FLORIDA SECURITIES DEALERS ASSOCIATION INDUSTRY OUTREACH PROGRAM
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Exploring the DOL Fiduciary Rule and Best Interest Contract Exemption

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Exploring the DOL Fiduciary Rule and Best Interest Contract Exemption

- Review of the key provisions of the final Fiduciary Rule ("Fiduciary Rule") and Best Interest Contract Exemption ("BIC Exemption") that were issued by the Department of Labor ("DOL") on April 8, 2016 in connection with investment advice made to participants of retirement plans and owners of Individual Retirement Accounts ("IRAs").

Introduction

- As we will see, the Fiduciary Rule and BIC Exemption are very complex and burdensome.

  - The new rules cast a very wide net, sweeping in virtually all types of investment recommendations made to retirement plan and IRA investors for which the registered representative and financial institution receives compensation.

  - In light of the recent Presidential election results, we probably will not have any clarity as to what will happen to the Fiduciary Rule and BIC Exemption until well after the April 10, 2017 applicability date.

  - Until we know what will be the fate of the Fiduciary Rule and BIC Exemption, be prepared to comply with the Fiduciary Rule and BIC Exemption.

Caveat Based on Recent U.S. Presidential Election Results

- Unknown whether the new Trump Administration will seek to abrogate the Fiduciary Rule and BIC Exemption administratively.
  - Since the Fiduciary Rule and BIC Exemption are "final" and effective (though not yet applicable), a new regulation would have to be proposed to repeal the rules, including setting new notice and comment periods.
  - Unlikely that any repeal of the Fiduciary Rule and BIC Exemption would occur within Trump's first 100 days in office, meaning that the Fiduciary Rule and BIC Exemption are likely to remain in effect on the April 10, 2017 applicability date.
- There is also legislation that is pending in the House of Representatives which would prohibit enforcement of the Fiduciary Rule and BIC Exemption.
  - On September 13, 2016, the House Financial Services Committee approved by a vote of 30 to 26 legislation which would among other things prohibit enforcement of the Fiduciary Rule and BIC Exemption.
  - The legislation blocking enforcement of the Fiduciary Rule and BIC Exemption is part of a much larger bill known as the "Financial CHOICE (Creating Hope and Opportunity for Investors, Consumers and Entrepreneurs) Act of 2016" (H.R. 5983) which is intended to repeal various provisions of Dodd-Frank.
- We won't know the fate of the Fiduciary Rule and BIC Exemption until after Trump's inauguration on January 20, 2017.
- There are also a number of challenges to the Fiduciary Rule and BIC Exemption which are pending in federal courts around the country.

The Fiduciary Rule and BIC Exemption -- Statutory and Regulatory Background

- The Fiduciary Rule and BIC Exemption were issued by the DOL pursuant to the Employee Retirement Income Security Act of 1974 (“ERISA”).
  - ERISA is the federal statute which, along with the Internal Revenue Code (“IRC”), govern retirement plans established or maintained by employers and unions along with IRAs and other types of pension plans.
    - ERISA Title I regulates retirement plans established or maintained by employers, unions or both.
    - ERISA Title I contains detailed reporting and disclosure requirements, rules relating to vesting and funding, fiduciary responsibility requirements, various enforcement rules, a private cause of action, and a broad preemption rule. ERISA § 1021, et seq.
  - ERISA Title II principally addresses the requirements that plans must fulfill in order to qualify for certain tax advantages. IRC § 4975.
    - ERISA Title II applies to IRAs and other plans not subject to Title I.
    - ERISA Title II includes a definition of "fiduciary" that parallels the definition found in Title I and which applies to IRAs.

- Threshold question:
  - Why does it matter if a financial institution and its registered representative that provides an investment recommendation to a retirement plan or IRA are deemed to be fiduciaries?
- Answer:
  - Because of the legal duties imposed by ERISA on fiduciaries plus liability for breaches of fiduciary duty as well as a bar on receiving many of the types of compensation that a financial institution and its registered representative typically receive in connection with a transaction.

- A person is a “fiduciary” with respect to a retirement plan under ERISA if “he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so.” ERISA § 1002(21)(A).

  - In 1975, the DOL issued a regulation which defined when a registered representative is deemed to have “render[ed] investment advice” so as to make that person a fiduciary under ERISA.

  - Five part test

  - A person was deemed to “render investment advice” only if he: (1) “renders advice to the plan as to the value of securities or other property, or makes recommendation[s] as to the advisability of investing in, purchasing, or selling securities or other property,” and he does so (2) “on a regular basis” (3) “pursuant to a mutual agreement, arrangement, or understanding, written or otherwise, between such person and the plan or a fiduciary with respect to the plan,” (4) that the advice given “will serve as a primary basis for investment decisions with respect to plan assets,” and (5) that the advice will be “individualized . . . based on the particular needs of the plan.” 29 C.F.R. § 2510.3-21(c)(1).

  - This is the definition which has now been superseded by the Fiduciary Rule.

❖ERISA imposes various duties on persons who are deemed to be fiduciaries with respect to ERISA Title I retirement plans, including the duties of loyalty and prudence.

- The duty of loyalty requires that a fiduciary of an ERISA plan "discharge his duties with respect to [the] plan solely in the interest of the participants and beneficiaries . . . for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan." ERISA § 1104(a)(1).

- The duty of prudence requires that a fiduciary act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims," including by "diversifying the investments of the plan so as to minimize the risk of large losses." ERISA § 1104(a)(1)(B)-(C).

- The ERISA statute itself does not subject fiduciaries of IRAs and other non-ERISA Title I plans to the duties of loyalty and prudence.

- However, the duties of loyalty and prudence now apply to fiduciaries of IRAs and other non-ERISA Title I plans by virtue of the new Fiduciary Rule and BIC Exemption.

- Liability for breaches of fiduciary duty
  - A fiduciary who violates the duties of prudence and loyalty is “personally liable” for any losses to the plan stemming from such a breach. ERISA § 1109(a).
  - ERISA creates a private cause of action permitting plan participants and beneficiaries (but not IRA owners and other non-ERISA Title I plans) to enforce this right, to recover lost benefits, and to enforce the terms of the plan.
  - ERISA also empowers the Secretary of Labor to bring suit “for appropriate relief” or “to collect any civil penalty” for violations of certain provisions of the statute. ERISA § 1132(a).

- ERISA also bars certain transactions that are deemed likely to injure the pension plan, known as “prohibited transactions.”

  - A fiduciary may not “deal with the assets of the plan in his own interest or for his own account,” may not “in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries,” and may not “receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.” ERISA § 1106(b).

  - Additionally, a fiduciary may not cause a plan to engage in certain transactions with a “party in interest,” a category which includes the fiduciary himself, the employer sponsoring the plan, and persons providing services to the plan. ERISA §§ 1002(14) and 1106(a).

  - ERISA authorizes the Secretary of Labor to grant exemptions from the prohibited transactions rules -- either “conditional[ly] or unconditionally” -- provided that the exemption is “administratively feasible,” “in the interests of the plan and of its participants and beneficiaries,” and “protective of the rights of participants and beneficiaries of such plan.” ERISA § 1108(a).

❖Financial institutions and their registered representatives typically receive compensation for services to retirement investors through a variety of arrangements.

- ➢These include commissions paid by the plan, participant or beneficiary, or IRA, or commissions, sales loads, 12b-1 fees, revenue sharing and other payments from third parties that provide investment products.

- ➢Where the financial institution and its registered representative are deemed to be fiduciaries, such compensation arrangements would typically violate the prohibited transaction rules applicable to plan fiduciaries.

- ➢Where the financial institution and its registered representative are deemed to be fiduciaries, compensation that varies based on the registered representative's investment recommendations, as well as compensation from third parties in connection with his advice would violate the prohibited transactions rule.

- ➢A fiduciary's receipt of such payments would generally violate the prohibited transaction provisions of ERISA § 406(b) and IRC § 4975(c)(1)(E) and (F) because the amount of the fiduciary's compensation is affected by the use of its authority in providing investment advice, unless such payments meet the requirements of an exemption.

The Fiduciary Rule and BIC Exemption -- Rationale, Effective Date and Applicability

- The DOL's rationale for the new rules is to take into account the advent of 401k plans and IRAs, the dramatic increase in rollovers, and other developments that have transformed the retirement plan landscape and the associated investment market over the four decades since the original rule defining a fiduciary was issued.
- The DOL's view is that in light of the extensive changes in retirement investment practices and relationships, the new rules are intended to update existing rules to distinguish more appropriately between the sorts of advice relationships that should be treated as fiduciary in nature and those that should not.
- Final rules became effective on June 7, 2016, but do not become applicable until April 10, 2017.
  - DOL did this to allow sufficient time for entities affected by the new rules such as broker-dealers to make the necessary changes.
  - DOL has also delayed the full applicability of the BIC Exemption until January 1, 2018.
  - Between April 10, 2017 and January 1, 2018, broker-dealers can proceed with transactions involving retirement plan accounts and IRAs by complying with a set of "transitional" conditions, which are somewhat less onerous than the BIC Exemption requirements.

The Fiduciary Rule -- Key Provisions

- Issues with DOL's prior definition of fiduciary
  - One of the key problems with the DOL's now superseded definition of fiduciary, according to the DOL, is that the person needed to have made investment recommendations "on a regular basis" in order to be a fiduciary. 29 C.F.R. § 2510.3-21(c)(1).
    - Thus, occasional or intermittent advice, such as a one time recommendation as to the investment of assets being rolled over from a 401k plan into an IRA, was not sufficient to make someone a fiduciary under ERISA.

- DOL’s new definition of fiduciary
  - Final Fiduciary Definition, 81 Fed. Reg. 20946 at 20997-21000 (Apr. 8, 2016)
  - The new rule jettisons the five part test.
  - A registered representative is now deemed to be “rendering investment advice for a fee or other compensation” if:
    - Such person provides to a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner the following types of advice for a fee or other compensation, direct or indirect: (i) a recommendation as to the advisability of acquiring, holding, disposing of, or exchanging, securities or other investment property, or a recommendation as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred, or distributed from the plan or IRA; (ii) a recommendation as to the management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, . . . or recommendations with respect to rollovers, transfers, or distributions from a plan or IRA, including whether, in what amount, in what form, and to what destination such a rollover, transfer, or distribution should be made; and

- The recommendation is made either directly or indirectly (e.g., through or together with any affiliate) by a person who (i) represents or acknowledges that it is acting as a fiduciary within the meaning of ERISA or the IRC; (ii) renders the advice pursuant to a written or verbal agreement, arrangement, or understanding that the advice is based on the particular investment needs of the advice recipient; or (iii) directs the advice to a specific advice recipient or recipients regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the plan or IRA.

- A “recommendation” is defined as 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.
    - Whether a “recommendation” has been made is an objective rather than subjective inquiry.

- 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 retirement plan or IRA customer 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.

- 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.

- The rule excludes from the definition of “recommendation” the provision of the following services or the furnishing or making available of the following information and materials:
  - Investment platforms and associated activities.
  - A general communication that a reasonable person would not view as an investment recommendation, including general circulation newsletters, commentary in publicly broadcast talk shows, remarks and presentations in widely attended speeches and conferences, etc.
  - Investment-related information and materials such as (i) Plan information, (ii) general financial, investment and retirement information, (iii) asset allocation models, and (iv) interactive investment materials

❖The registered representative does not become a fiduciary under the rule where he provides investment advice to certain categories of persons who are deemed to be independent fiduciaries with financial expertise.

- The registered representative does not become a fiduciary by providing advice to a fiduciary of the plan or IRA who is independent of the registered representative with respect to an arm's length sale, purchase, loan, exchange, or other transaction related to the investment of securities or other investment property, if, prior to entering into the transaction, the registered representative:

  - knows or reasonably believes that the independent fiduciary of the plan or IRA is (i) a bank, (ii) an insurance carrier which is qualified under the laws of more than one state to perform the services of managing, acquiring or disposing of assets of a plan, (iii) a registered investment advisor, (iv) a broker-dealer, (v) 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 of the plan or IRA is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies,

- fairly informs the independent fiduciary that the person is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction and fairly informs the independent fiduciary of the existence and nature of the person's financial interests in the transaction,

- knows or reasonably believes that the independent fiduciary of the plan or IRA is a fiduciary under ERISA or the IRC, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction, and

- does not receive a fee or other compensation directly from the plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner for the provision of investment advice (as opposed to other services) in connection with the transaction.

- In addition to "render[ing] investment advice," the registered representative must also receive "a fee or other compensation" in order to be deemed a fiduciary.

  - The term "fee or other compensation, direct or indirect" means "any explicit fee or compensation for the advice received by the person (or by an affiliate) from any source, and any other fee or compensation received from any source in connection with or as a result of the 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."

  - A fee or compensation is paid "in connection with or as a result of" such transaction or service if "the fee or compensation would not have been paid but for the transaction or service or if eligibility for or the amount of the fee or compensation is based in whole or in part on the transaction or service."

- In sum, a registered representative who makes a one time investment recommendation to a specific retirement plan or IRA customer with respect to e.g. purchasing certain securities or the investing of assets being rolled over from a 401k into an IRA for which the registered representative receives compensation of virtually any sort is now deemed to be an ERISA fiduciary.
    - If the registered representative is paid on a commission basis or receives sales loads, 12b-1 fees, revenue sharing or other payment from third parties that provide investment products, he would likely be engaged in rendering the type of investment advice “for a fee” that would trigger the prohibited transaction rules.

The BIC Exemption

- Final BIC Exemption, 81 Fed. Reg. 21002 at 21075-21085 (Apr. 8, 2016).

- ERISA and the IRC generally prohibit fiduciaries from receiving payments from third parties and from acting on conflicts of interest, including using their authority to affect or increase their own compensation, in connection with transactions involving a plan or IRA.

  - Certain commonly used types of fees and compensation arrangements such as brokerage or insurance commissions, 12b-1 fees and revenue sharing payments, may fall within these prohibitions when received by fiduciaries as a result of transactions involving advice to the plan, plan participants and beneficiaries, and IRA owners.

  - The BIC Exemption allows investment advice fiduciaries, including registered investment advisers, broker-dealers, and insurance companies, and their agents and representatives, to receive these various forms of compensation that, in the absence of an exemption, would not be permitted under ERISA and the IRC.

•The BIC Exemption therefore permits registered representatives and financial institutions that are now deemed to be fiduciaries under the new Fiduciary Rule to receive compensation as a result of their rendering of investment advice to a retirement investor that varies based on their investment recommendations, as well as compensation from third parties in connection with their advice, if they satisfy certain conditions.

- The conditions to qualify for the BIC Exemption are:

  - The financial institution and its registered representative must abide by the DOL's "Impartial Conduct Standards."

  - The financial institution must acknowledge in writing to the retirement plan customer that the financial institution and its registered representative are fiduciaries under ERISA and the IRC.

  - With respect to IRAs and other non-ERISA Title I plans, the financial institution must agree that it will adhere to the BIC Exemption's Impartial Conduct Standards by way of a written contract that is enforceable by the IRA customer.

  - As we will see, the BIC Exemption establishes a much higher standard of care than the suitability standard.

- The Impartial Conduct Standards
  - The Impartial Conduct Standards have three parts
    - Duties of prudence and loyalty
    - No excessive compensation, i.e., only "reasonable compensation"
    - No materially misleading statements

- The duties of loyalty and prudence require that a financial institution and its registered representative “provide investment advice that is, at the time of the recommendation, in the best interest of the retirement investor.”

  - This requirement means that the financial institution and its registered representative are subject to the same duties of loyalty and prudence applicable under Title I of ERISA, even with respect to advice regarding IRAs and other plans that are not subject to ERISA Title I (and thus not otherwise subject to the duties of prudence and loyalty).

  - Under the BIC Exemption, investment advice is in the “best interest” of the retirement investor when the registered representative 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.”

  - There are separate requirements that apply where the financial institution limits investment recommendations, in whole or part, based on whether the investments are proprietary products or generate third party payments.

- Third party payments include sales charges when not paid directly by the Plan, participant or beneficiary account, or IRA; 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 or related entity by a third party as a result of a transaction involving a Plan, participant or beneficiary account, or IRA.

- The reasonable compensation requirement means that the recommended transaction cannot cause the financial institution, registered representative 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 § 408(b)(2) and IRC § 4975(d)(2).

- Statements by the financial institution and its registered representative to the retirement investor about the recommended transaction, fees and compensation, material conflicts of interest, and any other matters relevant to a retirement investors investment decisions, cannot be materially misleading at the time they are made.

- The financial institution is also required to (1) implement policies and procedures reasonably and prudently designed to prevent violations by its advisers of the Impartial Conduct Standards, (2) refrain from giving or using incentives for registered representatives to act contrary to the customer's best interest and (3) fairly disclose the fees, compensation, and material conflicts of interest associated with their recommendations.

- Written acknowledgment of fiduciary status
  - The financial institution must affirmatively state in writing that both the financial institution and its registered representative act as fiduciaries under ERISA or the IRC or both, with respect to any investment advice provided by the financial institution or the registered representative (1) in the case of an ERISA plan, with respect to any investment recommendations regarding the plan or participant or beneficiary account or (2) in the case of an IRA or other non-ERISA Title I plan, with respect to any investment advice provided by the financial institution or registered representative subject to the contract.
- Written contract requirement
  - For IRAs and other non-ERISA Title I plans, the financial institution must enter into a written contract with the IRA/other retirement plan customer by which the financial institution agrees that it and its registered representative will adhere to the Impartial Conduct Standards in a written contract that is enforceable by the retirement investor.
  - There is no such written contract requirement for retirement plans that are covered by ERISA Title I.
- The written contract requirement applies to IRAs and other non-ERISA Title I plans but not to ERISA Title I plans because the latter have the private right of action under ERISA to sue a fiduciary for breach of fiduciary duty, whereas the former do not have such right.
- IRAs and other non-ERISA Title I plans would have the right to sue the fiduciary financial institution and registered representative for breach of these standards through a state law breach of contract action.

- To be eligible for the BIC Exemption, the financial institution's contract with the retirement investor cannot have any of the following provisions:
  - Exculpatory provision disclaiming or otherwise limiting the financial institution's liability for a violation of the contract's terms.
  - Agreement to arbitrate or mediate individual claims in venues that are distant or that otherwise unreasonably limit the ability of the retirement investors to assert the claims safeguarded by the BIC Exemption.
  - A provision under which the Plan, IRA or retirement investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the financial institution or in an individual or class claim agrees to an amount representing liquidated damages for breach of the contract; in the event this provision is ruled by a court of competent jurisdiction to be invalid, then this provision shall not be a condition of the BIC Exemption unless and until the court's decision is reversed.
- The parties to the contract can, however, knowingly agree to waive the retirement investor's right to obtain punitive damages or rescission of recommended transactions to the extent such a waiver is permissible under applicable state or federal law.

o A financial institution that limits registered representatives' investment recommendations, in whole or part, based on whether the investments are proprietary products or generate third party payments, and a registered representative making recommendations subject to such limitations, satisfies the requirement that investment advice be in the best interest of the retirement investor if:

- Prior to or at the same time as the execution of the recommended transaction, the retirement investor is informed in writing (1) that the financial institution offers proprietary products or receives third party payments with respect to the purchase, sale, exchange, or holding of recommended investments, (2) of the limitations placed on the universe of investments that the registered representative may recommend to the retirement investor; and (3) of any material conflicts of interest that the financial institution or registered representative have with respect to the recommended transaction.

- The financial institution (1) documents in writing (A) its limitations on the universe of recommended investments; (B) the material conflicts of interest associated with any contract, agreement, or arrangement providing for its receipt of third party payments or associated with the sale or promotion of proprietary products; (C) any services it will provide to retirement investors in exchange for third party payments, as well as any services or consideration it will furnish to any other party in exchange for the third party payments; (D) reasonably concludes that the limitations on the universe of recommended investments and material conflicts of interest will not cause the financial institution or its registered representatives to receive compensation in excess of reasonable compensation for retirement investors; (E) reasonably determines that these limitations and material conflicts of interest will not cause the financial institution or its registered representatives to recommend imprudent investments; and (F) documents in writing the bases for its conclusions.

•The financial institution adopts, monitors, implements, and adheres to policies and procedures and incentive practices with respect to the Impartial Conduct Standards and material conflicts of interest.

•The financial institution does not use or rely upon quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended or would reasonably be expected to cause the registered representative to make imprudent investment recommendations, to subordinate the interests of the retirement investor to the registered representative's own interests, or to make recommendations based on the registered representative's considerations of factors or interests other than the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor.

•The financial institution complies with the duties of prudence and loyalty and reasonable compensation requirement.

- Where the fiduciary is a “level fee fiduciary,” there is a more streamlined set of requirements in order to satisfy the BIC Exemption.

  - A financial institution is a “level fee fiduciary” if the only fee received by the financial institution, the registered representative and any affiliate in connection with advisory or investment management services to the Plan or IRA assets is a “level fee” that is disclosed in advance to the retirement investor.

  - 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, rather than a commission or other transaction-based fee.

- The requirements to satisfy the BIC Exemption for a level fee fiduciary are:
    - Prior to or at the same time as the execution of the recommended transaction, the financial institution provides the retirement investor with a written statement of the financial institution's and its registered representative's fiduciary status.
    - The financial institution and registered representative comply with the Impartial Conduct Standards.
    - In the case of a recommendation to roll over assets from an ERISA plan to an IRA, the financial institution documents the specific reason or reasons why the recommendation was considered to be in the best interest of the retirement investor.
    - In the case of a recommendation to rollover from another IRA or to switch from a commission-based account to a level fee arrangement, the level fee fiduciary documents the reasons that the arrangement is considered to be in the best interest of the retirement investor, including, specifically, the services that will be provided for the fee.

- The BIC Exemption does not apply where:

  - The plan is covered by Title I of ERISA, and (i) the registered representative or financial institution or affiliate is the employer of employees covered by the Plan, or (ii) the registered representative or financial institution is a named fiduciary or plan administrator (as defined in ERISA section 3(16)(A)) with respect to the Plan, or an affiliate thereof, that was selected to provide advice to the Plan by a fiduciary who is not independent;

  - The compensation is received as a result of a principal transaction;

  - The compensation is received as a result of investment advice to a retirement investor generated solely by an interactive web site in which computer software-based models or applications provide investment advice based on personal information each investor supplies through the web site without any personal interaction or advice from an individual registered representative (i.e., “robo-advice”) unless the robo-advice provider is a Level Fee Fiduciary that complies with the conditions applicable to Level Fee Fiduciaries; or

  - The registered representative has or exercises any discretionary authority or discretionary control with respect to the recommended transaction.

- DOL has issued a set of Frequently Asked Questions regarding the BIC Exemption.
    - Provides additional guidance on application of the BIC Exemption’s terms.

- Application of the BIC Exemption during Transition Period from April 10, 2017, to January 1, 2018

  - For the transition period from April 10, 2017 to January 1, 2018 (the "Transition Period"), financial institutions and their registered representatives will have to satisfy the following set of requirements in order to satisfy the BIC Exemption:

    - The financial institution and its registered representative must provide investment advice that is, at the time of the recommendation, in the best interest of the retirement investor; 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 financial institution or its registered representative.

•The recommended transaction does not cause the financial institution or its registered representative to receive, directly or indirectly, compensation for their services that is in excess of reasonable compensation.

•Statements by the financial institution and its registered representative 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, are not materially misleading at the time they are made.

•The financial institution must affirmatively state in writing to the retirement investor that the financial institution and its registered representative act as fiduciaries under ERISA or the IRC, or both, with respect to the recommendation.

•The financial institution must advise the retirement investor as to the financial institution's material conflicts of interest.

•The financial institution must disclose to the retirement investor whether the financial institution offers proprietary products or receives third party payments with respect to any investment recommendations; to the extent the financial institution or registered representative limits investment recommendations, in whole or part, to proprietary products or investments that generate third party payments, notifies the retirement investor of the limitations placed on the universe of investment recommendations.

- The Transition Period BIC Exemption does not apply where:

  - The plan is covered by Title I of ERISA, and (i) the registered representative, financial institution or any affiliate is the employer of employees covered by the Plan, or (ii) the registered representative or financial institution is a named fiduciary or plan administrator (as defined in ERISA § 3(16)(A)) with respect to the plan, or an affiliate thereof, that was selected to provide advice to the plan by a fiduciary who is not independent.

  - The compensation is received as a result of a principal transaction.

  - The compensation is received as a result of investment advice to a retirement investor generated solely by an interactive web site in which computer software-based models or applications provide investment advice based on personal information each investor supplies through the web site without any personal interaction or advice from an individual adviser (i.e. “robo-advice”); or

  - The registered representative has or exercises any discretionary authority or discretionary control with respect to the recommended transaction.

Litigation involving the Fiduciary Rule and BIC Exemption

- The National Association for Fixed Annuities v. Thomas E. Perez, Secretary of the United States Department of Labor, et al., Civil Action No. 16-1035 (RDM), 2016 U.S. Dist. LEXIS 153214 (D.D.C. Nov. 4, 2016).
  - On November 4, 2016, the Honorable Randolph D. Moss, U.S.D.J. granted summary judgment in favor of the DOL on the challenge to the Fiduciary Rule and BIC Exemption brought by the National Association for Fixed Annuities ("NAFA") and denied NAFA's motion for a preliminary injunction and summary judgment.
  - NAFA has filed an appeal with the United States Court of Appeals for the District of Columbia Circuit from Judge Moss's grant of summary judgment in favor of DOL, requesting expedited review by that court.
    - No timetable has been set for when NAFA's appeal will be adjudicated.
  - There are several other legal challenges to the Fiduciary Rule and BIC Exemption that are still pending in district courts across the country, including the challenge brought by the Securities Industry and Financial Markets Association ("SIFMA") which is pending in federal court in Dallas.
    - Oral argument on SIFMA's challenge was held on November 17, 2016.

Conclusion

- The Fiduciary Rule and BIC Exemption are very complex and burdensome.
  - The new rules cast a very wide net, sweeping in virtually all types of investment recommendations made to retirement plan and IRA investors for which the registered representative and financial institution receives compensation.
  - We probably will not have any clarity as to what will happen to the Fiduciary Rule and BIC Exemption, whether administratively, legislatively or judicially, until well after the April 10, 2017 applicability date.
  - Until then, be prepared to comply with the Fiduciary Rule and BIC Exemption.

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