On April 8, 2016, the U.S. Department of Labor ("DOL") published its final regulation (the "Final Rule") defining the term "fiduciary" for purposes of identifying persons who provide "investment advice" to ERISA plans, plan fiduciaries, participants and beneficiaries, IRAs and IRA owners. The new definition will become applicable on April 10, 2017 and is expected to profoundly alter the marketplace for investment-related services and products both at the plan level and at an individual participant and IRA holder level.

As part of its preamble to the Final Rule, DOL observes that the determination of who is a "fiduciary" is of central importance under the statutory framework of ERISA and the Internal Revenue Code of 1986 ("Code") since the protections, duties and liabilities under ERISA and the Code largely hinge on fiduciary status. Under these statutes, persons who are plan fiduciaries are obligated, when acting as such, to make decisions prudently and with undivided loyalty to the plan, its participants and beneficiaries. Moreover, plan fiduciaries have a duty to refrain from engaging in any of the "prohibited transactions" identified under ERISA, including the prohibitions against engaging in transactions that involve conflicts of interest or that may result in payments to the fiduciary by third parties dealing with the plan unless an exemption is available either under the statute itself or in the form of an administrative exemption granted by DOL.

Today, many plan and IRA product and service providers who are non-fiduciaries are permitted to make various programs and services available to plans, participants and IRAs even though they may have a direct or indirect financial interest in the investment or investment-related services they are offering. Under the Final Rule, many of these product and service providers will be re-characterized as fiduciaries. Once fiduciary status attaches, many financial arrangements that are today permissible may instead give rise to conflicts of interest that are prohibited unless and to the extent that prohibited transaction exemption relief is available. Recognizing this, DOL has in connection with the Final Rule also published significant new prohibited transaction exemptions to provide a pathway for soon-to-be newly identified fiduciaries to obtain prohibited transaction exemption relief. As discussed below, DOLs new "Best Interest Contract" or "BIC" exemption will be a key source of exemptive relief for many service providers from and after April 10, 2017, when the Final Rule will become applicable.

1 References in this article to ERISA's prohibited transaction restrictions should, unless otherwise noted, be read to include reference to the parallel restrictions under section 4975 of the Code.

2 In connection with the Final Rule, DOL also amended a number of existing prohibited transaction exemptions and granted a new principal transaction exemption.
A Summary of the Final Rule

Under the Final Rule, fiduciary status is generally triggered where a person provides a recommendation to a plan, plan fiduciary, participant, IRA or IRA holder concerning either

1. The advisability of buying, holding, or selling securities or other investments, including the investment of amounts rolled over from a plan or IRA, or
2. The management of securities or investment property including recommendations of investment policies or strategies, third-party investment advice providers or investment managers, investment account arrangements (e.g., brokerage vs. advisory) and recommendations of rollovers, transfers or distributions from a plan or IRA including their amount, form and destination.

Readers may wish to note the decided emphasis placed on rollover recommendations in both of these covered advice prongs; regulating the IRA rollover industry is a core DOL objective that is advanced through the Final Rule.

A “recommendation” is defined as a communication which, based on context, content and presentation, would reasonably be viewed as a suggestion to the recipient to engage in or refrain from engaging in a particular course of action. Communications that are general in nature and that a reasonable person would not regard as an investment recommendation, such as general marketing materials, general market data, or other research and news reports prepared for general distribution are excluded from the Final Rule’s definition of recommendation. Individually tailored communications to specific advice recipients about particular investments or investment strategies would likely give rise to a recommendation; the more individually tailored the communication, the more likely it will be viewed as a recommendation.

In addition to general communications, the Final Rule also lists two other categories of informational services that do not give rise to “recommendation” as follows:

1. Marketing or making available a “platform” of investment alternatives. While the Final Rule does not define the term “platform”, it indicates that providers who make available an array of investment alternatives from which a plan fiduciary may select the plan's menu of investment options
   • do not act as fiduciaries so long as the platform itself is not marketed in a manner that is individualized to the needs of the plan or its participants,
   • the platform provider discloses to the plan fiduciary responsible for selecting the plan’s investment option menu that it is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity, and
   • any selection and monitoring assistance made available to the plan sponsor is limited to identifying investment alternatives on the basis of objective criteria specified by the plan sponsor (e.g., stated parameters concerning expense ratios, fund size, asset type or credit quality);

2. Investment Education. The Final Rule preserves much of DOL’s original 1996 Interpretive Bulletin guidance for distinguishing between investment education and fiduciary advice. Plan information, general financial, investment and retirement information, asset allocation models and interactive investment materials may continue to be made available without triggering fiduciary status on the part of the provider. However, where a plan’s asset allocation or interactive educational materials identify a specific investment option, they must also identify each other plan investment option with similar risk and return characteristics and include a statement about where additional information on those other investment options may be obtained.

In the case of an IRA, the educational materials generally may not identify any specific investment alternative.

The Final Rule also contains a “seller’s exception”. It is configured to exclude persons who are providing recommendations as sellers to independent plan fiduciaries with financial expertise, from being categorized as investment advice fiduciaries. To fit within the seller’s exception, the person providing the recommendation must refrain from representing or acknowledging fiduciary status and must know or reasonably believe that the fiduciary representing the plan in the transaction is either a bank, an insurance company, a registered investment adviser, a broker-dealer or a fiduciary that holds or has under management or control, total assets of at least $50 million. To take advantage of the exception, the seller must know or reasonably believe that the independent plan fiduciary is capable of evaluating investment risks independently of the seller, must provide disclosures that the seller is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity, and must also provide disclosures about the nature of the person's financial interests in the transaction.

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See DOL Interpretive Bulletin 96-1, 29 CFR §2509.96-1.
DOL's Best Interest Contract or “BIC” Prohibited Transaction Exemption

As noted, the Final Rule is likely to have the effect of re-characterizing many persons who sell and market financial services and products to plans and IRAs as non-fiduciaries under current law, as fiduciaries from and after the rule’s April 10, 2017 applicability date. To allow those who may newly acquire fiduciary status under the Final Rule to continue doing business, DOL has granted the BIC exemption, which is intended to be a primary source of prohibited transaction relief. The BIC exemption contains numerous conditions, which vary somewhat depending on whether the fiduciary is interacting with a plan or an IRA, and on whether the fiduciary is recommending a “level fee” investment program.

Prohibited transaction exemption relief under BIC is available to “Financial Institutions” (i.e., banks, broker-dealers, registered investment advisers and insurance companies) and to the individual advisors who provide investment recommendations to such investors already have recourse to transaction provisions. Essentially, it provides for BIC relief are generally required to be in the form of a written contract with the Retirement Investor. The contract may be executed by the Retirement Investor either manually or via an electronic signature. By virtue of requiring a written contract in these circumstances, the Final Rule effectively creates a private enforcement mechanism for IRA holders to fill in for the lack of a private right of action under the Code to enforce violations of section 4975’s prohibited transaction provisions. Essentially, it gives IRA holders a right to sue. With respect to recommendations made to Retirement Investors in plans subject to ERISA, a bilateral contract is not required; such investors already have recourse to private rights of action against breaching fiduciaries under ERISA.

In addition, except where a program is being recommended by a “level fee fiduciary” (as described below), the Financial Institution must:

• **Provide Warranties.** Warranties must be provided that the Financial Institution has adopted and will comply with written policies and procedures reasonably and prudently designed to ensure that its advisors adhere to the Impartial Conduct Standards, that the Financial Institution has specifically identified its Material Conflicts of Interest (i.e., a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary) and that the Financial Institution will refrain from the use of quotas, appraisals, bonuses, contests, differential compensation or other actions and incentives that might reasonably be expected to cause advisors to make recommendations that are not in the Best Interest of the advice recipient.

• **Provide Disclosures.** Numerous disclosures are required to be provided in writing at or prior to the execution of a recommended transaction, including a description of the services to be provided, how they will be paid for (e.g., commissions), any compensation received from third parties and a link to the Financial Institution website where further information is available.

As noted, the warranty and disclosure requirements listed above do not apply where a level fee program is being recommended by a “level fee fiduciary”. The BIC exemption defines a “level fee fiduciary” to mean a Financial Institution and advisor where the only fee received in connection with advisory or investment management services is a fee or compensation provided on the basis of a fixed percentage of assets or a set fee that does not vary with the particular investment recommended, rather than for a commission or other transaction-based fee. Where, however, a level fee fiduciary is recommending a rollover or a switch from a commission based to a level fee arrangement, it is subject to a special condition requiring it to document how it arrived at a determination that the rollover or switch recommendation is in the client’s Best Interest. A level fee fiduciary, like all advice fiduciaries seeking relief under the BIC exemption, is required to comply with the fiduciary acknowledgment and adherence to Impartial Conduct Standards elements described above.

In the case of recommendations made to IRAs and IRA holders, the requirements for BIC relief are generally required to be provided in the form of a written contract with the Retirement Investor. The contract may be executed by the Retirement Investor either manually or via an electronic signature. By virtue of requiring a written contract in these circumstances, the Final Rule effectively creates a private enforcement mechanism for IRA holders to fill in for the lack of a private right of action under the Code to enforce violations of section 4975’s prohibited transaction provisions. Essentially, it gives IRA holders a right to sue. With respect to recommendations made to Retirement Investors in plans subject to ERISA, a bilateral contract is not required; such investors already have recourse to private rights of action against breaching fiduciaries under ERISA.

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Potential Issues for IRA and ERISA Retirement Plan Advisors to Consider

The Final Rule is primarily directed not at plan sponsors, but at plan service providers and vendors who may make investment-related recommendations, including, in particular, retirement plan advisors. Accordingly, advisors who may make investment recommendations to plans or who interface with plan participants for purposes of making rollover recommendations will likely need to confront the BIC exemption and how to comply with its myriad conditions including, most importantly, the Impartial Conduct Standards. Advisor firms who do business under a commission-based compensation model will need to evaluate how their compensation arrangements incent individual advisors and whether those models may need to be changed. Even for level fee advisors, the BIC exemption is likely to provoke a thorough review of existing business models, particularly in light of the special documentation requirements associated with rollover recommendations and recommendations to switch from a brokerage to a fee-based account. Moreover, recordkeepers may review and reconsider the potential fiduciary status implications of providing investment reviews, investment policy statements, and fund monitoring tools, particularly for plans with fewer than $50 million in assets.

Plan sponsors, in turn, will likely want to monitor what their service providers’ strategies will be for complying with the Final Rule and whether that strategy might impact the level or quality of the services the plan and its participants receive.