

# Chapman Client Alert

October 31, 2016

Current Issues Relevant to Our Clients

## Department of Labor Issues First Wave of FAQs to Explain Fiduciary Rule

As anticipated, on October 27, 2016, the Department of Labor (the “DOL”) issued its first wave of FAQs to address certain questions that have arisen with respect to the DOL’s previously issued fiduciary rule (the “Rule”). Generally, the Rule broadly defines who is a fiduciary under the Employee Retirement Income Security Act and the Internal Revenue Code and provides that parties providing fiduciary investment advice to plan sponsors, plan participant, and IRA owners are not permitted to receive payments that create conflicts of interest without complying with protective conditions in a prohibited transaction exemption. The FAQs mostly address questions under the DOL’s recently issued and/or amended prohibited transaction exemptions. The FAQs include no surprises or reversals to the previously published exemptions. Finally, the FAQs do not answer the questions that many product manufacturers and wholesalers have regarding the Rule.

Although there has been speculation that the DOL may delay the Rule’s April 10, 2017 applicability date, the FAQs indicate that the DOL believes that such date is appropriate and provides adequate time for plans and financial services providers to adjust to the change from non-fiduciary to fiduciary status. Note that the Best Interest Contract Exemption (the “BIC Exemption”) and Principal Transactions Exemption have a phased implementation that extends to January 1, 2018.

The DOL indicated that although it has broad authority to investigate and audit plans and plan fiduciaries, compliance assistance is a high priority. Its general approach to implementation of the Rule will be to emphasize assistance to plans, plan fiduciaries, and financial institutions who are working diligently and in good faith to understand and come into compliance with the new Rule and Exemptions.

The following are some of the highlights included in the FAQs:

- The BIC Exemption covers recommendations to retail investors with respect to all categories of assets, advice to roll over plan assets, and recommendations of persons that the customer should hire to serve as investment advisers and managers.
- Simply executing a transaction at the customer’s direction does not make a person a fiduciary. Similarly, the recommendations of a particular investment without the receipt of direct or indirect compensation does not make a person a fiduciary.
- Under the Rule, compensation is broadly defined to include any fee for advice required by the adviser (or affiliate) from any source in connection with the recommended purchase or sale of a security or the provision of investment advice services “including, though not limited to, commissions, loads, finder’s fees, revenue sharing payments, shareholder servicing fees, marketing or distribution fees, underwriting compensation, payments to brokerage firms in return for shelf space, recruitment compensation paid in connection with transfers of accounts to a registered representative’s new broker-dealer firm, gifts and gratuities, and expense reimbursements.”
- The receipt of fixed fees by advisers typically does not, in and of itself, raise prohibited transaction concerns. However, a conflict of interest will exist, for example, if an adviser recommends that a participant roll retirement savings out of a plan into a fee-based account that will generate ongoing fees for the adviser. The streamlined “BIC Lite Exemption” could be used by “level fee fiduciaries” to exempt the compensation from being a prohibited transaction.
- The BIC Exemption provides relief for investment advice to roll over a plan account into an IRA even if the adviser will subsequently serve as a discretionary investment manager with respect to the IRA as long as the adviser does not have discretionary authority or control with respect to the decision to rollover assets to the IRA.
- The BIC Exemption does not cover discretionary advice, including discretionary asset management advice. The conditions of the BIC Exemption are tailored to conflicts that arise in the context of the provision of investment advice, not the conflicts that could arise with respect to a discretionary money manager.

- Escalating incentive compensation payments to the adviser are possible as long as such payments are developed by taking specified “neutral” factors into account. For example, greater compensation cannot be paid to an adviser who sells higher margin products.
- The BIC Exemption is generally not available for robo-advice because the DOL views the marketplace for robo-advice as still evolving in ways that appear to avoid conflicts of interest and that minimize cost.
- As long as a financial institution has established a pricing schedule that meets the impartial conduct standards, including the reasonable compensation standard, it is permissible for advisers to discount prices for certain individual clients under the BIC Exemption.
- The FAQs mention that whether compensation is reasonable depends on the particular facts and circumstances. The essential question is whether the charges are reasonable in relation to what is received by the investor. Financial institutions should consider market prices and benchmarks, provide proper disclosure of relevant costs, charges and conflicts of interest, and prudently evaluate the customer’s need for services.
- Financial institutions may maintain certain adviser recruiting bonus programs and still comply with the BIC Exemption, provided such programs are not contingent on sales or production targets.
- In order to comply with the BIC Lite Exemption in relation to a rollover to an IRA, level fee fiduciaries must document the reasons the rollover was recommended, including whether all alternatives were considered, the fees and expenses associated with both the plan and IRA, whether the employer pays some or all of the plan’s administrative expense and the different level of services and investments available under each option. The adviser must be diligent and prudent in obtaining the necessary information on the plan in order to provide rollover advice.
- Level fee fiduciaries may rely on the BIC Lite Exemption as long as their compensation does not vary with the particular investment recommended. If an adviser is going to recommend products that generate third party payments that are transaction-based fees (such as 12b-1 fees and revenue sharing payments), the adviser must rely on the full BIC Exemption. However, it is possible for advisers to rely on the full BIC Exemption and the BIC Lite Exemption for different accounts depending on the manner of charging fees.
- The BIC Lite Exemption is not available for commission or transaction-based compensation arrangements that are limited to the sale of proprietary products.
- Financial institutions can amend existing contracts with investors to add the BIC Exemption requirements by using negative consent. If the financial institution elects to use a negative consent procedure, it may deliver the proposed amendment by mail, electronically or by posting the contract amendment in each retirement investor’s account. It may not, however, impose any new contractual obligations, restrictions, or liabilities by negative consent.

### For More Information

If you would like further information regarding the FAQs discussed in this article or the DOL Rule in general, please contact the attorney with whom you regularly work.

## Chapman and Cutler LLP

Attorneys at Law · Focused on Finance®

This document has been prepared by Chapman and Cutler LLP attorneys for informational purposes only. It is general in nature and based on authorities that are subject to change. It is not intended as legal advice. Accordingly, readers should consult with, and seek the advice of, their own counsel with respect to any individual situation that involves the material contained in this document, the application of such material to their specific circumstances, or any questions relating to their own affairs that may be raised by such material.

To the extent that any part of this summary is interpreted to provide tax advice, (i) no taxpayer may rely upon this summary for the purposes of avoiding penalties, (ii) this summary may be interpreted for tax purposes as being prepared in connection with the promotion of the transactions described, and (iii) taxpayers should consult independent tax advisors.

© 2016 Chapman and Cutler LLP. All rights reserved. Attorney Advertising Material.