CONFLICT OF INTEREST FAQs (Transition Period)

U.S. Department of Labor
Employee Benefits Security Administration
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On April 7, 2017, the Department announced that the applicability dates in its Fiduciary Rule and related prohibited transaction exemptions would be delayed from April 10, 2017 to June 9, 2017, with certain provisions in the exemptions further delayed to January 1, 2018. As a result, on June 9, 2017, investment advice providers to retirement savers will become fiduciaries, and the "impartial conduct standards" will become requirements of the exemptions. Other exemption conditions scheduled to become applicable on April 10, 2017, will be delayed to January 1, 2018, while the Department conducts its ongoing examination of the Fiduciary Rule as directed by President Donald J. Trump.

The following FAQs provide additional information on the transition period from June 9, 2017 to January 1, 2018.[1] This guidance, like the Fiduciary Rule and related exemptions, is generally limited to advice concerning investments in IRAs, ERISA-covered plans, and other plans covered by section 4975 of the Internal Revenue Code

Q1. When do firms and their advisers have to comply with the conditions of the new Best Interest Contract (BIC) Exemption and the Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Principal Transactions Exemption)?

Firms and their advisers must comply with the exemptions' conditions after June 9, 2017 if they receive compensation for investment advice in a manner that would violate the prohibited transaction rules, which are designed to protect retirement investors from conflicts of interest. Firms and advisers must either structure their compensation arrangements to avoid prohibited transactions or they must comply with an exemption such as the BIC Exemption or Principal Transactions Exemption.

The Department has adopted a phased implementation approach to both of these exemptions. The Fiduciary Rule's amended definition of fiduciary advice will first apply on June 9, 2017. On

[1] For the convenience of users, the Department has also republished the Best Interest Contract Exemption, the Principal Transactions Exemption and PTE 84-24, with the amended applicability dates, on EBSA's website. *See* www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2.

that same date, the BIC Exemption and Principal Transactions Exemption will become available to fiduciary advisers. At the outset, however, and for a transition period extending until January 1, 2018, fewer conditions will apply to financial institutions and advisers that seek to rely upon the exemptions.

During the transition period, financial institutions and advisers must comply with the "impartial conduct standards" which are consumer protection standards that ensure that advisers adhere to fiduciary norms and basic standards of fair dealing. The standards specifically require advisers and financial institutions to:

- Give advice that is in the "best interest" of the retirement investor. This best interest standard has two chief components: prudence and loyalty:
    - Under the prudence standard, the advice must meet a professional standard of care as specified in the text of the exemption;
    - Under the loyalty standard, the advice must be based on the interests of the customer, rather than the competing financial interest of the adviser or firm;
- Charge no more than reasonable compensation;[2] and
- Make no misleading statements about investment transactions, compensation, and conflicts of interest.

Absent further action from the Department, the transition period ends on January 1, 2018, and full compliance with all of the exemptions' conditions is required for firms and advisers that choose to engage in transactions that would otherwise be prohibited under ERISA and the Internal Revenue Code. These conditions importantly include, among other things, requirements to execute a contract with IRA investors with certain enforceable promises, make specified disclosures, and implement specified policies and procedures to protect retirement investors from advice that is not in their best interest. The contract could require the IRA investor to pursue individual claims through arbitration, but must preserve the investors' ability to bring class action claims in court.

[2] In the Principal Transactions Exemption, the impartial conduct standards specifically refer to the fiduciary's obligation to seek to obtain the best execution reasonably available under the circumstances with respect to the transaction, rather than to receive no more than "reasonable compensation." Accordingly, references in this document to "reasonable compensation" in the context of the Principal Transactions Exemption should be read to refer to this best execution.

Q2. When do parties have to comply with the new conditions in PTE 84-24, which was amended in connection with the Fiduciary Rule?

PTE 84-24 is an existing exemption that applies to a variety of transactions, including advisory transactions involving insurance and annuity contracts. In its 2016 rulemaking, the Department amended the conditions of PTE 84-24, added the impartial conduct standards as requirements for relief, and revoked relief for transactions involving fixed indexed annuity contracts and variable annuity contracts, effectively requiring advisers recommending these products to rely upon the BIC Exemption. However, the Department has now delayed applicability of the 2016 amendments until January 1, 2018, except for the impartial conduct standards, which are applicable June 9, 2017. Accordingly, parties may rely on PTE 84-24, subject to the existing conditions of the exemption and the impartial conduct standards, for recommendations involving all annuity contracts during the transition period.[3]

Q3. When do firms and their advisers have to comply with the new conditions in other pre-existing exemptions that were amended in connection with the Fiduciary Rule?

Compliance with the amended exemptions is required beginning June 9, 2017. The Department amended other pre-existing exemptions to require compliance with the impartial conduct standards and, in some cases, to more tightly restrict their availability for transactions subject to significant conflicts of interest. These exemptions are Prohibited Transaction Exemptions (PTEs) 75-1, 77-4, 80-83, 83-1, and 86-128. The new restrictions on the availability of these exemptions are applicable June 9, 2017. As noted above, the impartial conduct standards require fiduciaries to adhere to basic fiduciary norms and standards of fair dealing (act in the best interest of customers, charge no more than reasonable compensation, and not make misleading statements). There is an additional transition rule for certain transactions under PTE 86-128, which generally requires a written authorization executed in advance by an independent fiduciary or IRA owner. For IRAs and non-ERISA plans that were already customers of the financial institution as of June 9, 2017, the fiduciary engaging in the transaction need not obtain affirmative written consent for such transactions as would otherwise be required, but instead may rely on negative consent, as long as the fiduciary gave the required disclosures and consent termination form to the customer by that date (See PTE 86-128, as amended, at Section III(b)(2)).

[3] PTE 84-24 also historically provided relief for certain transactions involving investment company securities and principal underwriters. That relief was revoked in the 2016 amendments for transactions involving IRAs. The applicability date of that revocation is also delayed until January 1, 2018; accordingly, such transactions can continue to rely on PTE 84-24 until that time subject to the existing conditions of the exemption and the impartial conduct standards.

Q4. Will the Department make additional changes to the Fiduciary Rule or exemptions?

By Memorandum dated February 3, 2017, the President directed the Department to conduct an examination of the Fiduciary Rule to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice. The Department is engaging in a careful analysis of the issues raised in the President's Memorandum and it is possible, based on the results of the examination, that additional changes will be proposed. The Department also intends to issue a Request for Information (RFI) in the near future for additional public input on specific ideas for possible new exemptions or regulatory changes based on recent public comments and market developments. The Department is also aware that after the Fiduciary Rule was issued firms have begun to develop new business models and innovative market products. Many of the most promising responses to the Fiduciary Rule, such as brokers' possible use of "clean shares" in the mutual fund market to mitigate conflicts of interest, are likely to take significantly more time to implement than what the Department envisioned when it set January 1, 2018, as the applicability date for full compliance with all of the exemptions' conditions. By granting additional time, and perhaps creating a new streamlined exemption based upon the use of clean shares and other innovations for example, it may be possible for firms to create a compliance mechanism that is less costly and more effective than the sorts of interim measures that they might otherwise use. The RFI will specifically ask for public comment on whether an additional delay in the January 1, 2018 applicability date would allow for more effective retirement investor assistance and help avoid needless or excessive expense as firms build systems and compliance structures that may ultimately be unnecessary or mismatched with the Department's final decisions on the issues raised by the Presidential Memorandum.

Q5. Does the Department's decision to have the Fiduciary Rule and impartial conduct standards become applicable on June 9, 2017 mean it has effectively concluded its review under the President's Memorandum?

No. The Department's review of the Fiduciary Rule and exemptions is ongoing. The Department delayed full implementation of the Fiduciary Rule and associated PTEs in order to conduct the careful and thoughtful process contemplated in the Presidential Memorandum. The Memorandum did not purport to prejudge the outcome of the review, nor did it dictate specific changes to the applicability dates.

In its Regulatory Impact Analysis for the 2016 rulemaking, the Department concluded that conflicts of interest caused significant and ongoing harm to retirement investors, and that adherence to basic fiduciary norms and standards of fair dealing could help mitigate that harm. The Department's phased approach to implementation provides significant interim protection to retirement investors, even as it postpones applicability of many exemption conditions pending the Department's analysis of whether further changes are appropriate. This approach allows the

Department to protect the interests of retirement investors in receiving sound financial advice by imposing the basic obligations of a best interest standard, while still honoring the President's directive to reexamine its conclusions and to focus on potential undue burdens and unintended consequences of its prior rulemaking.

Q6. Many firms have plans to create new compensation systems that will effectively insulate their advisers from many or most conflicts of interest, but do not expect those systems to be fully in place during the transition period. As a result, individual advisers are likely to have conflicts of interest with respect to particular investment recommendations during the transition period that they may not have after the transition period expires. If these conflicts of interest persist during the transition period, does it follow that the BIC Exemption is unavailable to these institutions during that period or that they have failed to comply with the impartial conduct standards?

No. During the transition period, the BIC Exemption requires only that fiduciary advisers' recommendations meet the impartial conduct standards, including the obligation to give advice that is in the best interest of the retirement investor. As discussed above, the impartial conduct standards require fiduciaries to adhere to basic fiduciary norms and standards of fair dealing. In particular, fiduciaries' investment recommendations must be prudent, loyal, and free from material misrepresentations. Additionally, the firm and adviser must receive no more than reasonable compensation for their services, as ERISA and the Internal Revenue Code require. If, however, the fiduciaries adhere to these standards in making recommendations, they do not violate the exemption, even if new compensation systems are not yet implemented.

Accordingly, even if a fiduciary adviser recommends proprietary products or investments that generate commissions or other payments that vary with the investment recommended, the adviser can meet the impartial conduct standards by ensuring that the recommendations are prudent; the investment advice is based upon the customer's financial interests, rather than the adviser's competing financial interests in the transaction; the communications are free from material misrepresentations; and the associated fees and charges are reasonable. Of course, to the extent the adviser limits recommendations to proprietary products or receives compensation that varies with the product recommended, the adviser should be candid about the compensation and the limits on investments.

During the transition period, the Department expects financial institutions to adopt such policies and procedures as they reasonably conclude are necessary to ensure that advisers comply with the impartial conduct standards. During that period, however, the Department does not require firms and advisers to give their customers a warranty regarding their adoption of specific best interest policies and procedures, nor does it insist that they adhere to all of the specific provisions of Section IV of the BIC Exemption as a condition of compliance.[4] Instead, financial institutions retain flexibility to choose precisely how to safeguard compliance with the impartial conduct standards, whether by tamping down conflicts of interest associated with adviser compensation, increased monitoring and surveillance of investment recommendations, or other approaches or combinations of approaches. For example, some firms have indicated that they intend to rely upon or build on existing regulatory compliance structures to monitor their advisers' sales practices and recommendations, document the bases for those recommendations, and ensure that the impartial conduct standards are met (e.g., by subjecting transactions involving conflicts of interest to heightened scrutiny and surveillance).

Additionally, the Department is aware that firms' development and implementation of effective, long-term compliance solutions may in some cases require substantial time. For example, as a long-term solution, many firms may be evaluating whether to use "clean shares" as a means of mitigating conflicts of interest with respect to mutual funds, but believe that they will be unable to implement such an approach during the transition period (and possibly for some months to come).[5] Under this approach, the clean shares sold by the broker would not include any form of distribution-related payment to the broker. Instead, the financial institution could set its own commission levels uniformly across the different mutual funds that advisers may recommend, substantially insulating advisers from conflicts of interest among different mutual funds. Assuming the compensation is reasonable, such an approach is a potentially powerful means of reducing conflicts of interest with respect to mutual fund recommendations and correspondingly reducing the need for heightened surveillance around adviser conflicts of interest. Still other firms have expressed interest in a somewhat similar approach relying upon T-shares, rather than clean shares.

The Department understands, however, that the development of such a compliance approach may take longer than the transition period, which is currently scheduled to end on January 1, 2018. Accordingly, the Department is interested in hearing from stakeholders about the time necessary to develop and implement this and other effective compliance solutions, any impediments to implementation, and whether an additional extension of the January 1, 2018 date for full compliance with the BIC Exemption is appropriate in light of such considerations. Similarly, the Department is broadly available to discuss compliance approaches and related issues with interested parties, and would invite interested parties to contact the Department if they have

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[4] Section IV of the BIC Exemption provides a detailed statement of how firms that limit adviser's investment recommendations to proprietary products or to investments that generate third party payments can comply with the best interest standard. If the firm and the adviser meet the terms of Section IV -- including implementation of specific notice, documentation, and anti-conflict procedures -- they are "deemed" to satisfy the best interest standard. While firms and advisers certainly can rely upon Section IV during the transition period to satisfy the best interest standard, they are not required to do so as indicated in the text above.

[5] *See Capital Group*, SEC Staff Letter (Jan. 11, 2017), www.sec.gov/divisions/investment/noaction/2017/capital-group-011117-22d.htm

questions about planned compliance systems, policies and procedures, or other compliance-related issues.

Q7. Can robo-advice providers and other "level-fee advisers" rely on the BIC Exemption during the transition period?

Yes. The BIC Exemption provides specified relief for robo-advice providers that (with their affiliates) receive only a level fee in connection with advisory or investment management services provided to a plan or IRA that is disclosed in advance to the retirement investor (*i.e.*, they must be "level fee fiduciaries"). Such advice providers may rely on the exemption subject to adherence to the impartial conduct standards only, during the transition period. *See* Section II(h)(4). During the transition period, other level-fee fiduciaries may also rely on the exemption subject to adherence to the impartial conduct standards only, pursuant to Section IX.

Q8. How does the delay in the applicability dates affect the grandfathering relief in Section VII of the BIC Exemption?

Section VII of the BIC Exemption provides an exemption for specified compensation received in connection with investments that were made before the applicability date of the Fiduciary Rule, as well as compensation for recommendations to continue to adhere to a systematic purchase program established before the applicability date. Among other conditions, any new advice with respect to the grandfathered investments must meet the best interest standard. Section VII applies to investments made, and systematic purchase programs established, before the Fiduciary Rule and BIC Exemption became applicable (see Q11 for additional discussion of when the Fiduciary Rule and BIC Exemption became applicable).

Q9. Does PTE 84-24 apply to transactions involving IRAs during the transition period?

Yes. As explained above, the amendments adopted in 2016 will not become applicable until January 1, 2018, except for the impartial conduct standards, which are applicable on June 9, 2017. Therefore, the exemption as previously granted, will remain in force with a new Section VII setting forth the impartial conduct standards.[6]

Q10. What types of payments are covered by PTE 84-24 in the transition period?

If the conditions are satisfied, PTE 84-24 provides relief for an insurance company's receipt of compensation or other consideration in connection with the purchase of an insurance or annuity contract. Also, if the conditions are satisfied, PTE 84-24 covers the payment of commissions to

[6]See PTE 2002-13, 67 FR 9483 (March 1, 2002) (preamble discussion of certain exemptions, including PTE 84-24, that apply to plans described in Code section 4975).

insurance agents, brokers, pension consultants and investment company principal underwriters, and the exemption is not violated if a portion of that commission, in the form of a gross dealer concession, override, or similar payment, is paid to another entity such as an independent marketing organization.

Q11. The Department postponed the relevant applicability dates of the Fiduciary Rule and exemptions until Friday, June 9, 2017. Does this mean that advisers and financial institutions must be in full compliance before the close of business on June 9, 2017?

No. The Department has concluded that parties need not come into compliance until 11:59 PM (or immediately before midnight at the end of the day) local time on June 9, 2017, and will not be treated as fiduciaries under the Fiduciary Rule before then. The Department is interested in facilitating compliance, and understands that this approach may facilitate financial institutions' efforts to test new compliance systems over the weekend with reduced risk of disruption to the ongoing delivery of advisory services.

Q12. Would the following communications to a plan participant about increasing contributions to the plan be fiduciary investment advice under the Fiduciary Rule?

> **Communication 1: An email communication is sent to a plan participant on his birthday. The email tells the participant his current contribution rate to the plan and includes text and a chart explaining that if the participant increased his or her contribution by a specified percentage the participant's projected retirement savings at normal retirement age could increase by a stated sum based on specified assumptions. The email invites the participant to contact a call center for assistance if interested in increasing the contribution rate to the plan.**
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> **Communication 2: An interactive computer-based tool generates a retirement savings check-up report for a participant using information entered by the participant or using plan information automatically imported when the participant accesses the tool. The check-up report includes an illustration (such as a green, yellow or red light) and informational charts to tell the participant how well he or she is doing towards meeting his or her retirement savings goals. The tool allows the participant to make adjustments to savings goals, contribution rates, and investment allocations and then generate new check-up reports. The tool also includes links that the participant can use to make on-line adjustments to contribution rates and investment allocations.**
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> **Communication 3: A call center employee in interacting with a participant tells the participant that: (1) her employer will make a 100% matching contribution for every dollar the participant contributes up to 7% of the participant's annual salary;**

(2) the participant is currently only contributing 4% of her salary to the plan; (3) the employer matching contribution amounts to a 100% return on each dollar the participant contributes that is eligible for an employer match; (4) the participant needs to increase her contribution by 3% of her annual salary to take full advantage of that 100% return; and (5) the call center employee can help the participant if she wants to increase her contribution rate up to 7% of the participant's annual salary.

No. The Fiduciary Rule clearly states that furnishing or making available plan information and general financial, investment and retirement information described in paragraphs (b)(2)(iv)(A) and (B) of the Fiduciary Rule is not investment advice covered by the Fiduciary Rule irrespective of who provides or makes available the information and materials (*e.g.*, plan sponsor, fiduciary or service provider), the frequency with which the information and materials are provided, the form in which the information and materials are provided (*e.g.*, on an individual or group basis, in writing or orally, or via call center, video or computer software), or whether an identified category of information and materials is furnished or made available alone or in combination with other categories of information and materials, provided that the information and materials do not include (standing alone or in combination with other materials) recommendations with respect to specific investment products or specific plan or IRA alternatives, or recommendations with respect to investment or management of a particular security or securities or other investment property.

In the view of the Department, the communications described above fall within the plan information and general financial, investment and retirement information categories of investment education set forth in in paragraphs (b)(2)(iv)(A) and (B) of the Fiduciary Rule. Paragraph (b)(2)(iv)(A) of the Rule specifically treats as non-fiduciary communications the provision of information about "the benefits of plan or IRA participation" and the "benefits of increasing plan or IRA contributions." Of course, this FAQ provides just a few examples of non-fiduciary investment education about plan participation, not an exhaustive list. Readers should consult paragraph (b)(2)(iv) of the Fiduciary Rule for a broader description of the wide range of communications that are treated as non-fiduciary investment education, rather than fiduciary advice

Q13. Under the Fiduciary Rule, a party transacting business with an independent fiduciary of a plan or IRA in an arm's length transaction is excepted from the Fiduciary Rule if certain disclosure and fee requirements are met and the party reasonably believes that the independent fiduciary of the plan or IRA is a bank, insurance carrier, or registered broker-dealer or investment adviser, or any other independent fiduciary who manages or controls at least $50 million. Can a firm satisfy the reasonable belief requirements by including standardized representations in its disclosures that require the bank, insurance carrier, registered broker-dealer or investment adviser, or other independent fiduciary to affirmatively disclaim or modify the representations?

Yes. The Fiduciary Rule states that the reasonable belief requirements can be satisfied by relying on written representations from the bank, insurance carrier, or registered broker-dealer or investment adviser, or any other independent fiduciary. In the Department's view, negative consent to a written representation can be a written representation for purposes of the reasonable belief requirements.

Q14. Assume a registered investment adviser (model developer) provides a non-client-specific model portfolio to an unaffiliated registered investment adviser, bank, or broker-dealer. Assume further that the model developer does not individualize the model to the needs of any specific plan or IRA client of the fiduciary, does not contract with the end client, does not execute trades in the end client's portfolio, does not agree with the financial intermediary to assume fiduciary status, does not have any control over whether its model is used in managing any specific client account, and does not receive any fee or compensation directly from end clients who are plans or IRAs for use of the model. Would the model developer be providing investment advice for a fee or other compensation within the meaning of the Rule under those circumstances?

No. In the circumstances described above, the model developer would not be an investment advice fiduciary for purposes of the Fiduciary Rule because the Department would not treat the model developer as making a recommendation to an ERISA plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner for a fee or other compensation for purposes of the Fiduciary Rule. Assuming the model developer does not control how the unaffiliated registered investment adviser, bank, or broker-dealer charges fees to end clients, that conclusion would be the same under the circumstances described above even if the investment adviser pays a fee out of its own general assets to the model developer and then is separately reimbursed by a plan, plan participant or IRA (e.g., the investment adviser's invoice to the plan, participant or IRA includes a separate line item for model portfolio service fee).

Q15. How will the Department approach implementation of the Fiduciary Rule and exemptions during the transition period? To what extent will it adopt a non-enforcement policy for plans, plan fiduciaries, financial institutions, and others who are working diligently and in good faith to understand and comply with the new Rule and exemptions?

The Department has been and will continue working together with fiduciaries, financial institutions, recordkeepers, insurance companies, advisers, and other stakeholders to help them come into compliance with the Fiduciary Rule and related prohibited transaction exemptions. Although the Department has broad authority to investigate or audit employee benefit plans and plan fiduciaries, compliance assistance is a high priority for the Department. The Department's general approach to the June 9 implementation will be marked by an emphasis on compliance assistance (rather than citing violations and imposing penalties). This includes issuing a new temporary enforcement policy for the transition period, under which the Department will not pursue claims against fiduciaries who are working diligently and in good faith to comply with the fiduciary duty rule and exemptions. The temporary enforcement policy also includes confirmation from the Treasury Department and the IRS that the IRS will not apply § 4975 (which provides excise taxes relating to prohibited transactions) and related reporting obligations with respect to any transaction or agreement to which the Labor Department's temporary enforcement policy would apply.