of fiduciary investment advice, it is difficult to envision a situation where a consultant is not acting as an ERISA fiduciary. As described more fully above, if a consultant is newly a fiduciary under the Fiduciary Rule, its services and compensation structure may change. While most consultants have become ERISA fiduciaries, many 401(k) recordkeepers will take steps to make sure they do not become fiduciaries.

Many industry observers believe the Package will expedite the growth in 401(k) assets as less workers roll assets to IRAs. If this were to occur:

- Plan sponsors would pay more to service providers that receive an asset-based fee
- Target date fund construction may be based on assumptions about participant actions that may not match what participants actually do[28]
- Workers will have less access to lifetime income options in the drawdown phase of their retirement assets as annuities are more commonly purchased in an IRA than in a 401(k) plan[29]

The new expansive definition of ERISA fiduciary could cause additional employees of a plan sponsor to become fiduciaries unintentionally, potentially subjecting them to personal liability for ERISA violations. To avoid this result, the Fiduciary Rule contains a specific exception to consider.

Action Items:

1. *Plan sponsors should review contracts with consultants and advisers to see if they contain provisions that are designed to avoid ERISA fiduciary responsibility. For example, a contract may include an acknowledgment that advice provided by the*

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[28] The glide path of some target date funds ends at the target date and is not designed to manage assets in the retirement years.

[29] According to a 2014 industry survey, only 12% of large and midsize defined contribution plans offered lifetime income products.

consultant will not serve as "a primary basis for investment decisions." Contracts should be amended in light of the Fiduciary Rule and the services to be provided by the consultant or adviser.

2. *Plan sponsors should ask their recordkeepers if they intend to make any changes to the services that are currently provided (e.g., call centers, participant communications, plan sponsor reports).*
3. *Plan sponsors should consider whether there will be less rollovers from the plan to IRAs. If this is expected, plan sponsors should consider (a) converting asset-based compensation structures to fixed fees or taking advantage of the increasing economies of scale to negotiate a lower asset-based fee, (b) whether the assumptions regarding plan participant actions used in the construction of their target date funds should be changed and (c) whether to provide a lifetime income distribution option for 401(k) plan participants.*
4. *Plan sponsors should review compensation arrangements for employees that work on the sponsor's plans to determine which employees may be ERISA fiduciaries under the Fiduciary Rule. Although unlikely, if additional employees are ERISA fiduciaries, sponsors should consider ERISA fiduciary liability insurance needs.*

VII. Policy Context

As discussed above, the Fiduciary Rule has been several years in the making, demonstrating the DOL's remarkable persistence in finalizing a comprehensive change to the fiduciary definition. The initial attempt in October 2010 attracted significant bipartisan criticism for its potential impact on individual investors, particularly those with modest investments and minorities. In light of a heated public debate among lawmakers, the DOL withdrew its fiduciary duty proposal just as Congress enacted an appropriations measure that prevented DOL from continuing the rulemaking.

Since then, the DOL has navigated multiple hearings, extensive comment letters, and continued debate among lawmakers.[30] Importantly, the April 2015 reproposal had the strong support of the Obama White House and was coupled with aggressive DOL engagement on Capitol Hill, with a focus on moderate Democrats. Consequently, the left-right coalition that led to the withdrawal of the initial proposed rule eroded, leaving in its place a largely partisan divide. Whereas Republicans remain strongly opposed to the rulemaking, Democratic criticism has been tempered and focused on making the reproposal workable.

Now considered a legacy for President Obama, the Administration moved with urgency to finalize the DOL's reproposal, issuing the Fiduciary Rule nearly one year after the April 2015 proposal. Timing has been critical due to the Congressional Review Act (CRA), which gives Congress sixty session days during which it can pass a resolution to overturn a major

[30] Further charging the political atmosphere, Senator Elizabeth Warren wrote to the SEC to request an investigation into what she believes are "contradictory" statements made by corporate officials at certain insurance companies about the impact of the proposed regulation on their companies. According to Warren, certain insurance companies sent the DOL comment letters that argued the proposed regulation, if finalized, would have dire consequences for certain business lines. At the same time, company officials made comments to the public that their companies would not be significantly adversely impacted. Letter from Senator Elizabeth Warren (Massachusetts) to The Honorable Mary Jo White, Chair, Securities Exchange Commission (Mar. 31, 2016).

regulation. Such a resolution can be overturned by the President, allowing the regulation to remain in place. Because of the truncated legislative calendar due to the election year, the Obama Administration could have risked having the next Congress and Administration determine the fate of the DOL's fiduciary duty rulemaking by issuing the final rule at a later time.

In the coming months, the Fiduciary Rule is expected to continue to be the subject of intense debate. Republican Members of the Senate and the House have moved to block the Fiduciary Rule. On April 18, Senate Health, Education, Labor, and Pensions (HELP) Subcommittee on Employment and Workplace Safety Chairman Johnny Isakson (R-GA) introduced a resolution of disapproval under the CRA to stop the Fiduciary Rule with the support of thirty-one Republican Senators, including Senate HELP Committee Chairman Lamar Alexander (R-TN) and Senate Budget Committee Chairman Mike Enzi (R-WY). A day later, House Education and the Workforce Subcommittee on Health, Employment, Labor, and Pensions Chairman Phil Roe (R-TN) introduced a resolution of disapproval in the House with support from Congressman Charles Boustany (R-LA) and Congresswoman Ann Wagner (R-MO). The House Education and the Workforce Committee has marked up and approved the resolution; similar committee consideration is possible in the Senate.

A resolution of disapproval is unlikely to block the Fiduciary Rule. Even if both the Senate and the House approve the resolution, President Obama will veto it. Opponents of the Fiduciary Rule would then need a two-thirds vote in each chamber in order to override the veto, which is unlikely as a sufficient number of Democrats are unlikely to cross party lines. Nevertheless, the resolutions will likely continue to gather support from opponents of the Fiduciary Rule and serve to reinforce their messaging on the rule.

Additionally, Congress will resume its oversight responsibilities and hold a series of hearings on the Fiduciary Rule. Secretary of Labor Thomas Perez said during a recent House Education and the Workforce Committee hearing that he would welcome an opportunity to testify on the Fiduciary Rule and the changes made to the proposed rule. We expect the Chairmen and Ranking Members of the Committees with jurisdiction to take his offer, particularly as Democrats consistently insisted last year to wait until the Fiduciary Rule was released before advancing legislative alternatives. These hearings will serve as a platform for partisan messaging.

Opponents of the Fiduciary Rule will likely revamp efforts to advance standalone legislation dealing with the rulemaking. Bipartisan legislative alternatives to the fiduciary duty rulemaking gaining traction in Congress include the Affordable Retirement Advice Protection Act (H.R.4293), introduced by Chairman Roe (R-TN), and the Strengthening Access to Valuable Education and Retirement Support Act of 2015 (H.R. 4294), introduced by House Ways and Means Subcommittee on Oversight Chairman Peter Roskam (R-IL). The House Education and the Workforce Committee approved the paralleled bills on party-line votes earlier this year. The House Ways and Means Committee advanced H.R. 4294 with Republicans and the bill's main Democratic sponsors in support. Although such efforts will be leveraged for partisan messaging, opponents of the rule are unlikely to garner sufficient support to move these bills through Congress and override the President's veto.

The most promising legislative avenue to try to prevent the Fiduciary Rule from going into effect will likely be a rider to government funding legislation. In March, House Appropriations Subcommittee on Labor, Health and Human Services, and Education Chairman Tom Cole (R-OK) indicated that the fiduciary duty rulemaking is a rider target for the government

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funding bill. A rider in must-pass legislation may put more pressure on President Obama than standalone bills, but it is unlikely to attract sufficient Democrats. A similar effort failed to incorporate a rider into last year's omnibus appropriation bill that would have prevented the DOL from advancing the fiduciary duty rulemaking. Potential riders included measures to prevent the DOL from implementing the rule, as well as a rider that would have required the DOL to open another comment period before finalizing the rule. This was an area of significant contention, but Democrats prevailed against Republicans, allowing the DOL to continue to advance the rulemaking.

In sum, the current political dynamics create significant impediments to Congressional activity to stop the Fiduciary Rule before its "applicability date" (April 2017 for many requirements). Perhaps the political dynamics may need to be reevaluated after November's Presidential and Congressional elections.

Attachment A

Impartial Conduct Standards (81 Fed Reg. at 21077 (Apr. 8, 2016)

The Financial Institution affirmatively states that it and its Advisers will adhere to the following standards and, they in fact, comply with the standards:

(1) When providing investment advice to the Retirement Investor, the Financial Institution and the Adviser(s) provide investment advice that is, at the time of the recommendation, in the Best Interest of the Retirement Investor. As further defined in Section VIII(d) [of the BIC Exemption], such advice reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party;

(2) The recommended transaction will not cause the Financial Institution, Adviser or their Affiliates or Related Entities to receive, directly or indirectly, compensation for their services that is in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2).

(3) Statements by the Financial Institution and its Advisers to the Retirement Investor about the recommended transaction, fees and compensation, Material Conflicts of Interest, and any other matters relevant to a Retirement Investor's investment decisions, will not be materially misleading at the time they are made.

DOL Finalizes The ERISA Fiduciary Regulation -- What It Means For Your Business

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