



DOL'S New Fiduciary Conflicts of Interest Rules *By: Thomas K. Potter, III*

The U.S. Department of Labor recently announced a new suite of Rules that are a game-changer for any Financial Institution that gives investment advice (including rollovers and distributions) to owners or beneficiaries of IRAs, HSAs, Archer Medical Savings Accounts, Coverdells, ERISA Plans and more.*

I. What Do the Rules Do?

The Rules were designed to address conflicts of interest affecting investment advice to retirement investors when advisors who are fiduciaries receive compensation (direct or indirect) that may vary with the advice given (“differential compensation”). The Rules prohibit some activities and seek to provide measures to protect investors, while allowing some traditional compensation practices common in the market.

The Rules lay down a sweeping definition of who is a fiduciary with respect to any ERISA plan or “qualified-money” retirement or tax-deferred account. Some transactions and relationships are “exclusions” to the “investment advice” definition. But those who are fiduciaries to retirement investors can avoid prohibited transaction liability, but must comply with substantial “Impartial Conduct Standards,” conflict-management supervision and compliance requirements and disclosure requirements in order to meet the requirements of various administrative “exemptions” to the Rule.

The new Rules – over 1,000 pages of regulatory text in all – require substantial compliance by **April 10, 2017** and full compliance by **January 1, 2018**.

Compliance with the Rules will entail significant enterprise inventory, process management, new contractual terms and expanded public and client disclosures. Many firms may need to reconsider basic business strategies.

The Rules’ requirements create an entirely new private cause of action for Retirement Investors. And failure to comply exposes firms not merely to regulatory risk, but also to could lead to personal liability [ERISA § 405, 409], excise taxes [IRC § 4975] and civil penalties under ERISA [§ 502(i)].

The main Rule is at 81 FR 20946, 29 CFR Parts 2509, 2510, and 2550.

II. Who's a Fiduciary?

Until April 10, 2017, ERISA’s existing 5-part test remains: (1) advice regarding securities or property; (2) on regular basis; (3) under a mutual agreement; (4) that the advice is the primary basis for investment of plan assets; and (5) the advice is individualized.

* These are summaries only. Consult the text of the applicable Rule or Exemption and your advisor to be sure you understand how they apply to your circumstances.

Starting April 10, 2017, a new “3+3” test imposes fiduciary status when **any 1 from each column** (independent prongs) applies:

Receive a fee (direct or indirect) and...	
Recommendation: “Communication that, based on its content, context, and presentation would reasonably be viewed as a suggestion that recipient take or refrain from a particular course of action.”	<ul style="list-style-type: none"> › objective test › modeled after FINRA Rule › the more tailored, the more likely a recommendation › a selective list = a recommendation › series of actions together may be a recommendation › robo-advice not exempt
re:	And:
Buy, hold or sell in a plan or IRA	Admitted Fiduciary
Rollover, transfer or distribution from plan or IRA	Provides advice “with understanding” it’s based on recipient’s needs
Manage investments within plan or IRA (includes strategies and fiduciary referrals)	Advice regarding a particular investment decision to specific recipients

A. Fiduciary Exclusions.

The Rule sets up some overall **exclusions** to the broad fiduciary duty.

But Not Advice Exclusions:	
Re Plans -	
› Platform Providers	to independent plan fiduciary
› Selection & Monitoring Assistance	to independent plan fiduciary
Re Plans & IRAs, etc.	
› “Hire me”	only if unaccompanied by recommendation (NB: hire me and roll out of your 401k/plan is a recommendation)
› General communications	journalism, general circulation newsletters, market data, prospectuses
› Investment Education	Plan information; general investment theory; asset allocation models; interactive general materials <ul style="list-style-type: none"> • based on well-accepted investment theory • no reference to specific products
But Not Advice “Carve-Outs”	
› Sophisticated Counterparty (“Seller”)	no-fee in arms’-length transaction with expert independent fiduciary that’s a bank, insurance carrier or BD or regulated institution with > \$50M AUM + disclaimer & disclosure of financial interest
› Swaps Transactions	but only for Plans, not IRAs
› Plan Sponsor / affiliate to employees	about attributes of employer plan
› BD pure execution services	Pure execution of non-discretionary agency trades for plan fiduciaries

III. “Safe Lane” Exemptions.

If your investment advice (recommendations) to Plans or Retirement Investors (any IRA owner or beneficiary) makes you a **fiduciary**, then you must fall within an **exemption** to avoid having prohibited transactions.

A. Administrative Exemptions to the Rule.

The 15 exemptions are designed to allow **fiduciaries** to receive “differential compensation,” while providing contractual, conduct, procedural (supervision and compliance) and disclosure requirements aimed at protecting investors and promoting more fully-informed investment decisions.

Because they provide exemptions for conduct otherwise subject to the Rule, non-compliance with any of their requirements can result in a prohibited transaction. To rely on a “safe-lane” exemption, you must stay in your lane.

Overview of Exemptions (= “safe lanes”)	
Exemption	Generally, for
Best Interest Contract (“BIC”)	The basic, broadest, exemption for Financial Institutions, covering most brokerage and rollover/distribution relationships
BIC Light	“Level-fee” fiduciaries
BIC Plus	Financial Institutions with limited product platforms
Bank Networking Agreements	Under banking regs.
Insurance / Annuities	Pre-existing party-in-interest or otherwise disqualified FI’s can engage in transactions, provided the transaction is: (1) ordinary-course; (2) yields only “reasonable compensation”; (3) on terms at least as favorable as an arms-length 3 rd party transaction.
Pre-Existing Transactions	Grandfathers transactions (e.g. SWIP, exchanges, dividend sweeps) before April 10, 2017 and hold/sell recommendations after (but not comp changes)
Principal Transactions	Fixed-income transactions
PTE 75-1(V)	BD margin in nondiscretionary accounts to avoid fails
PTE 75-1(III)	Offerings bought from unaffiliated syndicate member where fiduciary is syndicate member
PTE 77-4(IV)	Affiliated open-end mutual funds
PTE 80-83	Securities where proceeds retire issuer’s debt to affiliate
PTE 83-1	Mortgage pool certificates sponsored, trustees or insured by fiduciary or affiliate
PTE 84-24	Insurance (fixed rate annuities) & traditional mutual funds (no variable or indexed annuities)
PTE 86-128	Commission from affiliated brokerage (agency trades or crosses; government market-making) or unaffiliated mutual funds – for advisory IRAs
Frost / SunAmerica	Offset or credit-back arrangements

B. Impartial Conduct Standards.

Virtually all of the “safe-lane” exemptions depend upon a Financial Institution’s adoption of and adherence to Impartial Conduct Standards. They require:

(1) **Advice in the Best Interest** of the Retirement Investor, at the time given, that:

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.*

This standard combines the fiduciary duties of prudence (a documented process of care) and loyalty (the investor’s interest over yours).

(2) Receipt of only **Reasonable Compensation** ... a long-standing definition under ERISA § 408(b)(1); IRC § 4975(d)(2) that looks to the facts and circumstances of the overall services rendered, benchmarked to the market and documented.

(3) **Not Misleading** information (transaction details; fees & compensation; Material Conflicts].

C. The Best Interest Contract (“BIC”) Exemption.

The basic, broadest exemption is the Best Interest Contract (“BIC”) exemption. It allows Financial Institutions to receive compensation for investment advice to non-ERISA Plans, IRAs, and Retail Fiduciaries by adopting an investor contract that:

- Acknowledges the Institution and Advisors fiduciary status;
- Warrants the FI’s adoption of and compliance with anti-conflicts policies and procedures, described on your website in greater detail and available at no cost on request;
- Discloses any Material Conflicts of Interest and describes how they are handled, with an identified Chief Conflicts Officer (not unlike that section of an RIA’s ADV Part 2); and,
- Complies with mandatory 3-tiered disclosure: (i) point of sale; with (ii) more specifics available; and (iii) a public web link;

together with some other requirements.

Many of the “safe-lane” exemptions require all or part of the BIC’s requirements, so they are presented here in some greater detail:

Best Interest Contract	81 FR 21002, 29 CFR Part 2550	
Topic	Requirement Summary	Reg §
Who	Financial Institution (“FI”) and “Retirement Investor” (1) participant or beneficiary in self-directed Plan or IRA; (2) beneficial owner acting for his IRA; (3) Retail Fiduciary (not bank, BD, insurer and <\$50M AUM)	I(b)
Not Available To	<ul style="list-style-type: none"> • Plan Fiduciaries • Principal Transactions (use exemption 81 FR 21089) • Robo-Advisors (neutral web-based interactive program based on investor input) • Discretionary Accounts 	I(c)
Contract	<ul style="list-style-type: none"> • Enforceable written contract • May be a master • Expressly covers advice prior to execution to secure exemption • Copy web-available to investor through account logon 	II(a, f)
Contract Formation	<p>(i) New Contracts:</p> <ul style="list-style-type: none"> • Before or with execution • Stand-alone or part of new-account / amendments • Electronic signatures ok <p>(ii) Amendments:</p> <ul style="list-style-type: none"> • Delivered before Dec. 1, 2017 (allows 30-day rescission) • Mail or electronic delivery • Negative Consent ok, BUT no new investor obligations, liabilities or restrictions 	II(a)
Fiduciary Acknowledgement	States affirmatively that FI and Advisor(s) act as fiduciaries under ERISA and IRC w/r/t advice under this Agreement NB: new cause of action for breach – in arbitration or court (state, unless diversity)	II(b)
Impartial Conduct Standards	Affirmatively states that FI and Advisor(s) will comply	II(c)
Warranties re Conflicts of Interest Program	Affirmative warranties [NB: suit for breach]: (1) FI adopted & complies with WSPs for Impartial Conduct Standards (2) FI’s program: (a) specifically identified & documented Material Conflicts of Interest; (b) adopted measures to prevent them for violating Impartial Conduct Standards; (c) no comp practices that incentivize violations of Impartial Conduct Standards	II(d)
Contract May Not Have	(1) Exculpatory or limitation of liability provisions; (2) Class-action waivers or limitations or Liquidated damages provisions ...but may waive punitive damages or rescission if state law permits... (3) Unreasonable (e.g. distant venue) arbitration provisions [NB: arbitration clause is allowed subject to industry rules]	I(f)

<p>Disclosures – POS</p>	<p>(in BIC or separate document incorporated by reference delivered contemporaneously):</p> <p>(1) States: (i) Best Interest Standard; (ii) Services provided under Contract; (iii) How Investor will pay (including indirect or 3rd party).</p> <p>(2) Describes: (i) Material Conflicts of Interest; (ii) Any fees or charges on Account; (iii) Types of expected 3rd party comp.</p> <p>(3) Informs how to get free: (i) Written description of WSPs; (ii) Specific disclosures of costs, fees and comp for recommended transactions (in relative context).</p> <p>(4) Web-link [NB: public] to: (i) model disclosure contract updated quarterly; (ii) written description of WSPs.</p> <p>(5) Discloses: (i) Whether FI offers proprietary products; (ii) What limits on any limited product offerings (“may limit” won’t work).</p> <p>(6) Contact Info: (i) For FI ombudsman or Chief Conflicts Officer; (ii) For BrokerCheck, IARD or similar.</p> <p>(7) Describes Account Monitoring: whether; frequency; basis for alerts.</p> <p>...updated annually or with any material change.</p>	<p>II(e); III(a)</p>
<p>Disclosures – Available on Request</p>	<ul style="list-style-type: none"> • written description of WSPs • specific transaction cost, fees and comp • NB: If requested pre-transaction, provide pre-transaction; otherwise within 30 days. 	<p>II(c)(3) III(a)</p>
<p>Disclosures - Web</p>	<p>(1) Free to public generally:</p> <p>(i) Discussion FI’s business model and its Material Conflicts;</p> <p>(ii) Schedule of typical account or contract fees and service charges;</p> <p>(iii) Model Contract and Disclosures, reviewed quarterly and updated within 30 days if necessary;</p> <p>(iv) Written description of WSPs with summary of key provisions for conflict-mitigation and incentive practices;</p> <p>(v) As applicable, a list of all product manufacturers and parties providing 3rd party payments</p> <ul style="list-style-type: none"> • by product or class • description of arrangements • whether and how they impact FA comp; • benefits from FI to provider in exchange. <p>(vi) Disclosure of FI’s compensation and incentive arrangements with FA’s, including recruiting or retention and full and fair description of grids.</p> <p>(vii) May use bands, ranges, etc. so long as fair and reasonable to informed decision-making</p> <p>(2) If this info is in other required disclosures, you can post them with a link to access.</p> <p>(3) Unless otherwise prohibited by law.</p>	<p>III(b)(1)</p>
<p>Notice to DOL</p>	<p>Of intent to rely on BIC by emailing e_BICE@dol.gov, eff. until written revocation</p>	<p>V(a)</p>

Record Retention	<ul style="list-style-type: none"> • Period of use + 6 years; • Available for exam by DOL, IRS, Plan fiduciaries and IRA owners 	V(b-c)
Compliance Deadlines	<ul style="list-style-type: none"> • April 10, 2017: substantive compliance with Best Interest Standard; fiduciary acknowledgement, and Disclosures (including Material Conflicts); designate CCfO • January 1, 2018: stand up formal BIC Contracts, WSPs, all disclosures and website 	IX

D. Other Exemption Summaries.

1. “BIC Light.” Subsection II(h) of the BIC Exemption excuses “Level-fee” Fiduciaries (those without *any* differential comp at either the FI or Advisor level) from compliance with BIC § § II(a, d-g), III and IV (81 FR 21002, 29 CFR Part 2550), ***so long as*** the Level-Fee Fiduciary:

- Acknowledges its fiduciary status;
- Complies with Impartial Conduct Standards;
- Documents the specific reasons why a Plan-to-IRA roll-over recommendation was Best Interest, addressing:
 - (i) All alternatives (including leave it alone);
 - (ii) Fees/expenses;
 - (iii) Employer pays?
 - (iv) Comparison services/investments available
 - (v) If Commission or IRA to level-fee, why? (describing any additional services available).

2. “BIC Plus.” Subsection IV of the BIC Exemption allows those Financial Institutions that restrict FA’s to proprietary products (even in part) or 3rd-party-payment products to use the BIC exemption, but impose additional requirements for these FI’s to meet the Best Interest Standard. BIC-Plus FIs also must [§ IV (b)]:

- (1) Inform (at POS) of limitations on product offering, how, and on what basis;
- (2) Describe (at POS) Material Conflicts of Interest (and also comply with BIC POS and web-based disclosure requirements);
- (3) Maintains written documentation of
 - Limitations
 - Material Conflicts of Interest
 - Services the FI provides to payors
 - FI’s reasonable conclusion (and basis) the product-offering limitations don’t violate the reasonable compensation requirement;
 - FI’s reasonable conclusion (and basis) it’s program will not cause imprudent recommendations by the FI and its FA’s.
- (4) Adopts WSPs and incentive practice limitations
- (5) Only reasonable comp expected at time of recommendation
- (6) Fiduciary / Impartial Conduct Standards

(81 FR 21002 §IV(b), 29 CFR Part 2550).

3. Bank Networking Agreements. Subsection II(i) of the BIC Exemption allows Bank FI's and Bank-employee FA's to receive compensation under a Bank Networking Agreement, provided only that the advice adheres to the Impartial Conduct Standards.

4. Purchases & Sales, Including Insurance & Annuities. Section VI of the BIC Exemption allows FI's having a pre-existing party-in-interest or service-provider relationship with a Plan or IRA (thus otherwise would be disqualified under ERISA) to engage in transactions, provided the transaction is: (1) ordinary-course; (2) yields only "reasonable compensation"; (3) on terms at least as favorable as an arms-length 3rd party transaction.

This exemption is not available to: (1) Named Fiduciary to Plan; (2) Principal Transaction compensation (but not Riskless Principal Transaction); (3) Robo-advice, unless it is BIC-light compliant for a Level-Fee Fiduciary; or to (4) Discretionary accounts.

5. Pre-Existing Transactions. Section VII of the BIC Exemption grandfathers post-effective compensation (trails) from transactions and strategies (*e.g.* SWIP, exchanges, dividend sweeps) executed before April 10, 2017 and hold/sell recommendations on the same property thereafter (but not comp changes). It provides the Rule does not apply to:

- (i) Property acquired before April 10, 2017; or,
- (ii) Acquired per prior recommendation to adhere to systematic purchase program

So long as:

- (1) It is at the prior comp terms (not expired or renewed);
- (2) Was not a violation when it occurred;
- (3) Results in no new comp; DOL explicitly stated this exemption does apply to mutual fund exchanges or prior rebalancing plan [**NB:** any additional comp requires put-back];
- (4) The comp is not unreasonable; and
- (5) Any new recommendations made with fiduciary prudence.

6. Principal Transactions and Fixed-income Transactions. A separate exemption (81 FR 21089, 29 CFR Part 2550) allows certain principal and riskless-principal transactions in a modified-BIC setting with requirements including:

The Exemption doesn't apply to Discretionary Authority or ERISA Plans. § I(c).

Contract, Impartial Conduct & Conditions, § II, including:

- (a) Contracts: A modified BIC contract
- (c)(2) with a best-execution clause complying with FINRA 2121, 5310
- (d)(4) WSPs that address credit risk and liquidity assessment methods
- (e)(2) Investor prior affirmative written consent
- (e)(3) factors / markets disclosures

Conditions, § III, including:

- (a) Debt Securities –
 - (1-2) for which the FI or FA isn't an issuer or underwriter
 - (3) Determined to be (i) moderate credit risk; (ii) sufficiently liquid for reasonable prompt sale at or near carrying value

- (c) Cash sales

Disclosures, § IV, including: (a) Pre-trade verbal re capacity; (b) Confirm per Rule 10b-10; (c) Annual disclosure, (i) Listing principal trades, etc.

Definitions, § VI, that limit (d) Debt Securities to US dollar-denominated registered corporates; agency or GSE or Treasuries; and (e) FI's = banks, SEC RIAs, BDs

7. BD Extension of Credit to Avoid Fails. PTE 75-1(V) allows BDs to extend margin in nondiscretionary accounts to avoid fails. (81 FR 21139, 29 CFR Part 2550).

8. Offerings from Unaffiliated Syndicate Members. PTE 75-1(III) applies the Impartial Conduct Standard, then allows Investors to purchase offerings from unaffiliated syndicate members where a Fiduciary is syndicate member. (81 FR 212087, 29 CFR Part 2550).

9. Affiliated Open-End Mutual Funds. PTE 77-4(IV) applies the Impartial Conduct Standard, then allows purchases from affiliated open-end mutual funds. (81 FR 212087, 29 CFR Part 2550).

10. Securities Retiring Issuer's Debt to Affiliate. PTE 80-83 applies the Impartial Conduct Standard, then allows purchases of securities where proceeds retire issuer's debt to affiliate. (81 FR 212087, 29 CFR Part 2550).

11. Mortgage Pool Certificates. PTE 83-1 applies the Impartial Conduct Standard, then allows purchases of mortgage pool certificates sponsored, trustee or insured by fiduciary or affiliate. (81 FR 212087, 29 CFR Part 2550).

12. Insurance & Traditional Mutual Funds. PTE 84-24 applies the Impartial Conduct Standard and some abbreviated Disclosure requirements with advance written authorization, then allows purchases of insurance (fixed rate annuities) & traditional mutual funds, but does not include no variable or indexed annuities. (81 FR 21147, 29 CFR Part 2550).

13. Affiliated Brokerage. PTE 86-128 allows commission from affiliated brokerage (agency trades or crosses; government market-making) or unaffiliated mutual funds – for advisory IRAs, upon application of the Impartial Conduct Standards, advance written authorization and other disclosures, advance written authorization and quarterly/annual reporting. (81 FR 21181, 29 CFR Part 2550).

14. Offset or Credit-Back. The Department's prior *Frost / SunAmerica* opinions allow Fiduciaries to "cure" otherwise prohibited transaction through certain offset or credit-back arrangements. *Sun America (AO 2001-09A)*; *Frost (AO 97-15A)*; *CountryTrust (AO 95-10A)*.

E. Comparative Table. A Table comparing the various exemptions and their requirements is Attachment A.

IV. How Do I Get There?

A. Identify & Commit Enterprise Stakeholders.

Who are your stakeholders (operations, technology, compliance, legal, compensation, product offerings, management)? Get them involved and all rowing together.

Get dedicated internal resources (not a side project in addition to someone's day job).

Focus from the start on execution with GANNT charts or other project management techniques and contemporaneous communication along the way.

Estimate man hours per task, aggregated (div. 10) = x (new) FTE. Then get senior management on board with resources.

B. Assess Your Business Model(s).

Examine and know your business model:

- (1) Client distributions and points of interaction;
- (2) Product offerings
- (3) Existing compensation practices
 - (a) Internal grids, practices, incentives;
 - (b) Third party relationships, revenues, payments
- (4) Upstream relationships

against the conflicts of interest subject of the new Rule and the "categories" of Exclusions and Exemptions.

C. Inventory.

Compare your assessments of your Engagement Model(s), Product Offerings and Compensation Practices to identify

- (1) Material Conflicts of Interest
- (2) Existing Conflicts Disclosures
- (3) Existing WSPs or Controls to eliminate or mitigate them
- (4) "Heat Maps" or Gap Analysis for each Model
- (5) Existing Resources you can cannibalize:
 - (a) Borrow from the ERISA Plan world and RIA materials;
 - (b) Organizations (SIFMA, IAA, NSCP)
 - (c) Vendors and third-parties: Sellers, Fund Complexes

D. Decide on Engagement Model(s) for Exemption(s).

Decide which parts of your present engagement models you can keep and which will need to change or be eliminated.

You may need to limit product offerings to reduce the number of product / conflict assessments and disclosures.

Can you ring-fence transactions in accounts that comply with the Exemptions, with accompanying Supervision and Compliance systems.

E. Design Supervision & Compliance.

(1) Roles and Responsibilities

Chief Conflicts Officer needs to be in the business (not staff or compliance)

(2) Supervision

- (a) Decide compliant work flow / client relationship norms first, then craft WSPs/compliance around that. Because they'll be publicly available (described), do not make them overly-ambitious.
- (b) Land on a tool that documents easily, e.g. drop down menus, etc. in notating customer interactions and preserving it for supervision; checklists; enforcement mechanisms (internally)
 - Use CRM/holding page technology – make it mandatory now. Leverage existing systems / processes.
 - Use worksheets, decision-tree to force best-interest decision and document roll-over and similar events
 - Planning tools? Verification of neutrality? ...build into documentation
- (c) Website disclosures (comp; procedures; how manage conflicts) and WSPs/workflow to maintain that quarterly (with corrective action) ... must be technologically-enabled (i.e. feed from funds and distributors) rather than manual process

(3) Compliance

Verification and correction processes? Note the correction deadlines within the Rule (30 days for written; 7 days for web).

How will you surveil? Testing?

F. Training & More Training.

Training & communication is key to change behavior w/r/t retirement accounts.

Don't wait until you're done. But make it ongoing and from senior business leaders.

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