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The DOL's New Fiduciary Rule: The Details on Disclosure

As discussed in our publication dated April 14, 2016, the final Department of Labor fiduciary rule provides for two new prohibited transaction exemptions, the Best Interest Contract Exemption (the "BIC Exemption") and the Principal Transaction Exemption (the "PT Exemption"). Financial institutions seeking to rely on these exemptions must make detailed disclosures to their retail clients, the Department of Labor and the general public. This publication focuses on these disclosure requirements.[1]

Our April 14 publication discussed the BIC Exemption and the PT Exemption in detail. Financial institutions may rely on the BIC Exemption when receiving certain types of compensation such as 12b-1 fees, commissions and revenue sharing payments that are affected by the investment recommendations and products sold to their retail retirement clients. The PT Exemption may be utilized when a financial institution is a principal in the purchase or sale of certain securities. Note that each of the BIC Exemption and the PT Exemption contain specific definitions of "financial institutions" and "advisers" for purposes of determining what entities may avail themselves of the respective exemptions.

The chart below describes the different disclosure requirements applicable under each of the BIC Exemption and the PT Exemption. In considering the chart, keep in mind the meanings of the following key terms:

- **Best Interest**: For purposes of the exemptions, investment advice is in the Best Interest of the Retirement Investor when the adviser and financial institution providing the advice act with 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.
- **Best Interest Contract**: For purposes of the chart, the term "Best Interest Contract" refers to the financial institution's existing or new client agreements that set forth the terms required by the BIC Exemption. These agreements could include, for example, investment advisory agreements, investment program agreements, account opening agreements, insurance contracts or annuity contracts.

[1] The final rule and related prohibited transaction exemptions are available at: https://www.dol.gov/ebsa/regs/conflictsofinterest.html. For a complete overview of the final rule, please see our client publication: "The US Department of Labor's Final Fiduciary Rule Incorporates Concessions to Financial Industry but Still Poses Key Challenges," available at: http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/04/The-US-Department-of-Labor-Final-Fiduciary-Rule-Incorporates-Concessions-to-Financial-Service-Industry-CGE-041416.pdf.

- **Impartial Conduct Standards**: Under the exemptions, adherence to the Impartial Conduct Standards means that (1) the financial institution and adviser will provide investment advice that is in the Best Interest of the retail retirement client, (2) the compensation received in connection with the recommended transaction is not in excess of reasonable compensation and (3) the financial institution and the adviser do not make materially misleading statements to the retail retirement client regarding the recommended transaction, fees and compensation, material conflicts of interest and any other matters relevant to a retail retirement client's investment decision.

- **Material Conflicts of Interest**: The exemptions note that these exist when an adviser or financial institution has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor.

- **Third-Party Payments**: Under the BIC Exemption, Third-Party Payments refer to sales charges not paid directly by the Retirement Investor, gross dealer concessions, revenue sharing payments, 12b-1 fees, distribution, solicitation or referral fees, volume-based fees, fees for seminars and educational programs and any other compensation, consideration or financial benefit provided to the financial institution or an affiliate by a third party as a result of a transaction involving a Retirement Investor.

Prohibited Transaction Exemption Disclosures

	BIC Exemption	PT Exemption
Primary Contractual Disclosure	**When.** Must be provided to the Retirement Investor prior to or at the same time as the recommended transaction. **Where.** Must be included in the Best Interest Contract or in a single separate written disclosure. **Content.** The financial institution must, in writing: • State the Best Interest standard of care, inform the Retirement Investor of services provided by the financial institution and adviser and describe how the Retirement Investor will pay for services (*e.g*. directly, through Third-Party Payments, through transaction-based payments such as commissions). • Describe Material Conflicts of Interest, disclose any fees the financial institution, adviser or affiliates will impose on the Retirement Investor or the client's account, state the types of Third-Party Payments the financial institution, adviser and affiliates will receive in connection with recommended investments. • Inform the Retirement Investor of his/her right to obtain the financial institution's written description of its policies and procedures designed to ensure compliance with the Impartial Conduct Standards and specific disclosure of costs fees and other compensation, including Third-Party Payments. • Include a link to the financial institution's website (described further below under "Website") and inform the Retirement Investor that model contract disclosures and written descriptions of the financial institutions policies and procedures designed to ensure compliance with the Impartial Conduct Standards are available free of charge on the website. • Disclose whether the financial institution	**When.** Must be provided to the Retirement Investor prior to or at the same time as the execution of the principal transaction or riskless principal transaction. **Where.** Must be provided in the relevant contract or in a single separate written disclosure. **Content.** The financial institution must, in writing: • Describe the circumstances in which the adviser and financial institution may engage in principal transactions and riskless principal transactions with the Retirement Investor. • Provide a description of the types of compensation that the adviser or financial institution may receive in connection with such transactions, including from third parties. • Describe the Material Conflicts of Interest associated with such principal transaction or riskless principal transaction. • Except for existing contracts, provide documentation of the Retirement Investor's written affirmative consent to such principal transaction or riskless principal transaction. • State that the consent to such principal transaction or riskless principal transaction is terminable at will upon written notice by the Retirement Investor at any time without penalty. • State that the Retirement Investor may obtain, free of charge, copies of the financial institution's policies and procedures designed to mitigate Material Conflicts of Interest. • State that model contract disclosures or other model notices of contractual terms, which are reviewed for accuracy at least quarterly and updated within 30 days if necessary, are

	BIC Exemption	PT Exemption
	offers proprietary products or receives Third-Party Payments and the extent to which the financial institution or adviser limits investment recommendations to proprietary products or products that generate Third-Party Payments[2] or any other limitations on the investments that the adviser may offer the Retirement Investor. • Provide telephone and email contact information for a representative of the financial institution for the Retirement Investor to communicate concern about advice or service received and, if applicable, a statement that the Retirement Investor can research the financial institution and advisers through the appropriate government data base (such as FINRA's BrokerCheck or IARD). • Describe whether the adviser and financial institution will monitor the Retirement Investor's investment and alert the Retirement Investor of any recommended change and, if so, the frequency of such monitoring and reasons for alerting the Retirement Investor.	available on the financial institution's website. • Disclose that the financial institution's written description of its policies and procedures designed to ensure compliance with the Impartial Conduct Standards are available free of charge on the financial institution's website. • Provide a description of whether or not the adviser and financial institution will monitor the Retirement Investor's investments that are acquired through the principal transactions and riskless principal transactions and alert the Retirement Investor to any recommended changes to those investments and, if so, how often the monitoring and notifying will occur.
Disclosures Provided in Connection with Specific Transactions	**When.** The financial institution must provide disclosure to the Retirement Investor prior to or at the same time as the execution of the recommended investment. **Where.** Must be provided in a single written document with respect to each transaction. However, the disclosures do not have to be repeated for subsequent recommendations of the same product within one year of either a previous contract disclosure or transaction-based disclosure. **Content.** The financial institution must: • State the Best Interest standard of care and describe any Material Conflicts of Interest.	**When.** The financial institution must provide disclosure to the Retirement Investor prior to or at the same time as the execution of the principal transaction or riskless principal transaction. **Where.** May be communicated orally or in writing. **Content.** The adviser or financial institution must inform the Retirement Investor of the capacity in which the financial institution may act with respect to such transaction.

2 A disclosure is insufficient if it states only that the financial institution or adviser "may" limit recommendation based on these factors without specifically disclosing the extent to which recommendations are actually limited on that basis.

	BIC Exemption	PT Exemption
	• Inform the Retirement Investor of his/her right to obtain the financial institution's written description of its policies and procedures designed to ensure compliance with the Impartial Conduct Standards and specific disclosure of costs fees and other compensation, including Third-Party Payments. • Include a link to the financial institution's website (described further below under "Website") and inform the Retirement Investor that model contract disclosures and written descriptions of the financial institutions policies and procedures designed to ensure compliance with the Impartial Conduct Standards are available free of charge on the website.	
Confirmation	Not applicable.	**When.** The financial institution must provide disclosure to the Retirement Investor at or before completion of the transaction. **Where.** Must be communicated in writing. **Content.** The adviser or the financial institution must provide confirmation of the principal transaction or riskless principal transaction.[3]
Annual Disclosures	Not applicable.	**When.** The adviser or the financial institution must provide the Retirement Investor the disclosure no less than annually. **Where.** Must be provided in a single written disclosure. **Content.** The annual disclosure must provide: • A list identifying each principal transaction and riskless principal transaction executed in the Retirement Investor's account in reliance on the PT Exemption during the applicable period, the date of the transaction and the

[3] This requirement may be satisfied by compliance with Rule 10b-10 under the Securities Exchange Act of 1934, as amended, or for advisers or financial institutions not subject to such Act, by complying with similar requirements imposed by another regulator or self-regulatory organization.

	BIC Exemption	PT Exemption
		price of the transaction. • A statement that the Retirement Investor's consent to such transactions is terminable at will upon written notice and without penalty. • A statement that the Retirement Investor may obtain, free of charge, information about the Principal Traded Asset. • A statement that model contract disclosures or other model notices of contractual terms, which are reviewed for accuracy at least quarterly and updated within 30 days if necessary, are available on the financial institution's website. • A statement that the financial institution's written description of its policies and procedures designed to ensure compliance with the Impartial Conduct Standards are available free of charge on the financial institution's website.
Website	**Content.** The financial institution must maintain a public website that includes: • A discussion of the financial institution's business model and Material Conflicts of Interest associated with the business model. • A schedule of typical account and contract fees and service charges. • A model contract or other model notice of contractual terms. • A written description of the financial institution's policies and procedures that describes or summarizes key conflict-mitigating components. • A list of all product manufacturers and other parties that provide Third-Party Payments to the financial institution or adviser in connection with recommended investments or products and a description of the arrangements, including how they impact adviser compensation and benefits provided by the financial institution in	**Content.** The financial institution must maintain a public website that includes: • A written summary of the financial institution's policies and procedures relating to mitigation of Material Conflicts of Interest and to incentive practices (this description must also be provided to Retirement Investors directly free of charge upon request).

	BIC Exemption	PT Exemption
	exchange for Third-Party Payments. • Disclosure of the financial institution's compensation and incentive arrangements with advisers, including incentives for recommending particular products, for advisers to move to the financial institution or stay at the financial institution and description of the payout or compensation grids.	

SHEARMAN & STERLING LLP

CONTACTS

John J. Cannon III
New York
+ 1.212.848.8159
jcannon@shearman.com

Nathan J. Greene
New York
+ 1.212.848.4668
ngreene@shearman.com

Adam S. Hakki
New York
+ 1.212.848.4924
ahakki@shearman.com

Kenneth J. Laverriere
New York
+ 1.212.848.8172
klaverriere@shearman.com

Doreen E. Lilienfeld
New York
+ 1.212.848.7171
dlilienfeld@shearman.com

Thomas M. Majewski
New York
+ 1.212.848.7182
thomas.majewski@shearman.com

Brian H. Polovoy
New York
+ 1.212.848.4703
bpolovoy@shearman.com

Linda E. Rappaport
New York
+ 1.212.848.7004
lrappaport@shearman.com

Russell D. Sacks
New York
+ 1.212.848.7585
rsacks@shearman.com

Paul S. Schreiber
New York
+ 1.212.848.8920
pschreiber@shearman.com