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DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

[Application Number D–11327]

ZRIN 1210–ZA25

Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 86–128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; Amendment to and Partial Revocation of PTE 75–1, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefits Plans and Certain Broker-Dealers, Reporting Dealers and Banks.

AGENCY: Employee Benefits Security Administration (EBSA), Department of Labor.

ACTION: Adoption of amendments to and partial revocations of PTEs 86–128 and 75–1.

SUMMARY: This document contains amendments to Prohibited Transaction Exemptions (PTEs) 86–128 and 75–1, exemptions from certain prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986 (the Code). The ERISA and Code provisions at issue generally prohibit fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs) from engaging in self-dealing in connection with transactions involving plans and IRAs. PTE 86–128 allows fiduciaries to receive compensation in connection with certain securities transactions entered into by plans and IRAs. The amendments increase the safeguards of the exemption. This document also contains a revocation of PTE 86–128 with respect to transactions involving investment advice fiduciaries and IRAs, and of PTE 75–1, Part II(2), and PTE 75–1, Parts I(b) and I(c), in light of existing or newly finalized relief, including the relief provided in the ''Best Interest Contract Exemption,'' published elsewhere in this issue of the **Federal Register**. The amendments and revocations affect participants and beneficiaries of plans, IRA owners and certain fiduciaries of plans and IRAs.

DATES: *Issance date:* These amendments and partial revocations are issued June 7, 2016.

Applicability date: These amendments are applicable to transactions occurring on or after April 10, 2017. For more information, see *Applicability Date,* below.

FOR FURTHER INFORMATION CONTACT: Brian Shiker or Erin Hesse, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor, 200 Constitution Avenue NW., Suite 400, Washington DC 20210, (202) 693–8540 (not a toll-free number).

SUPPLEMENTARY INFORMATION: The Department is amending and partially revoking PTEs 86–128 and 75–1 on its own motion, pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637 (October 27, 2011)).

Executive Summary

Purpose of Regulatory Action

These amendments and revocations are being granted in connection with its publication today, elsewhere in this issue of the **Federal Register**, of a final regulation defining who is a ''fiduciary'' of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries (Regulation). The Regulation also applies to the definition of a ''fiduciary'' of a plan (including an IRA) under the Code. The Regulation amends a prior regulation, dating to 1975, specifying when a person is a ''fiduciary'' under ERISA and the Code by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. The Regulation takes into account the advent of 401(k) 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 existing regulation was issued. In light of the extensive changes in retirement investment practices and relationships, the Regulation updates 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.

PTE 86–128 permits certain fiduciaries to receive fees in connection with certain mutual fund and other securities transactions entered into by plans and IRAs. A number of changes are finalized with respect to the scope of the exemption and of another existing exemption, PTE 75–1, including revocation of many transactions originally permitted with respect to IRAs. These amendments and revocations affect the conditions under which fiduciaries may receive fees and compensation when they transact with plans and IRAs.

The amendments and the partial revocations to PTEs 86–128 and 75–1 are part of the Department's regulatory initiative to mitigate the effects of harmful conflicts of interest associated with fiduciary investment advice. In the absence of an exemption, ERISA and the Code generally prohibit fiduciaries from using their authority to affect or increase their own compensation. A new exemption for receipt of compensation by fiduciaries that provide investment advice to IRA owners,[1] plan participants and beneficiaries, and certain plan fiduciaries, is adopted elsewhere in this issue of the **Federal Register**, in the ''Best Interest Contract Exemption.'' In the Department's view, the provisions of the Best Interest Contract Exemption better protect the interests of IRAs with respect to investment advice regarding the transactions for which relief was revoked.

ERISA section 408(a) specifically authorizes the Secretary of Labor to grant administrative exemptions from ERISA's prohibited transaction provisions.[2] Regulations at 29 CFR

[1] For purposes of this amendment, the terms ''Individual Retirement Account'' or ''IRA'' mean any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

[2] Code section 4975(c)(2) authorizes the Secretary of the Treasury to grant exemptions from the parallel prohibited transaction provisions of the Code. Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)) (Reorganization Plan) generally transferred the authority of the Secretary of the Treasury to grant administrative exemptions under Code section 4975 to the Secretary of Labor. To rationalize the administration and interpretation of dual provisions under ERISA and the Code, the Reorganization Plan divided the interpretive and rulemaking authority for these provisions between the Secretaries of Labor and of the Treasury, so that, in general, the agency with responsibility for a given provision of Title I of ERISA would also have responsibility for the corresponding provision in the Code. Among the sections transferred to the Department were the prohibited transaction provisions and the definition of a fiduciary in both Title I of ERISA and in the Code. ERISA's prohibited transaction rules, 29 U.S.C. 1106–1108, apply to ERISA-covered plans, and the Code's corresponding prohibited transaction rules, 26 U.S.C. 4975(c), apply both to ERISA-covered pension plans that are tax-qualified pension plans, as well as other tax-advantaged arrangements, such as IRAs, that are not subject to the fiduciary responsibility and prohibited transaction rules in ERISA. Specifically, section 102(a) of the Reorganization Plan provides the Department of Labor with ''all authority'' for ''regulations, rulings, opinions, and exemptions under section 4975 [of the Code]'' subject to certain exceptions not relevant here. Reorganization Plan section 102. In President Carter's message to Congress regarding the Reorganization Plan, he made explicitly clear

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2570.30 to 2570.52 describe the procedures for applying for an administrative exemption. The Department has determined that the amended exemptions are administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners.

Summary of the Major Provisions

PTE 86–128, as amended, permits certain fiduciaries, including both investment advice fiduciaries as defined under the Regulation and fiduciaries with discretionary authority or control over plan assets (*i.e.,* investment management fiduciaries), and their affiliates, to receive a fee directly from a plan for effecting or executing securities transactions as an agent on behalf of a plan. It also allows such fiduciaries to act in an ''agency cross transaction''—as an agent both for the plan and for another party—and receive reasonable compensation from the other party. Relief is also provided for investment advice fiduciaries and investment management fiduciaries to receive commissions from a plan or a mutual fund in connection with mutual fund transactions involving plans. This relief was originally available in another exemption, PTE 75–1, Part II(2), which is revoked today.

The Department has amended the exemption to protect IRA investors from the harmful impact of conflicts of interest. Before these amendments, the exemption granted broad relief to transactions involving IRAs, without protective conditions. We have determined that this approach is unprotective of these retirement investors and incompatible with this regulatory initiative's goal of guarding retirement investors against the harms caused by conflicts of interest. Therefore, the amendment requires investment managers to meet the terms of the exemption before engaging in covered transactions with respect to IRAs, and revokes relief for investment advice fiduciaries with respect to IRAs. Investment advice fiduciaries with respect to IRAs may rely instead on the Best Interest Contract Exemption finalized today elsewhere in this issue of the **Federal Register**, which has conditions specifically tailored to protect the interests of IRA investors.

The amendment requires fiduciaries relying on PTE 86–128 to adhere to ''Impartial Conduct Standards,'' including acting in the best interest of plans and IRAs, when they exercise their fiduciary authority. The amendment also adopts the proposed definition of Commission which sets forth the limited types of payments that are permitted under the exemption, and revises the disclosure and recordkeeping requirements under the exemption.

Finally, other changes are adopted with respect to PTE 75–1. PTE 75–1, Part II, is amended to revise the recordkeeping requirement of that exemption. Part I(b) and (c) of PTE 75–1, which provided relief for certain non-fiduciary services to plans and IRAs, is revoked. Upon revocation, persons seeking to engage in such transactions should look to the existing statutory exemptions provided in ERISA section 408(b)(2) and Code section 4975(d)(2), and the Department's implementing regulations at 29 CFR 2550.408b–2, for relief.

Executive Order 12866 and 13563 Statement

Under Executive Orders 12866 and 13563, the Department must determine whether a regulatory action is ''significant'' and therefore subject to the requirements of the Executive Order and subject to review by the Office of Management and Budget (OMB). Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing and streamlining rules, and of promoting flexibility. It also requires federal agencies to develop a plan under which the agencies will periodically review their existing significant regulations to make the agencies' regulatory programs more effective or less burdensome in achieving their regulatory objectives.

Under Executive Order 12866, ''significant'' regulatory actions are subject to the requirements of the Executive Order and review by the Office of Management and Budget (OMB). Section 3(f) of Executive Order 12866, defines a ''significant regulatory action'' as an action that is likely to result in a rule (1) having an annual effect on the economy of $100 million or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as ''economically significant'' regulatory actions); (2) creating serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order. Pursuant to the terms of the Executive Order, OMB has determined that this action is ''significant'' within the meaning of Section 3(f)(4) of the Executive Order. Accordingly, the Department has undertaken an assessment of the costs and benefits of the proposal, and OMB has reviewed this regulatory action. The Department's complete Regulatory Impact Analysis is available at *www.dol.gov/ebsa.*

Background

Regulation Defining a Fiduciary

As explained more fully in the preamble to the Regulation, ERISA is a comprehensive statute designed to protect the interests of plan participants and beneficiaries, the integrity of employee benefit plans, and the security of retirement, health, and other critical benefits. The broad public interest in ERISA-covered plans is reflected in its imposition of fiduciary responsibilities on parties engaging in important plan activities, as well as in the tax-favored status of plan assets and investments. One of the chief ways in which ERISA protects employee benefit plans is by requiring that plan fiduciaries comply with fundamental obligations rooted in the law of trusts. In particular, plan fiduciaries must manage plan assets prudently and with undivided loyalty to the plans and their participants and beneficiaries.[3] In addition, they must refrain from engaging in ''prohibited transactions,'' which ERISA does not permit because of the dangers posed by the fiduciaries' conflicts of interest with respect to the transactions.[4] When fiduciaries violate ERISA's fiduciary duties or the prohibited transaction rules, they may be held personally liable

that as a result of the plan, ''Labor will have statutory authority for fiduciary obligations. . . . Labor will be responsible for overseeing fiduciary conduct under these provisions.'' Reorganization Plan, Message of the President. These amended exemptions provide relief from the indicated prohibited transaction provisions of both ERISA and the Code.

[3] ERISA section 404(a).

[4] ERISA section 406. ERISA also prohibits certain transactions between a plan and a ''party in interest.''

for the breach.[5] In addition, violations of the prohibited transaction rules are subject to excise taxes under the Code.

The Code also has rules regarding fiduciary conduct with respect to tax-favored accounts that are not generally covered by ERISA, such as IRAs. In particular, fiduciaries of these arrangements, including IRAs, are subject to the prohibited transaction rules and, when they violate the rules, to the imposition of an excise tax enforced by the Internal Revenue Service. Unlike participants in plans covered by Title I of ERISA, IRA owners do not have a statutory right to bring suit against fiduciaries for violation of the prohibited transaction rules.

Under this statutory framework, the determination of who is a "fiduciary" is of central importance. Many of ERISA's and the Code's protections, duties, and liabilities hinge on fiduciary status. In relevant part, ERISA section 3(21)(A) and Code section 4975(e)(3) provide that a person is a fiduciary with respect to a plan or IRA to the extent he or she (i) exercises any discretionary authority or discretionary control with respect to management of such plan or IRA, or exercises any authority or control with respect to management or disposition of its assets; (ii) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan or IRA, or has any authority or responsibility to do so; or, (iii) has any discretionary authority or discretionary responsibility in the administration of such plan or IRA.

The statutory definition deliberately casts a wide net in assigning fiduciary responsibility with respect to plan and IRA assets. Thus, "any authority or control" over plan or IRA assets is sufficient to confer fiduciary status, and any persons who render "investment advice for a fee or other compensation, direct or indirect" are fiduciaries, regardless of whether they have direct control over the plan's or IRA's assets and regardless of their status as an investment adviser or broker under the federal securities laws. The statutory definition and associated responsibilities were enacted to ensure that plans, plan participants, and IRA owners can depend on persons who provide investment advice for a fee to provide recommendations that are untainted by conflicts of interest. In the absence of fiduciary status, the providers of investment advice are neither subject to ERISA's fundamental fiduciary standards, nor accountable under ERISA or the Code for imprudent, disloyal, or biased advice.

In 1975, the Department issued a regulation, at 29 CFR 2510.3–21(c)(1975), defining the circumstances under which a person is treated as providing "investment advice" to an employee benefit plan within the meaning of ERISA section 3(21)(A)(ii) (the "1975 regulation").[6] The 1975 regulation narrowed the scope of the statutory definition of fiduciary investment advice by creating a five-part test for fiduciary advice. Under the 1975 regulation, for advice to constitute "investment advice," an adviser[7] must (1) render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property (2) on a regular basis (3) pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary that (4) the advice will serve as a primary basis for investment decisions with respect to plan assets, and that (5) the advice will be individualized based on the particular needs of the plan. The regulation provided that an adviser is a fiduciary with respect to any particular instance of advice only if he or she meets each and every element of the five-part test with respect to the particular advice recipient or plan at issue.

The market for retirement advice has changed dramatically since the Department first promulgated the 1975 regulation. Individuals, rather than large employers and professional money managers, have become increasingly responsible for managing retirement assets as IRAs and participant-directed plans, such as 401(k) plans, have supplanted defined benefit pensions. At the same time, the variety and complexity of financial products have increased, widening the information gap between advisers and their clients. Plan fiduciaries, plan participants and IRA investors must often rely on experts for advice, but are unable to assess the quality of the expert's advice or effectively guard against the adviser's conflicts of interest. This challenge is especially true of retail investors who typically do not have financial expertise, and can ill-afford lower returns to their retirement savings caused by conflicts. The IRA accounts of these investors often account for all or the lion's share of their assets, and can represent all of savings earned for a lifetime of work. Losses and reduced returns can be devastating to the investors who depend upon such savings for support in their old age. As baby boomers retire, they are increasingly moving money from ERISA-covered plans, where their employer has both the incentive and the fiduciary duty to facilitate sound investment choices, to IRAs where both good and bad investment choices are myriad and advice that is conflicted is commonplace. These rollovers are expected to approach $2.4 trillion cumulatively from 2016 through 2020.[8] These trends were not apparent when the Department promulgated the 1975 rule. At that time, 401(k) plans did not yet exist and IRAs had only just been authorized.

As the marketplace for financial services has developed in the years since 1975, the five-part test has now come to undermine, rather than promote, the statutes' text and purposes. The narrowness of the 1975 regulation has allowed advisers, brokers, consultants and valuation firms to play a central role in shaping plan and IRA investments, without ensuring the accountability that Congress intended for persons having such influence and responsibility. Even when plan sponsors, participants, beneficiaries, and IRA owners clearly relied on paid advisers for impartial guidance, the 1975 regulation has allowed many advisers to avoid fiduciary status and disregard basic fiduciary obligations of care and prohibitions on disloyal and conflicted transactions. As a consequence, these advisers have been able to steer customers to investments based on their own self-interest (*e.g.,* products that generate higher fees for the adviser even if there are identical lower-fee products available), give imprudent advice, and engage in transactions that would otherwise be prohibited by ERISA and the Code without fear of accountability under either ERISA or the Code.

In the Department's amendments to the regulation defining fiduciary advice within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B), (the "Regulation") which are also published in this issue of the **Federal Register**, the Department is replacing the existing regulation with

[5] ERISA section 409; *see also* ERISA section 405.

[6] The Department of Treasury issued a virtually identical regulation, at 26 CFR 54.4975–9(c), which interprets Code section 4975(e)(3).

[7] When using the term "adviser," the Department does not refer only to investment advisers registered under the Investment Advisers Act of 1940 or under state law, but rather to any person rendering fiduciary investment advice under the Regulation. For example, as used herein, an adviser can be an individual who is, among other things, a representative of a registered investment adviser, a bank or similar financial institution, an insurance company, or a broker-dealer.

[8] Cerulli Associates, "Retirement Markets 2015."

one that more appropriately distinguishes between the sorts of advice relationships that should be treated as fiduciary in nature and those that should not, in light of the legal framework and financial marketplace in which IRAs and plans currently operate.[9]

The Regulation describes the types of advice that constitute "investment advice" with respect to plan or IRA assets for purposes of the definition of a fiduciary at ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B). The Regulation covers ERISA-covered plans, IRAs, and other plans not covered by Title I, such as Keogh plans, and health savings accounts described in section 223(d) of the Code.

As amended, the Regulation provides that a person renders investment advice with respect to assets of a plan or IRA if, among other things, the person provides, directly to a plan, a plan fiduciary, plan participant or beneficiary, IRA or IRA owner, the following types of advice, for a fee or other compensation, whether 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; and

(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, selection of other persons to provide investment advice or investment management services, types of investment account arrangements (brokerage vs. advisory); 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.

In addition, in order to be treated as a fiduciary, such person, either directly or indirectly (*e.g.,* through or together with any affiliate), must: Represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code with respect to the advice described; represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code; render 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 direct 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.

The Regulation also provides that as a threshold matter in order to be fiduciary advice, the communication must be a "recommendation" as defined therein. The Regulation, as a matter of clarification, provides that a variety of other communications do not constitute "recommendations," including non-fiduciary investment education; general communications; and specified communications by platform providers. These communications which do not rise to the level of "recommendations" under the regulation are discussed more fully in the preamble to the final Regulation.

The Regulation also specifies certain circumstances where the Department has determined that a person will not be treated as an investment advice fiduciary even though the person's activities technically may satisfy the definition of investment advice. For example, the Regulation contains a provision excluding recommendations to independent fiduciaries with financial expertise that are acting on behalf of plans or IRAs in arm's length transactions, if certain conditions are met. The independent fiduciary must be a bank, insurance carrier qualified to do business in more than one state, investment adviser registered under the Investment Advisers Act of 1940 or by a state, broker-dealer registered under the Securities Exchange Act of 1934 (Exchange Act), or any other independent fiduciary that holds, or has under management or control, assets of at least $50 million, and: (1) The person making the recommendation must know or reasonably believe 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 (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition); (2) the person must fairly inform 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 must fairly inform the independent fiduciary of the existence and nature of the person's financial interests in the transaction; (3) the person must know or reasonably believe that the independent fiduciary of the plan or IRA is a fiduciary under ERISA or the Code, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition); and (4) the person cannot 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.

Similarly, the Regulation provides that the provision of any advice to an employee benefit plan (as described in section 3(3) of ERISA) by a person who is a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, or a swap clearing firm in connection with a swap or security-based swap, as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a) and section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is not investment advice if certain conditions are met. Finally, the Regulation describes certain communications by employees of a plan sponsor, plan, or plan fiduciary that would not cause the employee to be an investment advice fiduciary if certain conditions are met.

Prohibited Transactions

The Department anticipates that the Regulation will cover many investment professionals who did not previously consider themselves to be fiduciaries under ERISA or the Code. Under the Regulation, these entities will be subject to the prohibited transaction restrictions in ERISA and the Code that apply specifically to fiduciaries. ERISA section 406(b)(1) and Code section 4975(c)(1)(E) prohibit a fiduciary from dealing with the income or assets of a plan or IRA in his own interest or his own account. ERISA section 406(b)(2), which does not apply to IRAs, provides that a fiduciary shall 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." ERISA

[9] The Department initially proposed an amendment to its regulation defining a fiduciary within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) on October 22, 2010, at 75 FR 65263. It subsequently announced its intention to withdraw the proposal and propose a new rule, consistent with the President's Executive Orders 12866 and 13563, in order to give the public a full opportunity to evaluate and comment on the new proposal and updated economic analysis. The first proposed amendment to the rule was withdrawn on April 20, 2015, *see* 80 FR 21927.

section 406(b)(3) and Code section 4975(c)(1)(F) prohibit a fiduciary from receiving any consideration for his own personal account from any party dealing with the plan or IRA in connection with a transaction involving assets of the plan or IRA.

Parallel regulations issued by the Departments of Labor and the Treasury explain that these provisions impose on fiduciaries of plans and IRAs a duty not to act on conflicts of interest that may affect the fiduciary's best judgment on behalf of the plan or IRA.[10] The prohibitions extend to a fiduciary causing a plan or IRA to pay an additional fee to such fiduciary, or to a person in which such fiduciary has an interest that may affect the exercise of the fiduciary's best judgment as a fiduciary. Likewise, a fiduciary is prohibited from receiving compensation from third parties in connection with a transaction involving the plan or IRA.[11]

Investment professionals are often compensated on a commission basis for effecting or executing securities transactions for plans, plan participants and beneficiaries, and IRAs. Because such payments vary based on the advice provided, the Department views a fiduciary that recommends to a plan or IRA a securities transaction and then receives a commission for itself or a related party as violating the prohibited transaction provisions of ERISA section 406(b) and Code section 4975(c)(1)(E).

Prohibited Transaction Exemptions 86–128 and 75–1, Part II

As the prohibited transaction provisions demonstrate, ERISA and the Code strongly disfavor conflicts of interest. In appropriate cases, however, the statutes provide exemptions from their broad prohibitions on conflicts of interest. For example, ERISA section 408(b)(14) and Code section 4975(d)(17) specifically exempt transactions involving the provision of fiduciary investment advice to a participant or beneficiary of an individual account plan or IRA owner if the advice, resulting transaction, and the adviser's fees meet stringent conditions carefully designed to guard against conflicts of interest.

In addition, the Secretary of Labor has discretionary authority to grant administrative exemptions under ERISA and the Code on an individual or class basis, but only if the Secretary first finds that the exemptions are (1) administratively feasible, (2) in the interests of plans and their participants and beneficiaries and IRA owners, and (3) protective of the rights of the participants and beneficiaries of such plans and IRA owners. Accordingly, fiduciary advisers may always give advice without need of an exemption if they avoid the sorts of conflicts of interest that result in prohibited transactions. However, when they choose to give advice in which they have a conflict of interest, they must rely upon an exemption.

Pursuant to its exemption authority, the Department has previously granted several conditional administrative class exemptions that are available to fiduciary advisers in defined circumstances. PTE 86–128[12] historically provided an exemption from these prohibited transactions provisions for certain types of fiduciaries to use their authority to cause a plan or IRA to pay a fee to the fiduciary, or its affiliate, for effecting or executing securities transactions as agent for the plan. The exemption further provided relief for these types of fiduciaries to act as agent in an "agency cross transaction" for both a plan or IRA and one or more other parties to the transaction, and for such fiduciaries or their affiliates to receive fees from the other party(ies) in connection with the agency cross transaction. An agency cross transaction is defined in the exemption as a securities transaction in which the same person acts as agent for both any seller and any buyer for the purchase or sale of a security.

As originally granted, the exemption in PTE 86–128 could be used only by fiduciaries who were not discretionary trustees, plan administrators, or employers of any employees covered by the plan.[13] PTE 86–128 was amended in 2002 to permit use of the exemption by discretionary trustees, and their affiliates subject to certain additional requirements.[14] Additionally, in 2011 the Department specifically noted in an Advisory Opinion that PTE 86–128 provides relief for covered transactions engaged in by fiduciaries who provide investment advice for a fee.[15]

Prohibited Transaction Exemption 75–1, Part II(2), provided relief for the purchase or sale by a plan of securities issued by an open-end investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*), provided that no fiduciary with respect to the plan who made the decision on behalf of the plan to enter into the transaction was a principal underwriter for, or affiliated with, such investment company within the meaning of sections 2(a)(29) and 2(a)(3) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(29) and 80a–2(a)(3)). The exemption permitted a fiduciary to receive a commission in connection with the purchase.

The conditions of the exemption required that the fiduciary customarily purchase and sell securities for its own account in the ordinary course of its business, that the transaction occur on terms at least as favorable to the plan as an arm's length transaction with an unrelated party, and that records be maintained. Contrary to our current approach to recordkeeping, the exemption imposed the recordkeeping burden on the plan or IRA involved in the transaction, rather than the fiduciary.

In connection with the proposed Regulation, the Department proposed an amendment to PTE 86–128. First, the Department proposed to increase the safeguards of the exemption by requiring fiduciaries that rely on the exemption to adhere to certain "Impartial Conduct Standards," including acting in the best interest of the plans and IRAs when exercising fiduciary authority, and by more precisely defining the types of payments that are permitted under the exemption.[16] Second, on a going forward basis, the Department proposed to restrict relief to IRA fiduciaries with discretionary authority or control over the management of the IRA's assets (*i.e.,* investment managers) and to impose the exemption's protective conditions on investment management fiduciaries when they engage in transactions with IRAs. Finally, the Department proposed

[10] Subsequent to the issuance of these regulations, Reorganization Plan No. 4 of 1978, 5 U.S.C. App. (2010), divided rulemaking and interpretive authority between the Secretaries of Labor and the Treasury. The Secretary of Labor was given interpretive and rulemaking authority regarding the definition of fiduciary under both Title I of ERISA and the Internal Revenue Code. *Id.* section 102(a) ("all authority of the Secretary of the Treasury to issue [regulations, rulings opinions, and exemptions under section 4975 of the Code] is hereby transferred to the Secretary of Labor").

[11] 29 CFR 2550.408b–2(e); 26 CFR 54.4975–6(a)(5).

[12] PTE 86–128, 51 FR 41686 (November 18, 1986), replaced PTE 79–1, 44 FR 5963 (January 30, 1979) and PTE 84–46, 49 FR 22157 (May 25, 1984).

[13] Plan trustees, plan administrators and employers were permitted to rely on the exemption if they returned or credited to the plan all profits (recapture of profits) earned in connection with the transactions covered by the exemption.

[14] 67 FR 64137 (October 17, 2002).

[15] *See* Advisory Opinion 2011–08A (June 21, 2011).

[16] As noted above, for purposes of this amendment, the terms "Individual Retirement Account" or "IRA" mean any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

to revoke relief for investment advice fiduciaries with respect to IRAs.

The Department also proposed that PTE 86–128 would apply to the transactions originally permitted under PTE 75–1, Part II(2). In this connection, we proposed to revoke PTE 75–1, Part II(2). We also proposed to revoke PTE 75–1, Part I(b) and (c), which provided relief for certain non-fiduciary services to plans and IRAs, in light of the existing statutory exemptions provided in ERISA section 408(b)(2) and Code section 4975(d)(2) and the Department's implementing regulations at 29 CFR 2550.408b–2.

These amendments and partial revocations follow a lengthy public notice and comment period, which gave interested persons an extensive opportunity to comment on the proposed Regulation, amendments and other related exemption proposals. The proposals initially provided for 75-day comment periods, ending on July 6, 2015, but the Department extended the comment periods to July 21, 2015. The Department then held four days of public hearings on the new regulatory package, including the proposed exemptions, in Washington, DC from August 10 to 13, 2015, at which over 75 speakers testified. The transcript of the hearing was made available on September 8, 2015, and the Department provided additional opportunity for interested persons to comment on the proposals or hearing transcript until September 24, 2015. A total of over 3000 comment letters were received on the new proposals. There were also over 300,000 submissions made as part of 30 separate petitions submitted on the proposal. These comments and petitions came from consumer groups, plan sponsors, financial services companies, academics, elected government officials, trade and industry associations, and others, both in support and in opposition to the rule.[17]

The Department has reviewed all comments, and after careful consideration of comments received, has decided to grant the amendments to and partial revocations of PTEs 86–128 and 75–1, Part II, as described below.

Description of the Amendments and Partial Revocations

As amended, PTE 86–128 preserves originally granted relief for mutual fund and securities transactions involving plans, with the added safeguards of the Impartial Conduct Standards and a clearer definition of the types of payments that are permitted. The amendment also adopts the proposed approach to relief for fiduciaries with respect to IRAs, which significantly increased the safeguards to these retirement investors. Investment management fiduciaries to IRAs may rely on Section I(a) of PTE 86–128 if they satisfy the conditions of the exemption, including the Impartial Conduct Standards, the disclosures and the authorizations. However, relief for investment advice fiduciaries is revoked. Also revoked is PTE 75–1, Part II(2), which permitted fiduciaries to receive compensation in connection with certain mutual fund transactions, under very few applicable safeguards, and PTE 75–1, Part I(b) and (c), in light of the statutory exemptions in ERISA section 408(b)(2) and Code section 4975(d)(2).

The Department revised PTE 86–128 and 75–1, Part II, in these ways in conjunction with the grant of a new exemption, the Best Interest Contract Exemption, adopted elsewhere in this issue of the **Federal Register**, that is specifically applicable to advice to certain "retirement investors"—generally retail investors such as plan participants and beneficiaries, IRA owners, and certain plan fiduciaries. The Best Interest Contract Exemption provides broader relief for investment advice fiduciaries recommending mutual fund and other securities transactions to retirement investors. The conditions of the Best Interest Contract Exemption more appropriately address these arrangements.

With respect to IRA owners and participants and beneficiaries in non-ERISA plans, the Best Interest Contract Exemption requires the investment advice fiduciary to contractually acknowledge fiduciary status and commit to adhere to the Impartial Conduct Standards. As a result, the Best Interest Contract Exemption ensures that IRA owners and the non-ERISA plan participants and beneficiaries have a contract-based claim if their advisers violate the fundamental fiduciary obligations of prudence and loyalty, a protection that is not present in PTE 86–128 and 75–1, Part II.

More generally, the Best Interest Contract Exemption includes safeguards that are uniquely protective of both plans and IRAs in today's complex financial marketplace, including the requirement that financial institutions relying on the exemption adopt anti-conflict policies and procedures designed to ensure that advisers satisfy the Impartial Conduct Standards. The Best Interest Contract Exemption is specifically tailored to address, among other things, the particular conflicts of interest associated with third party payments such as revenue sharing and 12b–1 fees that may not be readily apparent to the retirement investor but can provide powerful incentives to investment advice fiduciaries.

In addition to the Best Interest Contract Exemption, the Regulation adopted today makes provision for certain parties to avoid fiduciary status when they engage in arm's length transactions with plans or IRAs that are independently represented by a fiduciary with financial expertise. Such independent fiduciaries generally include banks, insurance carriers, registered investment advisers, broker-dealers and other fiduciaries with $50 million or more in assets under management or control. This provision in the Regulation complements the limitations in the Best Interest Contract Exemption and is available for transactions involving mutual fund and other securities transactions.

A number of commenters objected generally to changes to PTE 86–128 and PTE 75–1, Part II(2), on the basis that the originally granted exemptions provided sufficient protections to retirement investors. Commenters said there is no demonstrated harm to these consumers under the existing approach. The Department does not agree. The extensive changes in the retirement plan landscape and the associated investment market in recent decades undermine the continued adequacy of our original approach in PTE 86–128 and PTE 75–1, Part II(2). As noted in the accompanying Regulatory Impact Analysis, the Department has determined that investors saving for retirement lose billions of dollars each year as a result of conflicts of interest. PTE 86–128 and PTE 75–1 did not adequately safeguard against these losses, and indeed, in some cases, imposed no protective conditions whatsoever with respect to conflicted investment advice. The changes to these exemptions, discussed below, respond to the ongoing harms caused by conflicts of interest.

The Department did not fully revoke PTE 86–128 and PTE 75–1, Part II, however, where it determined that the conditions of those exemptions continued to be appropriate in connection with the narrow scope of relief provided. PTE 75–1, Part II, remains available for transactions involving non-fiduciary service providers and PTE 86–128 continues to provide narrow relief for commission payments to fiduciaries, in transactions involving ERISA plans and managed

[17] As used throughout this preamble, the term "comment" refers to information provided through these various sources, including written comments, petitions and witnesses at the public hearing.

IRAs, subject to the Impartial Conduct Standards as additional conditions of relief. Broader relief, for more types of payments to investment advice fiduciaries, is provided in the Best Interest Contract Exemption for transactions involving plans, IRAs, and non-ERISA plans. The Best Interest Contract Exemption is designed to address the fiduciary conflicts of interest associated with the variety of payments received in connection with transactions involving all plans and IRAs.

Scope of the Amended PTE 86–128

As amended, PTE 86–128 applies to the following transactions set forth in Section I of the exemption:

(a) (1) A plan fiduciary's using its authority to cause a plan to pay a Commission directly to that person or a Related Entity as agent for the plan in a securities transaction, but only to the extent that the securities transactions are not excessive, under the circumstances, in either amount or frequency; and (2) A plan fiduciary's acting as the agent in an agency cross transaction for both the plan and one or more other parties to the transaction and the receipt by such person of a Commission from one or more other parties to the transaction; and

(b) A plan fiduciary's using its authority to cause the plan to purchase shares of an open end investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) (Mutual Fund) from such fiduciary, and to the receipt of a Commission by such person in connection with such transaction, but only to the extent that such transactions are not excessive, under the circumstances, in either amount or frequency; provided that, the fiduciary (1) is a broker-dealer registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) acting in its capacity as a broker-dealer, and (2) is not a principal underwriter for, or affiliated with, such Mutual Fund, within the meaning of sections 2(a)(29) and 2(a)(3) of the Investment Company Act of 1940.

Thus, Section I(a) provides relief for transactions involving securities where a Commission, as defined in the exemption, is paid directly by the plan or IRA. Section I(b) provides relief for mutual fund transactions where a Commission is received but it does not have to be paid directly by the plan; the relief in Section I(b) extends to Commissions paid by a mutual fund or its affiliate. The final exemption makes clear that the relief provided in Section I(b) was intended to apply to broker-dealers acting in their capacity as broker-dealers.

Section I(c) establishes certain limitations on the relief provided, with respect to transactions involving IRAs. Section I(c)(1) provides that the exemption in Section I(a) does not apply if (A) the plan is an IRA [18] and (B) the fiduciary engaging in the transaction is a fiduciary by reason of the provision of investment advice for a fee, as described in Code section 4975(e)(3)(B) and the applicable regulations. Section I(c)(2) provides that the exemption in Section I(b) does not apply to transactions involving IRAs. Relief for investment advice fiduciaries (including broker-dealers) providing investment advice to IRAs is available under the Best Interest Contract Exemption.

Section I(c) was revised from the proposal, which stated: ''The exemptions set forth in Section I(a) and (b) do not apply to a transaction if (1) the plan is an Individual Retirement Account and (2) the fiduciary engaging in the transaction is a fiduciary by reason of the provision of investment advice for a fee, as described in Code section 4975(e)(3)(B) and the applicable regulations.'' The revision was made to clarify the intent of the proposal that, as amended, the exemption should be relied on for transactions involving IRAs only by fiduciaries with full investment discretion. As a result, the exemption in Section I(b) effectively would have been unavailable with respect to IRAs, since Section I(b) provides relief only to broker-dealers acting in their capacities as broker dealers. The final exemption makes that restriction explicit.

In addition, the exclusion from conditions of the exemption for certain plans not covering employees, including IRAs, contained in Section IV(a), was eliminated. Therefore, while investment advice fiduciaries to IRAs must rely on another exemption, fiduciaries that exercise full discretionary authority or control with respect to IRAs as described in Code section 4975(e)(3)(A) (*i.e.,* investment managers) may continue to rely on Section I(a) of the amended exemption, as long as they comply with the Impartial Conduct Standards and make the disclosures and receive the approvals that were originally required by the exemption with respect to other types of plans.

The Department notes that the transaction description set forth in Section I(a) of the proposal has been revised to refer to a ''securities transaction.'' The addition of the language is simply to ensure clarity with respect to the scope of the relief. PTE 86–128 has always been limited to securities transactions, and the Department added the language to remove any doubt that may have been created by its absence from the proposed language. Comments on issues of scope are discussed below.

IRAs

Commenters have broadly argued that no changes should be made with respect to the relief originally provided to and conditions imposed on IRA fiduciaries. The commenters stated that the Department has offered no evidence that a change is necessary. Further, they argued that excluding only certain IRA fiduciaries from PTE 86–128 will increase cost and create confusion.

As reflected in the Regulatory Impact Analysis, the prevalence of conflicts of interest in the marketplace for retirement investments is causing ongoing harm to retirement investors. Developments since the Department granted PTE 86–128, and its predecessor PTE 75–1, Part I, have exacerbated the dangers posed by conflicts of interest in the IRA marketplace. The amount of assets held in IRAs has grown dramatically, as the financial services marketplace and financial products have become more complex, and compensation structures have become increasingly conflicted.

To put the changes in the market place in context, IRAs were only established in 1975 (the same year as PTE 75–1 was issued). By 1984, IRAs still held just $159 billion in assets, compared with $589 billion in private-sector defined benefit plans and $287 billion in private-sector defined contribution plans. By the end of the 2014 third quarter, in contrast, IRAs held $6.3 trillion, far surpassing both defined benefit plans ($3.0 trillion) and defined contribution plans ($5.3 trillion). If current trends continue, defined benefit plans' role will decline further, and IRA growth will continue to outstrip that of defined contribution plans, as the workforce ages and the baby boom generation retires and more defined contribution accounts (and sometimes lump sum payouts of defined benefit benefits) are rolled into IRAs. Almost $2.5 trillion is projected to be rolled over from ERISA plans to IRAs between 2015 and 2019. The growth of IRAs has made more middle- and lower-income families into investors, and sound investing more critical to such families' retirement security.

[18] For purposes of this amendment, the terms ''Individual Retirement Account'' or ''IRA'' mean any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

Further, as more families have invested, investing has become more complicated. As IRAs grew during the 1980s and 1990s, their investment pattern changed, shifting away from bank products and toward mutual funds. Bank products typically provide a specified investment return, and perhaps charge an explicit fee. Single issue securities lack diversification and have uncertain returns, but the expenses associated with acquiring and holding them typically take the form of explicit up-front commissions and perhaps some ongoing account fees. Mutual funds are more diversified (and in this respect can simplify investing), but also have uncertain returns, and their fee arrangements can be more complex, and can include a variety of revenue sharing and other arrangements that can introduce conflicts into investment advice and that usually are not fully transparent to investors. The growth in IRAs and the shift in how IRA assets are invested point toward a growing risk that conflicts of interest will taint investment advice regarding IRAs and thereby compromise retirement security.

Prior to these amendments, PTE 86–128 did not protect IRA investors with respect to the transactions it covered, but rather gave fiduciaries a broad unconditional pass from the prohibited transaction rules, which Congress enacted to protect retirement investors from the dangers posed by conflicts of interest. Continuing to give free reign to conflicts of interest in this manner cannot be squared with the important anti-conflict purposes of the prohibited transaction rules, nor would it be in the interests of the IRAs or protective of the rights of IRA owners.[19] The amendments and revocations finalized today protect IRA investors from the abuses posed by conflicts of interest and the injuries identified in the Regulatory Impact Analysis. The decision to eliminate relief for investment advice fiduciaries in PTE 86–128 with respect to IRAs is consistent with the global approach that the Department has crafted to address the unique issues presented by investors in IRAs. Specifically, rather than increasing confusion and cost, the revocation of relief for such advisers from PTE 86–128 and the provision of relief for such advisers in the Best Interest Contract Exemption will ensure that IRA owners are treated consistently by those fiduciaries, as the fiduciaries comply with a common set of standards. The Best Interest Contract Exemption was crafted to more specifically address and protect the interests of retail retirement investors—plan participants and beneficiaries, IRA owners and certain plan fiduciaries—that rely on investment advice fiduciaries to engage in securities transactions, and it contains safeguards specifically crafted for these investors.

The amendments to PTE 86–128, by incorporating the same Impartial Conduct Standards as are required in the Best Interest Contract Exemption, will result in fiduciaries adhering to a common set of fiduciary norms across exemptions, covering multiple products and types of transactions. The uniform imposition of the standards will also reduce confusion to those consumers who already think their advisers owe them a fiduciary duty.[20] These amendments ensure that plans and IRAs receive advice that is subject to prudence and is in their best interest, and is not tilted to particular products, recommendations, or fees because they are less regulated, even though just as dangerous.

One commenter suggested that "sophisticated" IRA owners should not be subject to the exemption's amendments. The commenter argued that large or sophisticated investors are not in need of the protections and disclosures the amended exemption provides to IRAs, whether through PTE 86–128 or the Best Interest Contract Exemption. The Department does not agree, however, that the size of the account balance or the wealth of the retirement invest are strong indicators of investment expertise. Nor does the Department believe that large accounts or wealthy investors are less deserving of protection from losses caused by imprudent or disloyal advice. Individuals may have large account balances as a result of years of hard work and careful savings, rollover of an account balance from a defined benefit plan, or inheritance. None of these pathways to large accounts necessarily correlate with financial acumen or the ability to bear losses. Similarly, the Department does not believe that any particular level of income or amount of net assets renders disclosures of fees and conflicts of interest unnecessary or negates the importance of adherence to basic fiduciary norms when giving advice. In the Department's view, all IRAs would benefit from consistent adherence to fiduciary norms and basic disclosure.

Finally, a commenter requested assurances that this revocation of relief with respect to IRA investment advisers was not applicable to investment advice fiduciaries that provide advice to non-IRA plan clients. The language of Section I(c)(1) and (2) is specifically limited to IRAs (as defined in the exemption). If a plan is not an IRA, it is not subject to the exclusion set forth in that section, and the fiduciary may rely upon the exemption to the extent the transaction falls within the exemption's scope and the fiduciary complies with the exemption's conditions, further described below, such as the Impartial Conduct Standards, disclosure, and consent requirements. However, the Department notes the exemption, as amended, will not provide relief for a recommended rollover from an ERISA plan to an IRA, where the resulting compensation is a Commission on the IRA investments.

Mutual Fund Exemption

Section I(b) of PTE 86–128, as amended, includes relief for mutual fund transactions, originally permitted under PTE 75–1, Part II(2). Granted under the heading "Principal transactions," PTE 75–1, Part II(2) contained an exemption for mutual fund purchases between fiduciaries and plans or IRAs. Although it provided relief for fiduciary self-dealing and conflicts of interest, the exemption was only available if the fiduciary who decides on behalf of the plan or IRA to enter into the transaction was not a principal underwriter for, or affiliated with, the mutual fund. As set forth above, it was subject to minimal safeguards for retirement investors.

The new covered transaction in Section I(b) applies to broker-dealers acting in their capacity as broker-dealers. The exemption is subject to the general prohibition in PTE 86–128 on churning, and the new Impartial Conduct Standards in Section II. In addition, a new Section IV to PTE 86–128 sets forth conditions applicable solely to the proposed new covered transaction. The new Section IV incorporates conditions originally applicable to PTE 75–1, Part II(2).

Specifically, the conditions applicable to the new covered transaction in Section I(b), as set forth in Section IV, are: (1) The fiduciary customarily sells securities for its own account in the ordinary course of its business as a broker-dealer; (2) the transaction is at least as favorable to the plan or IRA as an arm's length transaction with an unrelated party would be; and (3) unless

[19] Code section 4975(c)(2).

[20] Angela A. Hung, Noreen Clancy, Jeff Dominitz, Eric Talley, Claude Berrebi, Farrukh Suvankulov, Investor and Industry Perspectives on Investment Advisers and Broker-Dealers, RAND Institute for Civil Justice, commissioned by the U.S. Securities and Exchange Commission, 2008, at *http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.*

rendered inapplicable by Section V of the exemption, the requirements of Sections III(a) through III(f), III(h) and III(i) (if applicable), and III(j), governing who may rely on the exemption, and requiring certain disclosures and authorizations, are satisfied with respect to the transaction. The exceptions contained in Section V are applicable to this new covered transaction as well.[21]

One commenter expressed the broad belief that no changes should be made to the existing exemptive relief. The commenter indicated that no evidence of harm exists and no policy reason could justify the change, arguing that the only result will be increased burdens and costs. The Department disagrees. As outlined in the proposal and as described above, the movement of the existing exemption from PTE 75–1, Part II(2), to PTE 86–128 for plans, or the Best Interest Contract Exemption, for IRAs, is fitting based on the nature of the transaction, the ongoing injury that conflicts of interest cause to retirement investors, and the additional protections that can be provided to retirement investors. The Department's accompanying Regulatory Impact Analysis indicates that the status quo is harming investors.

Beyond a general objection, the same commenter suggested that the scope of the relief provided by Section I(b) should be significantly expanded. As originally proposed, Section I(b) was limited to transactions involving shares in an open end investment company registered under the Investment Company Act of 1940, in which the fiduciary was acting as "principal." The commenter indicated that the exemption should include Unit Investment Trusts, which are registered investment companies but not open end investment companies, as well as other products that are traded on a principal basis.

The Department does not disagree with the commenter's premise that relief may be necessary for certain principal transactions and transactions involving Unit Investment Trusts. However, such relief is provided through separate exemptions under specifically tailored conditions, the Best Interest Contract Exemption and the Principal Transactions Exemption, published elsewhere in this issue of the **Federal Register**. Both of these exemptions cover Unit Investment Trusts and the Principal Transactions Exemption provides relief for principal transactions in certain other assets.

One commenter reacted to the Department's description of the transaction described in PTE 75–1, Part II(2) as a "riskless principal" transaction. The commenter indicated that the language of proposed Section I(b) required the transaction to be a "principal" transaction and would require the fiduciary engaged in the transaction to report the transaction as a principal transaction, while some market participants confirm these sales as agency trades. Although agency trades are covered by the relief in Section I(a), the relief in Section I(b) is broader in the sense that it covers the receipt of a commission from either the plan or the mutual fund.

The Department has revised the language of Section I(b) to eliminate the reference to the fiduciary acting as "principal." The Department did not intend to require market participants to change the nomenclature in their confirmations or to exclude any transactions based solely on the nomenclature. To avoid any resulting confusion, the mutual fund exemption in PTE 86–128, as amended, is not limited to riskless principal transactions, and provides relief with respect to covered transactions regardless of whether they are technically confirmed as "principal" transactions.

In connection with the new covered transaction, the Department is revoking PTE 75–1, Part II(2), which had provided relief for a plan fiduciary's using its authority to cause the plan to purchase shares of a mutual fund from the fiduciary, because those transactions are now covered by PTE 86–128.

Related Entities

As originally promulgated, PTE 86–128 provided relief for a fiduciary to use its authority to cause a plan or IRA to pay a fee to *that person* for effecting or executing securities transactions. The term "person" was defined to include the person and its affiliates, which are: (1) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with, the person; (2) any officer, director, partner, employee, relative (as defined in ERISA section 3(15)), brother, sister, or spouse of a brother or sister, of the person; and (3) any corporation or partnership of which the person is an officer, director or employee or in which such person is a partner.

In the amended exemption, relief extends beyond the person and its affiliates, to "related entities."[22] The term "related entity" is defined as an entity, other than an affiliate, in which a fiduciary has an interest that may affect the exercise of its best judgment as a fiduciary. This aspect of the proposal was designed to address concern that the relief provided by the exemption to persons (including their affiliates) would otherwise be too narrow to give adequate relief for covered transactions. In this regard, it is a prohibited transaction for a fiduciary to use the "authority, control, or responsibility which makes such a person a fiduciary to cause a plan to pay an additional fee to such fiduciary (or to a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary) to provide a service."[23] It is not necessary, however, for a fiduciary to have control over or be under control by an entity (as contemplated by the definition of "affiliate") in order for the fiduciary to have an interest in the entity that may arguably affect the exercise of the fiduciary's best judgment as a fiduciary. As a result, the exemption might not have given full relief for some covered transactions because they generated compensation for related entities that fell outside the definition of "affiliate."

Accordingly, the Department proposed revising the exemption to encompass such related parties, and requested comment on the necessity of incorporating relief for related entities in PTE 86–128, and the approach taken in the proposal to do so. A single commenter responded to the Department's call for comment, and it supported incorporating relief for related entities and expressed its general agreement with the necessity of such action. The Department has finalized these amendments without change.

Impartial Conduct Standards

Section II of PTE 86–128, as amended, requires that the fiduciary engaging in a covered transaction comply with fundamental Impartial Conduct Standards. Generally stated, the Impartial Conduct Standards require that, with respect to the transaction, the fiduciary must act in the plan's or IRA's Best Interest; receive no more than reasonable compensation, and make no misleading statements to the plan or IRA. As defined in the exemption, a fiduciary acts in the Best Interest of a

[21] Relief was not proposed in the new Section I(b) for sales by a plan or IRA to a fiduciary due to the Department's belief that it is not necessary for a plan to sell a mutual fund share to a fiduciary. The Department requested comment on this limitation but no comments were received. As a result, in the final amendment, the Department has not expanded the description of the covered transaction in this respect.

[22] See Section VII(m).

[23] ERISA section 406(b); Code section 4975(c)(1)(E).

plan or IRA when the fiduciary acts 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 plan or IRA, without regard to the financial or other interests of the fiduciary, its affiliate, a Related Entity or other party.

The Impartial Conduct Standards represent fundamental obligations of fair dealing and fiduciary conduct. The concepts of prudence, undivided loyalty and reasonable compensation are all deeply rooted in ERISA and the common law of agency and trusts.[24] These longstanding concepts of law and equity were developed in significant part to deal with the issues that arise when agents and persons in a position of trust have conflicting loyalties, and accordingly, are well-suited to the problems posed by conflicted investment advice. The phrase ''without regard to'' is a concise expression of ERISA's duty of loyalty, as expressed in section 404(a)(1)(A) of ERISA and applied in the context of advice. It is consistent with the formulation stated in the common law, and it is consistent with the language used by Congress in Section 913(g)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act),[25] and cited in the Staff of the U.S. Securities and Exchange Commission ''Study on Investment Advisers and Broker-Dealers, as required under the Dodd-Frank Act'' (Jan. 2011) (SEC staff Dodd-Frank Study).[26] Further, the ''reasonable compensation'' obligation is already required under ERISA section 408(b)(2) and Code section 4975(d)(2) of financial services providers, including financial services providers, whether fiduciaries or not.[27]

Under ERISA section 408(a) and Code section 4975(c)(2), the Department cannot grant an exemption unless it first finds that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners. Imposition of the Impartial Conduct Standards as a condition of this exemption is critical to the Department's ability to make these findings.

The Impartial Conduct Standards are conditions of the amended exemption for the provision of advice with respect to all plans and IRAs. However, in contrast to the Best Interest Contract Exemption and the Principal Transactions Exemption, there is no contract requirement for advice to plans or IRAs under this amended exemption.

The Department received many comments on the proposal to include the Impartial Conduct Standards as part of these existing exemptions. A number of commenters focused on the Department's authority to impose the Impartial Conduct Standards as conditions of the exemption. Commenters' arguments regarding the Impartial Conduct Standards as applicable to IRAs and non-ERISA plans were based generally on the fact that the standards, as noted above, are consistent with longstanding principles of prudence and loyalty set forth in ERISA section 404, but which have no counterpart in the Code. Commenters took the position that because Congress did not choose to impose the standards of prudence and loyalty on fiduciaries with respect to IRAs and non-ERISA plans, the Department exceeded its authority in proposing similar standards as a condition of relief in a prohibited transaction exemption.

With respect to ERISA plans, commenters stated that Congress' separation of the duties of prudence and loyalty (in ERISA section 404) from the prohibited transaction provisions (in ERISA section 406), showed an intent that the two should remain separate. Commenters additionally questioned why the conduct standards were necessary for ERISA plans, when such plans already have an enforceable right to fiduciary conduct that is both prudent and loyal. Commenters asserted that imposing the Impartial Conduct Standards as conditions of the exemption created strict liability for prudence violations.

Some commenters additionally took the position that Congress, in the Dodd-Frank Act, gave the SEC the authority to establish standards for broker-dealers and investment advisers and therefore, the Department did not have the authority to act in that area.

The Department disagrees that this amendment to the exemption exceeds its authority. The Department has clear authority under ERISA section 408(a) and the Reorganization Plan [28] to grant administrative exemptions from the prohibited transaction provisions of both ERISA and the Code. Congress gave the Department broad discretion to grant or deny exemptions and to craft conditions for those exemptions, subject only to the overarching requirement that the exemption be administratively feasible, in the interests of plans, plan participants and beneficiaries and IRA owners, and protective of their rights.[29] Nothing in ERISA or the Code suggests that the Department is forbidden to borrow from time-honored trust-law standards and principles developed by the courts to ensure proper fiduciary conduct.

The Impartial Conduct Standards represent, in the Department's view, baseline standards of fundamental fair dealing that must be present when fiduciaries make conflicted investment recommendations to retirement investors. After careful consideration, the Department determined that broad relief could be provided to investment advice fiduciaries receiving conflicted compensation only if such fiduciaries provided advice in accordance with the Impartial Conduct Standards—*i.e.,* if they provided prudent advice without regard to the interests of such fiduciaries and their affiliates and related entities, in exchange for reasonable compensation and without misleading the investors.

These Impartial Conduct Standards are necessary to ensure that advisers' recommendations reflect the best interest of their retirement investor customers, rather than the conflicting financial interests of the advisers and their financial institutions. As a result, advisers and financial institutions bear the burden of showing compliance with the exemption and face liability for engaging in a non-exempt prohibited

[24] See generally ERISA sections 404(a), 408(b)(2); Restatement (Third) of Trusts section 78 (2007), and Restatement (Third) of Agency section 8.01.

[25] Section 913(g) governs ''Standard of Conduct'' and subsection (1) provides that ''The Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.''

[26] SEC Staff Study on Investment Advisers and Broker-Dealers, January 2011, available at *https://www.sec.gov/news/studies/2011/913studyfinal.pdf,* pp.109–110.

[27] ERISA section 408(b)(2) and Code section 4975(d)(2) exempt certain arrangements between ERISA plans, IRAs, and non-ERISA plans, and service providers, that otherwise would be prohibited transactions under ERISA section 406 and Code section 4975. Specifically, ERISA section 408(b)(2) and Code section 4975(d)(2) provide relief from the prohibited transaction rules for service contracts or arrangements if the contract or arrangement is reasonable, the services are necessary for the establishment or operation of the plan or IRA, and no more than reasonable compensation is paid for the services.

[28] *See* fn. 2, *supra,* discussing Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)).

[29] *See* ERISA section 408(a) and Code section 4975(c)(2).

transaction if they fail to provide advice that is prudent or otherwise in violation of the standards. The Department does not view this as a flaw in the exemptions, as commenters suggested, but rather as a significant deterrent to violations of important conditions under the exemptions.

The Department similarly disagrees that Congress' directive to the SEC in the Dodd-Frank Act limits its authority to establish appropriate and protective conditions in the context of a prohibited transaction exemption. Section 913 of that Act directs the SEC to conduct a study on the standards of care applicable to brokers-dealers and investment advisers, and issue a report containing, among other things:

> an analysis of whether [sic] any identified legal or regulatory gaps, shortcomings, or overlap in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers.[30]

Section 913 authorizes, but does not require, the SEC to issue rules addressing standards of care for broker-dealers and investment advisers for providing personalized investment advice about securities to retail customers.[31] Nothing in the Dodd-Frank Act indicates that Congress meant to preclude the Department's regulation of fiduciary investment advice under ERISA or its application of such a regulation to securities brokers or dealers. To the contrary, Dodd-Frank in directing the SEC study specifically directed the SEC to consider the effectiveness of existing legal and regulatory standards of care under other federal and state authorities. Dodd-Frank Act, sec. 913(b)(1) and (c)(1). The Dodd-Frank Act did not take away the Department's responsibility with respect the definition of fiduciary under ERISA and in the Code; nor did it qualify the Department's authority to issue exemptions that are administratively feasible, in the interests of plans, participants and beneficiaries, and IRA owners, and protective of the rights of participants and beneficiaries of the plans and IRA owners.

Some commenters suggested that it would be unnecessary to impose the Impartial Conduct Standards on advisers with respect to ERISA plans, as fiduciaries to these Plans already are required to operate within similar statutory fiduciary obligations. The Department considered this comment but has determined not to eliminate the conduct standards as conditions of the exemptions for ERISA plans. One of the Department's goals is to ensure equal footing for all retirement investors. The SEC staff study required by section 913 of the Dodd-Frank Act found that investors were frequently confused by the differing standards of care applicable to broker-dealers and registered investment advisers. The Department hopes to minimize such confusion in the market for retirement advice by holding fiduciaries to similar standards, regardless of whether they are giving the advice to an ERISA plan, IRA, or a non-ERISA plan.

Moreover, inclusion of the standards as conditions of these existing exemptions adds an important additional safeguard for ERISA and IRA investors alike because the party engaging in a prohibited transaction has the burden of showing compliance with an applicable exemption, when violations are alleged.[32] In the Department's view, this burden-shifting is appropriate because of the dangers posed by conflicts of interest, as reflected in the Department's Regulatory Impact Analysis and the difficulties retirement investors have in effectively policing such violations.[33] One important way for financial institutions to ensure that they can meet this burden is by implementing strong anti-conflict policies and procedures, and by refraining from creating incentives to violate the Impartial Conduct Standards. Thus, the Standards' treatment as exemption conditions creates an important incentive for financial institutions to carefully monitor and oversee their advisers' conduct for adherence with fiduciary norms.

Other commenters generally asserted that the Impartial Conduct Standards were too vague and would result in the exemption failing to meet the ''administratively feasible'' requirement under ERISA section 408(a) and Code section 4975(c)(2). The Department disagrees with these commenters' suggestion that ERISA section 408(a) and Code section 4975(c)(2) fail to be satisfied by a principles-based approach, or that standards are unduly vague. It is worth repeating that the Impartial Conduct Standards are built on concepts that are longstanding and familiar in ERISA and the common law of trusts and agency. Far from requiring adherence to novel standards with no antecedents, the exemptions primarily require adherence to well-established fundamental obligations of fair dealing and fiduciary conduct. This preamble provides specific interpretations and responses to a number of issues raised in connection with a number of the Impartial Conduct Standards.

Comments on each of the Impartial Conduct Standards are discussed below. In this regard, some commenters focused their comments on the Impartial Conduct Standards in the proposed Best Interest Contract Exemption and other proposals, as opposed to the proposed amendment to PTE 86–128. The Department determined it was important that the provisions of the exemptions, including the Impartial Conduct Standards, be uniform and compatible across exemptions. For this reason, the Department considered all comments made on any of the exemption proposals on a consolidated basis, and made corresponding changes across the projects. For ease of use, this preamble includes the same general discussion of comments as in the Best Interest Contract Exemption, despite the fact that some comments discussed below were not made directly with respect to this exemption.

a. Best Interest Standard

Under Section II(a), when exercising fiduciary authority described in ERISA section 3(21)(A)(i) or (ii), or Code section 4975(e)(3)(A) or (B), with respect to the assets involved in the transaction, a fiduciary relying on the amended exemption must act in the Best Interest of the plan or IRA, at the time of the exercise of authority (including, in the case of an investment advice fiduciary, the recommendation). A fiduciary acts in the Best Interest of the plan or IRA when:

> the fiduciary acts 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 plan [or IRA], without regard to the financial or other interests of the fiduciary, its affiliate, a Related Entity, or other party.

This Best Interest standard set forth in the final amendment is based on longstanding concepts derived from ERISA and the law of trusts. It is meant to express the concept, set forth in ERISA section 404, that a fiduciary is required to act ''solely in the interest of the participants . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a

[30] Dodd-Frank Act, sec. 913(d)(2)(B).

[31] 15 U.S.C. 80b–11(g)(1).

[32] *See e.g., Fish* v. *GreatBanc Trust Company,* 749 F.3d 671 (7th Cir. 2014).

[33] *See* Regulatory Impact Analysis, available at *www.dol.gov/ebsa.*

prudent man 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.'' Similarly, both ERISA section 404(a)(1)(A) and the trust-law duty of loyalty require fiduciaries to put the interests of trust beneficiaries first, without regard to the fiduciaries' own self-interest. Under this standard, for example, an investment advice fiduciary, in choosing between two investments, could not select an investment because it is better for the investment advice fiduciary's bottom line even though it is a worse choice for the plan or IRA.

A wide range of commenters indicated support for a broad ''best interest'' standard. Some comments indicated that the best interest standard is consistent with the way advisers provide investment advice to clients today. However, a number of these commenters expressed misgivings as to the definition used in the proposed amendment, in particular, the ''without regard to'' formulation. The commenters indicated uncertainty as to the meaning of the phrase, including whether it permitted the fiduciary engaging the in the transaction to be paid.

Other commenters asked the Department to use a different definition of Best Interest, or simply use the exact language from ERISA's section 404 duty of loyalty. Others suggested definitional approaches that would require that the fiduciary ''not subordinate'' their customers' interests to their own interests, or that the fiduciary ''put their customers' interests ahead of their own interests,'' or similar constructs.[34]

The Financial Industry Regulatory Authority (FINRA) [35] suggested that the federal securities laws should form the foundation of the Best Interest standard. Specifically, FINRA urged that the Best Interest definition in the exemption incorporate the ''suitability'' standard applicable to investment advisers and broker dealers under securities laws. According to FINRA, this would facilitate customer enforcement of the Best Interest standard by providing adjudicators with a well-established basis on which to find a violation.

Other commenters found the Best Interest standard to be an appropriate statement of the obligations of a fiduciary investment advice provider and believed it would provide concrete protections against conflicted recommendations. These commenters asked the Department to maintain the Best Interest definition as proposed. One commenter wrote that the term ''best interest'' is commonly used in connection with a fiduciary's duty of loyalty and cautioned the Department against creating an exemption that failed to include the duty of loyalty. Others urged the Department to avoid definitional changes that would reduce current protections to plans and IRAs. Some commenters also noted that the ''without regard to'' language is consistent with the recommended standard in the SEC staff Dodd-Frank Study, and suggested that it had the added benefit of potentially harmonizing with a future securities law standard for broker-dealers.

The final amendment retains the Best Interest definition as proposed, with minor adjustments. The first prong of the standard was revised to more closely track the statutory language of ERISA section 404(a), and, is consistent with the Department's intent to hold investment advice fiduciaries to a prudent investment professional standard. Accordingly, the definition of Best Interest now requires advice that reflects ''the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person *acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims,* based on the investment objectives, risk tolerance, financial circumstances, and needs of the plan [or IRA]. . .'' The exemption adopts the second prong of the proposed definition, ''without regard to the financial or other interests of the fiduciary, affiliate, or other party,'' without change.

The Department continues to believe that the ''without regard to'' language sets forth the appropriate, protective standard under which a fiduciary investment adviser should act. Although the exemption provides broad relief for fiduciaries to receive commissions and other payments based on their advice, the standard ensures that the advice will not be tainted by self-interest. Many of the alternative approaches suggested by commenters pose their own ambiguities and interpretive challenges, and lower standards run the risk of undermining this regulatory initiative's goal of reducing the impact of conflicts of interest on plans and IRAs.

The Department has not specifically incorporated the suitability obligation as an element of the Best Interest standard, as suggested by FINRA, but many aspects of suitability are also elements of the Best Interest standard. An investment recommendation that is not suitable under the securities laws would not meet the Best Interest standard. Under FINRA's Rule 2111(a) on suitability, broker-dealers ''must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer.'' The text of rule 2111(a), however, does not do any of the following: Reference a best interest standard, clearly require brokers to put their client's interests ahead of their own, expressly prohibit the selection of the least suitable (but more remunerative) of available investments, or require them to take the kind of measures to avoid or mitigate conflicts of interests that are required as conditions of this amended exemption.

The Department recognizes that FINRA issued guidance on Rule 2111 in which it explains that ''in interpreting the suitability rule, numerous cases explicitly state that a broker's recommendations must be consistent with his customers' best interests,'' and provided examples of conduct that would be prohibited under this standard, including conduct that this exemption would not allow.[36] The guidance goes on to state that ''[t]he suitability requirement that a broker make only those recommendations that are consistent with the customer's best interests prohibits a broker from placing his or her interests ahead of the customer's interests.'' The Department, however, is reluctant to adopt as an express standard such guidance, which has not been formalized as a clear rule and that may be subject to change. Additionally, FINRA's suitability rule may be subject to interpretations which could conflict with interpretations by the Department, and the cases cited in the FINRA guidance, as read by the Department, involved egregious fact patterns that one would have thought violated the suitability standard, even without reference to the customer's ''best interest.'' Accordingly, after review of the issue, the Department has decided not to accept the comment. The Department has concluded that its articulation of a clear loyalty standard within the exemption, rather than by reference to the FINRA guidance, will provide clarity and certainty to investors and better protect their interests.

The Best Interest standard, as set forth in the exemption, is intended to effectively incorporate the objective

[34] The alternative approaches are discussed in greater detail in the preamble to the Best Interest Contract Exemption, finalized elsewhere in this issue of the **Federal Register**.

[35] FINRA is registered with the Securities and Exchange Commission (SEC) as a national securities association and is a self-regulatory organization, as those terms are defined in the Exchange Act, which operates under SEC oversight.

[36] FINRA Regulatory Notice 12–25, p. 3 (2012).

standards of care and undivided loyalty that have been applied under ERISA for more than forty years. Under these objective standards, the fiduciary must adhere to a professional standard of care in making investment management decisions, executing transactions, or providing investment recommendations that are in the plan's or IRA's Best Interest. The fiduciary may not base his or her decisions or recommendations on the fiduciary's own financial interest. Nor may the fiduciary make or recommend the investment, unless it meets the objective prudent person standard of care. Additionally, the duties of loyalty and prudence embodied in ERISA are objective obligations that do not require proof of fraud or misrepresentation, and full disclosure is not a defense to making an imprudent recommendation or favoring one's own interests at the plan's or IRA's expense.

Several commenters requested additional guidance on the Best Interest standard. Investment advice fiduciaries that are concerned about satisfying the standard may wish to consult the policies and procedures requirement in Section II(d) of the Best Interest Contract Exemption. While these policies and procedures are not an express condition of PTE 86–128, they may provide useful guidance for financial institutions wishing to ensure that individual advisers adhere to the Impartial Conduct Standards. The preamble to the Best Interest Contract Exemption provides examples of policies and procedures prudently designed to ensure that advisers adhere to the Impartial Conduct Standards. The examples are not intended to be exhaustive or mutually exclusive, and range from examples that focus on eliminating or nearly eliminating compensation differentials to examples that permit, but police, the differentials.

A few commenters also questioned the requirement in the Best Interest standard that the fiduciary's actions be made without regard to the interest of the fiduciary, its affiliate, a Related Entity or "*other party.*" The commenters indicated they did not know the purpose of the reference to "other party" and asked that it be deleted. The Department intends the reference to make clear that a fiduciary operating within the Impartial Conduct Standards should not take into account the interests of any party other than the plan or IRA—whether the other party is related to the fiduciary engaging in the covered transaction or not—in exercising fiduciary authority. For example, an entity that may be unrelated to the fiduciary but could still constitute an "other party," for these purposes, is the manufacturer of the investment product being recommended or purchased.

Other commenters asked for confirmation that the Best Interest standard is applied based on the facts and circumstances as they existed at the time of the recommendation, and not based on hindsight. Consistent with the well-established legal principles that exist under ERISA today, the Department confirms that the Best Interest standard is not a hindsight standard, but rather is based on the facts as they existed at the time of the recommendation. Thus, the courts have evaluated the prudence of a fiduciary's actions under ERISA by focusing on the process the fiduciary used to reach its determination or recommendation—whether the fiduciaries, "at the time they engaged in the challenged transactions, employed the proper procedures to investigate the merits of the investment and to structure the investment." [37] The standard does not measure compliance by reference to how investments subsequently performed or turn fiduciaries into guarantors of investment performance, even though they gave advice that was prudent and loyal at the time of transaction.[38]

This is not to suggest that the ERISA section 404 prudence standard or Best Interest standard, are solely procedural standards. Thus, the prudence standard, as incorporated in the Best Interest standard, is an objective standard of care that requires fiduciaries to investigate and evaluate investments, make recommendations, and exercise sound judgment in the same way that knowledgeable and impartial professionals would. "[T]his is not a search for subjective good faith—a pure heart and an empty head are not enough." [39] Whether or not the fiduciary is actually familiar with the sound investment principles necessary to make particular recommendations, the fiduciary must adhere to an objective professional standard. Additionally, fiduciaries are held to a particularly stringent standard of prudence when they have a conflict of interest.[40] For this reason, the Department declines to provide a safe harbor based solely on "procedural prudence" as requested by a commenter.

The Department additionally confirms its intent that the phrase "without regard to" be given the same meaning as the language in ERISA section 404 that requires a fiduciary to act "solely in the interest of" participants and beneficiaries, as such standard has been interpreted by the Department and the courts. Accordingly, the standard would not, as some commenters suggested, foreclose the fiduciary from being paid "reasonable compensation," and the exemption specifically contemplates such compensation.

In response to commenter concerns, the Department also confirms that the Best Interest standard does not impose an unattainable obligation on fiduciaries to somehow identify the single "best" investment for the plan or IRA out of all the investments in the national or international marketplace, assuming such advice were even possible. Instead, as discussed above, the Best Interest standard set out in the exemption, incorporates two fundamental and well-established fiduciary obligations: The duties of prudence and loyalty. Thus, the fiduciary's obligation under the Best Interest standard is to manage or give advice that adheres to professional standards of prudence, and to put the plan's or IRA's financial interests in the driver's seat, rather than the competing interests of the fiduciary or other parties.

Finally, in response to questions regarding the extent to which this Best Interest standard or other provisions of the exemption impose an ongoing monitoring obligation on fiduciaries, the text does not impose a monitoring requirement, but instead leaves that to the parties' arrangements, agreements, and understandings. This is consistent with the Department's interpretation of an investment advice fiduciary's monitoring responsibility as articulated in the preamble to the Regulation.

[37] *Donovan* v. *Mazzola,* 716 F.2d 1226, 1232 (9th Cir. 1983).

[38] One commenter requested an adjustment to the "prudence" component of the Best Interest Standard, under which the standard would be that of a "prudent person serving clients with similar retirement needs and offering a similar array of products." In this way, the commenter sought to accommodate varying perspectives and opinions on particular investment products and business practices. The Department disagrees with the comment, which could be read as qualifying the stringency of the prudence obligation based on the fiduciary's independent decisions on which products to offer, rather than on the needs of the particular retirement investor. Therefore, the Department did not adopt this suggestion.

[39] *Donovan* v. *Cunningham,* 716 F.2d 1455, 1467 (5th Cir. 1983), *cert. denied,* 467 U.S. 1251 (1984); *see also DiFelice* v. *U.S. Airways, Inc.,* 497 F.3d 410, 418 (4th Cir. 2007) ("Good faith does not provide a defense to a claim of a breach of these fiduciary duties; 'a pure heart and an empty head are not enough.' ").

[40] *Donovan* v. *Bierwirth,* 680 F.2d 263, 271 (2d Cir. 1982) ("the decisions [of the fiduciary] must be made with an eye single to the interests of the participants and beneficiaries"); *see also Bussian* v. *RJR Nabisco, Inc.,* 223 F.3d 286, 298 (5th Cir. 2000); *Leigh* v. *Engle,* 727 F.2d 113, 126 (7th Cir. 1984).

b. Reasonable Compensation

The Impartial Conduct Standards also include the reasonable compensation standard, set forth in Section II(b). Under this standard, the fiduciary engaging in the covered transaction and any Related Entity must not receive compensation in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2).

The obligation to pay no more than reasonable compensation to service providers is long recognized under ERISA and the Code. ERISA section 408(b)(2) and Code section 4975(d)(2) require that services arrangements involving plans and IRAs result in no more than reasonable compensation to the service provider. Accordingly, fiduciaries—as service providers—have long been subject to this requirement, regardless of their fiduciary status. At bottom, the standard simply requires that compensation not be excessive relative to the value of the particular services, rights, and benefits the fiduciary is delivering to the plan or IRA. Given the conflicts of interest associated with the commissions, it is particularly important that fiduciaries adhere to these statutory standards which are rooted in common law principles.[41]

Several commenters supported this standard and said that the reasonable compensation requirement is an important and well-established protection. A number of other commenters requested greater specificity as to the meaning of the reasonable compensation standard. As proposed, the standard stated:

> All compensation received by the [fiduciary] and any Related Entity in connection with the transaction is reasonable in relation to the total services the person and any Related Entity provide to the plan.

Some commenters stated that the proposed reasonable compensation standard was too vague. Because the language of the proposal did not reference ERISA section 408(b)(2) and Code section 4975(d)(2), commenters asked whether the standard differed from those statutory provisions. In particular, a commenter questioned the meaning of the proposed language ''in relation to the total services the person and any Related Entity provide to the plan.'' The commenter indicated that the proposal did not adequately explain this formulation of reasonable compensation.

There was concern that the standard could be applied retroactively rather than based on the parties' reasonable beliefs as to the reasonableness of the compensation as determined at the time the fiduciary exercised authority over plan assets or made an investment recommendation. Commenters also indicated uncertainty as to how to comply with the condition and asked whether it would be necessary to survey the market to determine market rates. Some commenters requested that the Department include the words ''and customary,'' in the reasonable compensation definition, to specifically permit existing compensation arrangements. One commenter raised the concern that the reasonable compensation determination raised antitrust concerns because it would require investment advice fiduciaries to agree upon a market rate and result in anti-competitive behavior.

Commenters also asked the Department to provide examples of scenarios that met the reasonable compensation standard and safe harbors and others requested examples of scenarios that would fail to meet these standards. FINRA and other commenters suggested that the Department incorporate existing FINRA rules 2121 and 2122, and NASD rule 2830 regarding the reasonableness of compensation for broker-dealers.[42]

Finally, a few commenters took the position that the reasonable compensation determination should not be a requirement of the exemption. In their view, a plan fiduciary that is not the fiduciary engaging in the covered transaction (perhaps the authorizing fiduciary) should decide the reasonableness of the compensation. Another commenter suggested that if an independent plan fiduciary sets the menu this should be sufficient to comply with the reasonable compensation standard.

In response to comments on this requirement, the Department has retained the reasonable compensation standard as a condition of the exemption. As noted above, the obligation that service providers receive no more than ''reasonable compensation'' for their services is already established by ERISA and the Code, and has long applied to financial services providers, whether fiduciaries or not. The condition is also consistent with other class exemptions granted and amended today. It is particularly important that fiduciaries adhere to these standards when engaging in the transactions covered under this exemption, so as to avoid exposing plans and IRAs to harms associated with conflicts of interest.

Some commenters suggested that the reasonable compensation determination be made by another plan fiduciary. However, the exemption (like the statutory obligation) obligates investment advice fiduciaries to avoid overcharging their plan and IRA customers, despite any conflicts of interest associated with their compensation. Fiduciaries and other service providers may not charge more than reasonable compensation regardless of whether another fiduciary has signed off on the compensation. Nothing in the exemption, however, precludes fiduciaries from seeking impartial review of their fee structures to safeguard against abuse, and they may well want to include such reviews as part of their supervisory practices.

Further, the Department disagrees that the requirement is inconsistent with antitrust laws. Nothing in the exemption contemplates or requires that Advisers or Financial Institutions agree upon a price with their competitors. The focus of the reasonable compensation condition is on preventing overcharges to Retirement Investors, not promoting anti-competitive practices. Indeed, if Advisors and Financial Institutions consulted with competitors to set prices, the agreed-upon prices could well violate the condition.

In response to comments, however, the operative text of the final exemption was clarified to adopt the well-established reasonable compensation standard, as set out in ERISA section 408(b)(2) and Code section 4975(d)(2), and the regulations thereunder. The reasonableness of the fees depends on the particular facts and circumstances at the time of the fiduciary investment recommendation or exercise of fiduciary authority. Several factors inform whether compensation is reasonable including, *inter alia,* the market pricing of service(s) provided and the underlying asset(s), the scope of monitoring, and the complexity of the product. No single factor is dispositive in determining whether compensation is reasonable; the essential question is whether the charges are reasonable in relation to what the plan or IRA receives. Consistent with the Department's prior interpretations of this standard, the Department confirms that a fiduciary does not have to recommend the transaction that is the

[41] *See generally* Restatement (Third) of Trusts section 38 (2003).

[42] FINRA's comment letter described NASD rule 2830 as imposing specific caps on compensation with respect to investment company securities that broker-dealers may sell. While the Department views this cap as an important protection of investors, it establishes an outside limit rather than a standard of reasonable compensation.

lowest cost or that generates the lowest fees without regard to other relevant factors. In this regard, the Department declines to specifically reference FINRA's standard in the exemption, but rather relies on ERISA's own longstanding reasonable compensation formulation.

In response to concerns about application of the standard to investment products that bundle together services and investment guarantees or other benefits, the Department responds that the reasonable compensation condition is intended to apply to the compensation received by the Financial Institution, Adviser, Affiliates, and Related Entities in same manner as the reasonable compensation condition set forth in ERISA section 408(b)(2) and Code section 4975(d)(2). Accordingly, the exemption's reasonable compensation standard covers compensation received directly from the plan or IRA and indirect compensation received from any source other than the plan or IRA in connection with the recommended transaction.[43] When assessing the reasonableness of a charge, one generally needs to consider the value of all the services and benefits provided for the charge, not just some. If parties need additional guidance in this respect, they should refer to the Department's interpretations under ERISA section 408(b)(2) and Code section 4975(d)(2) and the Department will provide additional guidance if necessary.

The Department declines suggestions to provide specific examples of ''reasonable'' amounts or specific safe harbors. Ultimately, the ''reasonable compensation'' standard is a market based standard. As noted above, the standard incorporates the familiar ERISA section 408(b)(2) and Code section 4975(d)(2) standards. The Department is unwilling to condone all ''customary'' compensation arrangements and declines to adopt a standard that turns on whether the agreement is ''customary.'' For example, it may in some instances be ''customary'' to charge customers fees that are not transparent or that bear little relationship to the value of the services actually rendered, but that does not make the charges reasonable. Similarly, the Department declines to provide that the reasonable compensation condition is automatically satisfied as long as the charges do not exceed specific pricing ceilings or restrictions imposed by other regulators or self-regulatory organizations. Certainly, charging an investor even more than permitted under such a ceiling or restriction would generally violate the prohibition on ''unreasonable compensation.'' But the reasonable compensation standard does not merely forbid fiduciaries from charging amounts that are per se illegal under other regulatory regimes. Finally, the Department notes that all recommendations are subject to the overarching Best Interest standard, which incorporates the fundamental fiduciary obligations of prudence and loyalty. An imprudent recommendation for an investor to overpay for an investment transaction would violate that standard, regardless of whether the overpayment was attributable to compensation for services, a charge for benefits or guarantees, or something else.

c. Misleading Statements

The final Impartial Conduct Standard, set forth in Section II(c), requires that the fiduciary's statements about the transaction, fees and compensation, Material Conflicts of Interest, and any other matters relevant to a plan's or IRA's investment decisions, may not be materially misleading at the time they are made. For this purpose, a fiduciary's failure to disclose a Material Conflict of Interest relevant to the services the fiduciary is providing or other actions it is taking in relation to a plan's investment decisions is deemed to be a misleading statement. In response to commenters, the Department adjusted the text to clarify that the standard is measured at the time of the representations, *i.e.,* the statements must not be misleading ''at the time they are made.'' Similarly, the Department added a materiality standard in response to comments.

Some comments focused on the proposed definition of Material Conflict of Interest. As proposed, a Material Conflict of Interest was defined to exist when a person has a financial interest that could affect the exercise of its best judgment as a fiduciary in rendering advice to a plan or IRA. Some commenters took the position that the proposal did not adequately explain the term ''material'' or incorporate a ''materiality'' standard into the definition. A commenter wrote that the proposed definition was so broad it would be difficult for financial institutions to comply with the various aspects of the exemption related to Material Conflicts of Interest, such as provisions requiring disclosures of Material Conflicts of Interest.

Another commenter indicated that the Department should not use the term ''material'' in defining conflicts of interest. The commenter believed that it could result in a standard that was too subjective from the perspective of the fiduciary and could undermine the protectiveness of the exemption.

After consideration of the comments, the Department adjusted the definition of Material Conflict of Interest to provide that a material conflict of interest exists when a fiduciary has a ''financial interest that *a reasonable person would conclude* could affect the exercise of its best judgment as a fiduciary in rendering advice to a plan or IRA.'' This language responds to concerns about the breadth and potential subjectivity of the standard.

The Department did not accept certain other comments, however. One commenter requested that the Department add a qualifier providing that the standard is violated only if the statement was ''reasonably relied'' on by the retirement investor. The Department rejected the comment. The Department's aim is to ensure that fiduciaries uniformly adhere to the Impartial Conduct Standards, including the obligation to avoid materially misleading statements.

One commenter asked the Department to require only that the fiduciary ''reasonably believe'' the statements are not misleading. The Department is concerned that this standard too could undermine the protections of this condition, by requiring retirement investors to prove the fiduciary's actual knowledge rather than focusing on whether the statement is objectively misleading. However, to address commenters' concerns about the risks of engaging in a prohibited transaction, as noted above, the Department has clarified that the standard is measured at the time of the representations and has added a materiality standard.

The Department believes that plans and IRAs are best served by statements and representations that are free from material misstatements. Fiduciaries best avoid liability—and best promote the interests of plans and IRA—by ensuring that accurate communications are a consistent standard in all their interactions with their customers.

A commenter suggested that the Department adopt FINRA's ''Frequently Asked Questions regarding Rule 2210'' regarding the term misleading.[44]

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[43] Such compensation includes, for example charges against the investment, such as commissions, sales loads, sales charges, redemption fees, surrender charges, exchange fees, account fees and purchase fees, as well as compensation included in operating expenses and other ongoing charges, such as wrap fees.

[44] *Currently available at http://www.finra.org/industry/finra-rule-2210-questions-and-answers.*

FINRA's Rule 2210, Communications with the Public, sets forth a number of procedural rules and standards that are designed to, among other things, prevent broker-dealer communications from being misleading. The Department agrees that adherence to FINRA's standards can promote materially accurate communications, and certainly believes that fiduciaries should pay careful attention to such guidance documents. After review of the rule and FAQs, however, the Department declines to simply adopt FINRA's guidance, which addresses written communications, since the condition of the exemption is broader in this respect. In the Department's view, the meaning of the standard is clear, and is already part of a plan fiduciary's obligations under ERISA. If, however, issues arise in implementation of the exemption, the Department will consider requests for additional guidance.

Commissions

To provide certainty with respect to the payments permitted by the exemption in both Section I(a) and new Section I(b), the amendment adds a new defined term ''Commission.'' This term replaces the language originally in the exemption that permits a fiduciary to cause a plan or IRA to pay a ''fee for effecting or executing securities transactions.'' The term ''Commission'' is defined to mean a brokerage commission or sales load paid for the service of effecting or executing the transaction, but not a 12b–1 fee, revenue sharing payment, marketing fee, administrative fee, sub–TA fee, or sub-accounting fee.[45] Further, based on the language of Section I(a)(1), the term ''Commission'' as used in that section is limited to payments directly from the plan or IRA.[46] The Department has clarified this by adding the word ''directly'' to the language of the final exemption for the avoidance of doubt. On the other hand, the Commission payment described in Section I(b) is not limited to payments directly from the plan or IRA and includes payments from the mutual fund. The Department understands that sales load payments in connection with mutual fund transactions are commonly made by the mutual fund.

In connection with this clarifying amendment to the definition of commission, two commenters requested that the Commission definition specifically include, not exclude, 12b–1 fees, revenue sharing payments, marketing fees, administrative fees, sub-TA fees, sub-accounting fees and other consideration. The commenters indicate that these forms of compensation are inherent to agency transactions and without documented harm. Further, these forms of compensation are used to pay for services. Without this compensation, the commenters argue, brokers will cease offering agency services to plans and IRAs.

The Department agrees that many of these forms of compensation may be commonly associated with agency transactions, particularly with respect to mutual fund purchases, holdings and sales. However, as stated above, such forms of compensation do raise substantial conflict of interest concerns that are not addressed by this exemption. PTE 86–128 was originally granted in 1975 and amended several times over the years. The exemption narrowly applied to fees from a plan or IRA for effecting or executing securities transactions. The Department has never formally interpreted or amended PTE 86–128 to provide relief for the forms of indirect compensation suggested by commenters, such as 12b–1 fees and revenue sharing payments. In the Department's view, it does not contain conditions that adequately address the particular conflicts associated with such payments. On the other hand, the Best Interest Contract Exemption was designed for such payments and includes conditions to address them. The Department intends that parties seeking a wider scope of relief should rely on the Best Interest Contract Exemption as opposed to PTE 86–128, as amended.

Conditions of the Exemption in Section III

Section III of the exemption establishes conditions applicable to the covered transactions. Among the conditions is the requirement in Section III(b) that the covered transaction occur under a written authorization executed in advance by an independent fiduciary of each plan whose assets are involved in the transaction. A commenter asked us to clarify whether an IRA owner could satisfy the authorization requirements applicable to the independent plan fiduciary. In response, we have added ''or IRA owner'' throughout the requirements in Section III related to plan fiduciary authorization, to make clear that an IRA owner may authorize the covered transaction with respect to the IRA. We did not, however, add the IRA owner to the provision requiring the plan fiduciary to be ''independent'' of the person engaging in the covered transaction. Therefore, an IRA owner employed by the investment management fiduciary relying on the exemption will still be able to satisfy the authorization requirement. This reflects the Department's view that the interaction of the employer and employee with regard to an IRA that is not employer sponsored is likely to be voluntary and less likely to have the heightened conflicts of interest associated with an employer providing advice to an employer-sponsored plan, and earning a profit. Accordingly, an investment management fiduciary may provide advice to the beneficial owner of an IRA who is employed by the fiduciary and receive prohibited compensation as a result, provided the IRA is not covered by Title I of ERISA.

For IRAs and non-ERISA plans that are existing customers as of the Applicability Date of this amendment, the Department has provided that the fiduciary engaging in the transaction need not receive the affirmative consent generally required by Section III(b), but may instead rely on the IRA's or non-ERISA plan's negative consent, as long as the disclosures and consent termination form are provided to the IRA or non-ERISA plan by the Applicability Date.

The Department received other comments on conditions in Section III of PTE 86–128 that touch on discreet concerns. One commenter raised the bulk of these concerns. The comments related to the annual reauthorization requirement in Section III(c) and the portfolio turnover ratio requirement in Section III(f)(4), and are discussed below.

Annual Reauthorization

Section III(c) provides that an annual reauthorization is necessary for a fiduciary to engage in transactions pursuant to the exemption. As an alternative to affirmative reauthorization, the fiduciary may supply a form expressly providing an election to terminate the authorization with instructions on the use of the form. The instructions must provide for a 30-day window after which failure to return the form or some other written notification of the plan's intent to terminate the authorization will result in continued authorization.

[45] In light of the proposed language referencing ''brokerage commission'' and ''sales loads,'' terms commonly associated with equity securities and mutual funds, this definition does not extend to a commission on a variable annuity contract or any other annuity contract that is a non-exempt security under federal securities laws.

[46] Section I(a)(2) of the amended exemption clarifies that relief for plan fiduciaries acting as agents in agency cross transactions is limited to compensation paid in the form of Commissions, although the Commission may be paid by the other party to the transaction.

A commenter first asked for clarification regarding the ability of a fiduciary to rely on the exemption's relief during the 30-day reauthorization window established in Section III(c). In response, the Department states that relief is available until the point at which a fiduciary fails to comply with a condition of the exemption. Since a fiduciary will not be in breach of a condition until the expiration of the 30-day window, the fiduciary may rely on the exemption's relief until the closing of that window, and it will not retroactively lose the relief relied upon by the fiduciary during the 30-day window.

Second, the commenter argued that the termination notice contemplated by Section III(c) should be effective only if the customer uses a specific termination form. The Department disagrees. The exemption provides that the termination notice must be a written notice (whether first class mail, personal delivery or email). Requiring a written notice should avoid the problems created by oral notices (*e.g.,* miscommunication, misremembering, etc.), without creating inappropriate impediments for the investor seeking to terminate the arrangement. The fiduciary's obligations rightly extend to ensuring that the plan's or IRA's decisions to terminate an arrangement are honored, rather than disregarded. The Department does not want to create technical hurdles that could prevent faithful adherence to the investor's decisions, or permit otherwise prohibited transactions to proceed without the investor's assent.

Portfolio Turnover Ratio

Section III(f)(4) establishes the requirement that the fiduciary provide a portfolio turnover ratio at least once per year. The portfolio turnover ratio is a disclosure designed to assist the authorizing fiduciary or IRA owner by disclosing the amount of turnover or churning in the portfolio during the applicable period. Section III(f)(4)(B) describes the "annualized portfolio turnover ratio" as calculated as a percentage of the plan assets over which the fiduciary had discretionary investment authority at any time during the period covered by the report.

The commenter addressed the application of the portfolio turnover ratio disclosure requirement to investment advice fiduciaries. The commenter argued that the provision of the portfolio turnover ratio was not originally required under the exemption and was not workable in the investment adviser context since the adviser does not manage the investor's portfolio.

The Department acknowledges that Section III(f), prior to the amendment, included potentially contradictory language regarding the applicability of the portfolio turnover ratio disclosure to investment advice fiduciaries. In addition, the Department concurs with the commenter that the portfolio turnover ratio may not be as necessary to plans and participants and beneficiaries in the context of an investment advice relationship, as opposed to an investment management relationship where the fiduciary is making discretionary investment decisions. As a result, the final exemption makes clear that the portfolio turnover ratio is not required from fiduciaries that have not exercised discretionary authority over trading in the plan's account during the applicable year.

Exceptions From Conditions in Section V

Recapture of Profits Exception

Section V(b) of the amended exemption provides that certain conditions in Section III do not apply in any case where the person who is engaging in a covered transaction returns or credits to the plan all profits earned by that person and any Related Entity in connection with the securities transactions associated with the covered transaction. This provision is referred to as the recapture of profits exception. The Department provided an exception from the conditions in Section III for the recapture of profits due to the benefits to the plans and IRAs of such arrangements.

As explained above, discretionary trustees were first permitted to rely on PTE 86–128 without meeting the "recapture of profits" provision pursuant to an amendment in 2002 (2002 Amendment). The 2002 Amendment imposed additional conditions on such trustees. However, the 2002 Amendment also introduced uncertainty as to whether trustees could continue to rely on the recapture of profits exception instead of complying with the additional conditions. The Department did not intend to call such arrangements into question, and, accordingly, has modified the exemption to permit trustees to utilize the exception as originally permitted in PTE 86–128 for the recapture of profits.

The Department received a supportive comment on these provisions and has finalized the amendments as proposed.

Pooled Funds

Section V(c) provides special rules for pooled funds. Under that provision, the disclosure and authorization conditions set forth in Section III(b), (c) and (d) do not apply to pooled funds, if the alternate conditions in Section V(c) are satisfied. One such condition, in Section V(c)(1)(B), is that

[t]he authorizing fiduciary is furnished with any reasonably available information that the person engaging or proposing to engage in the covered transaction reasonably believes to be necessary to determine whether the authorization should be given or continued, not less than 30 days prior to implementation of the arrangement or material change thereto, including (but not limited to) a description of the person's brokerage placement practices, and, where requested any other reasonably available information regarding the matter upon the reasonable request of the authorizing fiduciary at any time.

The proposed amendment to PTE 86–128 included a revision to this provision, under which the authorizing fiduciary would be furnished with information "reasonably necessary" to determine whether the authorization should be given or continued, rather than "reasonably available information" that the investment advice fiduciary or investment management fiduciary reasonably believed is necessary to determine whether the authorization should be given or continued. One commenter objected to this proposed revision, on the basis that this new standard might require the fiduciary to provide information not in its possession or to prove that it had provided all information others might find relevant, and as a result, could cause fiduciaries to stop relying on the exemption.

The Department proposed the revision with a "reasonableness" qualifier to avoid overbroad application. However, the Department understands market participants' preference for a longstanding standard. As a practical matter, the Department does not believe that there will be much difference in the materials provided under this standard than under the one proposed. The authorizing fiduciary must still review sufficient information to determine whether the authorization should be given or continued. The Department, therefore, has accepted the comment, and the final amendment reverts back to the original language.

Recordkeeping Requirements

A new Section VI to PTE 86–128 requires the fiduciary engaging in a transaction covered by the exemption to maintain for six years records necessary to enable certain persons (described in Section VI(b)) to determine whether the conditions of this exemption have been met with respect to the transaction. The recordkeeping requirement is consistent with other existing class exemptions as well as the recordkeeping provisions of the other exemptions published in this issue of the **Federal Register**.

One commenter addressed the proposed record keeping requirement. The commenter suggested that the requirement should contain a "reasonableness" standard. The commenter also suggested that the exemption make clear that access by plans and participants and beneficiaries is limited to their own plans and their own accounts, and that any failure to maintain the required records with respect to a given transaction or set of transactions does not affect exemptive relief for other transactions. Lastly, the commenter indicated that the 30 day requirement for notice with respect to a refusal of disclosure of records, on the basis that the records involve privileged trade secrets or other privileged commercial or financial information, was not sufficient. The commenter sought a 90-day period.

The Department has modified the recordkeeping provision to include a reasonableness standard for making the records available, and clarify which parties may view the records that are maintained by the fiduciary engaging in the covered transaction. As revised, the exemption requires the records be "reasonably" available, rather than "unconditionally available" and does not authorize plan fiduciaries, participants, beneficiaries, contributing employers, employee organizations with members covered by the plan, and IRA owners to examine records regarding another plan or IRA. In addition, fiduciaries are not required to disclose privileged trade secrets or privileged commercial or financial information to any of the parties other than the Department, as was also true of the proposal.

The Department also added new language to the recordkeeping condition to indicate that the consequences of failure to comply with the recordkeeping requirement are limited to the transactions affected by the failure. Therefore, a new Section VI(b)(4) provides that

> Failure to maintain the required records necessary to determine whether the conditions of this exemption have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions.

Finally, in accordance with other exemptions granted and amended today, Financial Institutions are also not required to disclose records if such disclosure would be precluded by 12 U.S.C. 484, relating to visitorial powers over national banks and federal savings associations.[47] The Department has not accepted the commenter's request to extend the response period from 30 days to 90 days for notifying a party seeking records that the records are exempt from disclosure based on the assertion that disclosure would divulge trade secrets or privileged information. The Department notes that this provision is standard in many prohibited transaction exemptions.[48] The Department does not anticipate that this provision will be widely used and believes the 30 day period is sufficient for the unusual circumstance in which it is invoked.

Definitions

Section VII of PTE 86–128 sets forth definitions applicable to the exemption. One commenter suggested revisions to the definition of "independent" in Section VII(f). This term is used in connection with the authorization requirements under the exemption and it requires that the person making the authorizations be independent of the investment advice fiduciary or investment management fiduciary seeking to rely on the exemption. As proposed, the definition of independent would have precluded the authorizing entity from receiving any compensation or other consideration for his or her own account from the investment advice fiduciary or investment management fiduciary.

A commenter indicated that the definition might inadvertently disqualify certain entities that provide services (*e.g.,* accounting, legal or consulting) to the fiduciary from utilizing the services of the fiduciary because they could not provide the independent authorizations required under the exemption. The commenter suggested defining entities that receive less than 5% of their gross income from the fiduciary as "independent."

The Department agrees with the commenter; provided, however, that the expanded definition is determined based on the current tax year and may not be in excess of 2% of the fiduciary's annual revenues based on the prior year. This approach is consistent with the Department's general approach to fiduciary independence. For example, the prohibited transaction exemption procedures provide a presumption of independence for appraisers and fiduciaries if the revenue they receive from a party is not more than 2% of their total annual revenue.[49] We have revised the definition accordingly.

The same commenter indicated that the exemption's definition of IRA in Section VII(k) should not include other non-ERISA plans covered by Code section 4975, such as Health Savings Accounts (HSAs), Archer Medical Savings Accounts and Coverdell Education Savings Accounts. However, in response, the Department notes that these accounts, like IRAs, are tax-preferred. Further, some of the accounts, such as HSAs, can be used as long term savings accounts for retiree health care expenses. These types of accounts also are expressly defined by Code section 4975(e)(1) as plans that are subject to the Code's prohibited transaction rules. Thus, although they generally may hold fewer assets and may exist for shorter durations than IRAs, there is no statutory reason to treat them differently than other conflicted transactions and no basis for suspecting that the conflicts are any less influential with respect to advice with respect to these arrangements. Accordingly, the Department does not agree with the commenters that the owners of these accounts are entitled to less protection than IRA investors. The Regulation continues to include advisers to these "plans," and this exemption provides relief to them in the same manner it does for individual retirement accounts described in section 408(a) of the Code.

Amendment to and Partial Revocation of PTE 75–1

PTE 75–1, Part I(b) and (c)

The Department is revoking Part I(b) and I(c) of PTE 75–1, and Part II(2) of PTE 75–1. Part I(b) of PTE 75–1 provided relief from ERISA section 406 and the taxes imposed by Code section 4975(a) and (b), for the effecting of securities transactions, including clearance, settlement or custodial functions incidental to effecting the transactions, by parties in interest or disqualified persons other than fiduciaries. Part I(c) of PTE 75–1 provided relief from ERISA section 406

[47] A commenter with respect to the Best Interest Contract Exemption raised concerns that the Department's right to review a bank's records under that exemption could conflict with federal banking laws that prohibit agencies other than the Office of the Comptroller of the Currency (OCC) from exercising "visitorial" powers over national banks and federal savings associations. To address the comment, Financial Institutions are not required to disclose records if the disclosure would be precluded by 12 U.S.C. 484. A corresponding change was made in this exemption.

[48] *See e.g.,* PTE 2015–08, 80 FR 44753 (July 27, 2015) (Wells Fargo Company); PTE 2015–09, 80 FR 44760 (July 27, 2015) (Robert W. Baird & Co., Inc.); PTE 2014–06, 79 FR 3072 (July 24, 2014) (AT&T Inc.).

[49] 29 CFR 2570.31(j).

and Code section 4975(a) and (b) for the furnishing of advice regarding securities or other property to a plan or IRA by a party in interest or disqualified person under circumstances which do not make the party in interest or disqualified person a fiduciary with respect to the plan or IRA.

PTE 75–1 was granted shortly after ERISA's passage in order to provide certainty to the securities industry over the nature and extent to which ordinary and customary transactions between broker-dealers and plans or IRAs would be subject to the ERISA prohibited transaction rules. Paragraphs (b) and (c) in Part I of PTE 75–1, specifically, served to provide exemptive relief for certain non-fiduciary services provided by broker-dealers in securities transactions. Code section 4975(d)(2), ERISA section 408(b)(2) and regulations thereunder, have clarified the scope of relief for service providers to plans and IRAs.[50] The Department believes that the relief provided in Parts I(b) and I(c) of PTE 75–1 duplicates the relief available under the statutory exemptions. Therefore, the Department is revoking these parts.

PTE 75–1, Part II

As noted earlier, the exemption in PTE 75–1, Part II(2), is being incorporated into PTE 86–128. Accordingly, the Department is revoking PTE 75–1, Part II(2). In connection with the revocation of PTE 75–1, Part II(2), the Department is amending Section (e) of the remaining exemption in PTE 75–1, Part II, the recordkeeping provisions of the exemption, to place the recordkeeping responsibility on the broker-dealer, reporting dealer, or bank engaging in transactions with the plan or IRA, as opposed to the plan or IRA itself.

A few commenters suggested that the Department should not revoke PTE 75–1, Part II(2). They argued that that exemption provides needed relief for consideration received in connection with mutual fund share transactions.

As stated above, the Department disagrees. PTE 75–1, Part II(2) was an exemption that was broadly interpreted beyond what was intended, and that contained minimal safeguards. Providing an exemption for fiduciaries to receive compensation under the conditions of PTE 75–1, Part II(2) is not protective of retirement investors. Instead, the Department has provided relatively limited relief for mutual fund transactions in Section I(b) of the amended PTE 86–128 and much broader relief in the Best Interest Contract Exemption. The Best Interest Contract Exemption, as stated above, imposes more appropriate conditions on the receipt of compensation that goes beyond simple commissions.

Applicability Date

The Regulation will become effective June 7, 2016 and these amended exemptions are issued on that same date. The Regulation is effective at the earliest possible effective date under the Congressional Review Act. For the exemptions, the issuance date serves as the date on which the amended exemptions are intended to take effect for purposes of the Congressional Review Act. This date was selected in order to provide certainty to plans, plan fiduciaries, plan participants and beneficiaries, IRAs, and IRA owners that the new protections afforded by the Regulation are officially part of the law and regulations governing their investment advice providers, and to inform financial services providers and other affected service providers that the Regulation and amended exemptions are final and not subject to further amendment or modification without additional public notice and comment. The Department expects that this effective date will remove uncertainty as an obstacle to regulated firms allocating capital and other resources toward transition and longer term compliance adjustments to systems and business practices.

The Department has also determined that, in light of the importance of the Regulation's consumer protections and the significance of the continuing monetary harm to retirement investors without the rule's changes, that an Applicability Date of April 10, 2017, is adequate time for plans and their affected financial services and other service providers to adjust to the basic change from non-fiduciary to fiduciary status. The amendments to and partial revocations of PTEs 86–128 and 75–1, Part II, as finalized herein have the same Applicability Date; parties may therefore rely on the amended exemptions beginning on the Applicability Date. For the avoidance of doubt, no revocation will be applicable prior to the Applicability Date.

Paperwork Reduction Act Statement

In accordance with the requirements of the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506(c)(2)), the Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 86–128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; and the Amendment to and Partial Revocation of PTE 75–1, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefits Plans and Certain Broker-Dealers, Reporting Dealers and Banks published as part of the Department's proposal to amend its 1975 rule that defines when a person who provides investment advice to an employee benefit plan or IRA becomes a fiduciary, solicited comments on the information collections included therein. The Department also submitted an information collection request (ICR) to OMB in accordance with 44 U.S.C. 3507(d), contemporaneously with the publication of the proposed regulation, for OMB's review. The Department received two comments from one commenter that specifically addressed the paperwork burden analysis of the information collections. Additionally, many comments were submitted, described elsewhere in the preamble to the accompanying final rule, which contained information relevant to the costs and administrative burdens attendant to the proposals. The Department took into account such public comments in connection with making changes to the prohibited transaction exemption, analyzing the economic impact of the proposals, and developing the revised paperwork burden analysis summarized below.

In connection with publication of this final amendment to and partial revocation of PTE 86–128 and this final amendment to and partial revocation of PTE 75–1, the Department is submitting an ICR to OMB requesting approval of a revision to OMB Control Number 1210–0059. The Department will notify the public when OMB approves the revised ICR.

A copy of the ICR may be obtained by contacting the PRA addressee shown below or at *http://www.RegInfo.gov.* PRA ADDRESSEE: G. Christopher Cosby, Office of Policy and Research, U.S. Department of Labor, Employee Benefits Security Administration, 200 Constitution Avenue NW., Room N–5718, Washington, DC 20210. Telephone: (202) 693–8824; Fax: (202) 219–4745. These are not toll-free numbers.

As discussed in detail below, as amended, PTE 86–128 will require financial firms to make certain disclosures to plan fiduciaries and owners of managed IRAs in order to receive relief from ERISA's and the Code's prohibited transaction rules for the receipt of commissions and to engage in transactions involving mutual

[50] See 29 CFR 2550.408b–2, 42 FR 32390 (June 24, 1977) and Reasonable Contract or Arrangement under Section 408(b)(2)—Fee Disclosure, Final Rule, 77 FR 5632 (Feb. 3, 2012).

fund shares.[51] Financial firms relying on either PTE 86–128 or PTE 75–1, as amended, will be required to maintain records necessary to demonstrate that the conditions of these exemptions have been met. These requirements are information collection requests (ICRs) subject to the Paperwork Reduction Act.

The Department has made the following assumptions in order to establish a reasonable estimate of the paperwork burden associated with these ICRs:

- 51.8 percent of disclosures to retirement investors with respect to ERISA plans [52] and 44.1 percent of disclosures to retirement investors with respect to IRAs and non-ERISA plans [53] will be distributed electronically via means already used by respondents in the normal course of business and the costs arising from electronic distribution will be negligible, while the remaining disclosures will be distributed on paper and mailed at a cost of $0.05 per page for materials and $0.49 for first class postage; [54]
- Financial institutions will use existing in-house resources to prepare the legal authorizations and disclosures, and maintain the recordkeeping systems necessary to meet the requirements of the exemption;
- A combination of personnel will perform the tasks associated with the ICRs at an hourly wage rate of $167.32 for a financial manager, $55.21 for clerical personnel, and $133.61 for a legal professional; [55] and
- Approximately 2,800 financial institutions [56] will take advantage of this exemption and they will use this exemption in conjunction with transactions involving 23.7 percent of their client plans and managed IRAs.[57]

Disclosures and Consent Forms

In order to receive commissions in conjunction with the purchase of mutual fund shares and other securities, sections III(b) and III(d) of PTE 86–128 as amended require financial institutions to obtain advance written authorization from a plan fiduciary independent of the financial institutions (the authorizing fiduciary), or managed IRA owner, and furnish the authorizing fiduciary or managed IRA owner with information necessary to determine whether an authorization should be made, including a copy of the exemption, a form for termination, a description of the financial institution's brokerage placement practices, and any other reasonably available information regarding the matter that the authorizing fiduciary or managed IRA owner requests.

Section III(c) requires financial institutions to obtain annual written reauthorization or provide the authorizing fiduciary or managed IRA owner with an annual termination form explaining that the authorization is terminable at will, without penalty to the plan or IRA, and that failure to return the form will result in continued authorization for the financial institution to engage in covered transactions on behalf of the plan or IRA. Furthermore, Section III(e) requires the financial institution to provide the authorizing fiduciary with either (a) a confirmation slip for each individual securities transaction within 10 days of the transaction containing the information described in Rule 10b–10(a)(1–7) under the Securities Exchange Act of 1934, 17 CFR 240.10b–10 or (b) a quarterly report containing certain financial information including the total of all transaction-related charges incurred by the plan. The Department assumes that financial institutions will meet this requirement for 40 percent of plans and IRAs through the provision of a confirmation slip, which already is provided to their clients in the normal course of business, while financial institutions will meet this requirement for 60 percent of plans and IRAs through provision of the quarterly report.

Finally, Section III(f) requires the financial institution to provide the authorizing fiduciary or managed IRA owner with an annual summary of the confirmation slips or quarterly reports. The summary must contain the following information: The total of all securities transaction-related charges incurred by the plan or IRA during the period in connection with the covered securities transactions; the amount of the securities transaction-related charges retained by the authorized person and the amount of these charges paid to other persons for execution or other services; a description of the financial institution's brokerage placement practices if such practices have materially changed during the period covered by the summary; and a

[51] As discussed below, the amendment requires investment managers to meet the terms of the exemption before engaging in covered transactions with respect to IRAs, and revokes relief for investment advice fiduciaries with respect to IRAs.

[52] According to data from the National Telecommunications and Information Agency (NTIA), 33.4 percent of individuals age 25 and over have access to the Internet at work. According to a Greenwald & Associates survey, 84 percent of plan participants find it acceptable to make electronic delivery the default option, which is used as the proxy for the number of participants who will not opt out that are automatically enrolled (for a total of 28.1 percent receiving electronic disclosure at work). Additionally, the NTIA reports that 38.9 percent of individuals age 25 and over have access to the Internet outside of work. According to a Pew Research Center survey, 61 percent of Internet users use online banking, which is used as the proxy for the number of Internet users who will opt in for electronic disclosure (for a total of 23.7 percent receiving electronic disclosure outside of work). Combining the 28.1 percent who receive electronic disclosure at work with the 23.7 percent who receive electronic disclosure outside of work produces a total of 51.8 percent who will receive electronic disclosure overall.

[53] According to data from the NTIA, 72.4 percent of individuals age 25 and older have access to the Internet. According to a Pew Research Center survey, 61 percent of Internet users use online banking, which is used as the proxy for the number of Internet users who will opt in for electronic disclosure. Combining these data produces an estimate of 44.1 percent of individuals who will receive electronic disclosures.

[54] The Department received a comment stating that no cost of postage had been considered in the proposal. In fact, postage had been considered. Detail has been added for improved transparency.

[55] For a description of the Department's methodology for calculating wage rates, see *http://www.dol.gov/ebsa/pdf/labor-cost-inputs-used-in-ebsa-opr-ria-and-pra-burden-calculations-march-2016.pdf.* The Department's methodology for calculating the overhead cost input of its wage rates was adjusted from the proposed amendment to this PTE to the final amendment to this PTE. In the proposal, the Department based its overhead cost estimates on longstanding internal EBSA calculations for the cost of overhead. In response to a public comment stating that the overhead cost estimates were too low and without any supporting evidence, the Department incorporated published U.S. Census Bureau survey data on overhead costs into its wage rate estimates.

[56] One commenter questioned the basis for the Department's assumption regarding the number of Financial Institutions likely to use the exemption. According to the "2015 Investment Management Compliance Testing Survey," Investment Adviser Association, cited in the regulatory impact analysis for the accompanying rule, 63 percent of Registered Investment Advisers service ERISA-covered plans and IRAs. The Department is using this to form a proxy for the share of broker-dealers that service ERISA-covered plans and IRAs. The Department conservatively assumes that all of the 42 large broker-dealers, 63 percent of the 233 medium broker-dealers (147), and 63 percent of the 3,682 small broker-dealers (2,320) work with ERISA-covered plans and IRAs. Therefore, of the 3,997 broker-dealers registered with the Securities and Exchange Commission, 2,536 broker-dealers service ERISA-covered plans and managed IRAs. The Department anticipates that the exemption will be used primarily, but not exclusively, by broker-dealers. Further, the Department assumes that all broker-dealers servicing the retirement market will use the exemption. The Department believes that some Registered Investment Advisers will use the exemption, but all of those RIAs will be dually registered and accounted for in the broker-dealer counts. The Department has rounded up to 2,800 to account for any other financial institutions that may use the exemption. Further, the Department assumes that approximately 1,800 of the financial institutions using the exemption focus their business primarily on ERISA-covered plans, while 1,000 of the financial institutions using the exemption focus their business primarily on managed IRAs and non-ERISA plans.

[57] This is a weighted average of the Department's estimates of the share of DB plans and DC plans with broker-dealer relationships. The Department does not have a reliable estimate of the number of managed IRAs, and non-ERISA plans with relationships with financial institutions seeking exemptive relief, but believes it to be less than 10,000, which would not materially impact the weighted average.

portfolio turnover ratio calculated in a manner reasonably designed to provide the authorizing fiduciary the information needed to assist in discharging its duty of prudence. Section III(i) states that a financial institution that is a discretionary plan trustee who qualifies to use the exemption must provide the authorizing fiduciary or managed IRA owner with an annual report showing separately the commissions paid to affiliated brokers and non-affiliated brokers, on both a total dollar basis and a cents-per-share basis.

Legal Costs

According to the 2013 Form 5500, approximately 681,000 plans exist in the United States that could enter into relationships with financial institutions. The Department lacks reliable data on the number of managed IRA and non-ERISA plans with relationships with broker-dealers, but estimates that they number less than 10,000. Of these plans and managed IRAs, the Department assumes that 6.5 percent are new plans, managed IRAs and non-ERISA plans, or plans, managed IRAs or non-ERISA plans entering into relationships with new financial institutions [58] and, as stated previously, 23.7 percent of these plans, managed IRAs and non-ERISA plans will engage in transactions covered under this class exemption. The Department estimates that reviewing documents and granting written authorization to the financial institutions will require five hours of legal time for each of the approximately 11,000 plans, managed IRAs and non-ERISA plans entering into new relationships with financial institutions each year.[59] During the first year that these amendments take effect, it will also take five hours of legal time each of the approximately 1,000 financial institutions to draft an authorization notice to send to managed IRAs and non-ERISA plans that are existing clients. Finally, the Department estimates that it will take one hour of legal time for each of the approximately 2,800 financial institutions to produce the annual termination form. This legal work results in a total of approximately 59,000 hours at an equivalent cost of $7.9 million during the first year and 56,000 hours at an equivalent cost of $7.5 million during subsequent years.

Production and Distribution of Required Disclosures

The Department estimates that approximately 161,000 plans and 2,000 managed IRAs and non-ERISA plans have relationships with financial institutions and are likely to engage in transactions covered under this exemption. Of these 161,000 plans and 2,000 managed IRAs and non-ERISA plans, approximately 11,000 plans, managed IRAs, and non-ERISA plans, are new clients to the financial institutions each year.

The Department estimates that 11,000 plans, managed IRAs and non-ERISA plans will send financial institutions a two page authorization letter each year. Prior to obtaining authorization, financial institutions will send the same 11,000 plans, managed IRAs and non-ERISA plans a seven page pre-authorization disclosure.[60] During the first year, financial institutions will send 2,000 authorization notices to existing managed IRA clients and non-ERISA plan clients. Paper copies of the authorization letter, pre-authorization disclosure, and authorization notice will be mailed for 48.2 percent of the plans and 55.9 percent of managed IRAs and non-ERISA plans, and distributed electronically for the remaining 51.8 percent and 44.1 percent respectively. The Department estimates that electronic distribution will result in a de minimis cost, while paper distribution will cost approximately $9,000 during the first year and $7,000 during subsequent years. Paper distribution of the letter, disclosure, and notice will also require two minutes of clerical preparation time per letter, disclosure, or notice resulting in a total of 400 hours at an equivalent cost of $23,000 during the first year and 300 hours at an equivalent cost of approximately $19,000 during subsequent years.[61]

The Department estimates that all of the 161,000 plans and 2,000 managed IRAs and non-ERISA plans will receive a two-page annual termination form from financial institutions; 51.8 percent will be distributed electronically to plans and 44.1 percent will be distributed electronically to managed IRAs and non-ERISA plans, while 48.2 percent and 55.9 percent, respectively, will be mailed. The Department estimates that electronic distribution will result in a de minimis cost, while the paper distribution will cost $47,000. Paper distribution will also require two minutes of clerical preparation time per form resulting in a total of 3,000 hours at an equivalent cost of $146,000.

The Department estimates that 60 percent of plans, managed IRAs and non-ERISA plans (approximately 97,000 plans and 1,000 managed IRAs and non-ERISA plans) will receive quarterly two-page transaction reports from financial institutions four times per year; 51.8 percent will be distributed electronically to plans and 44.1 percent will be distributed electronically to managed IRAs and non-ERISA plans, while 48.2 percent and 55.9 percent, respectively, will be mailed. The Department estimates that electronic distribution will result in a de minimis cost, while paper distribution will cost $112,000. Paper distribution will also require two minutes of clerical preparation time per statement resulting in a total of 6,000 hours at an equivalent cost of $349,000.

The Department estimates that all of the 161,000 plans and 2,000 managed IRAs and non-ERISA plans will receive a five-page annual statement with a two-page summary of commissions paid from financial institutions; 51.8 percent will be distributed electronically to plans and 44.1 percent will be distributed electronically to managed IRAs and non-ERISA plans, while 48.2 percent and 55.9 percent, respectively, will be mailed. The Department assumes that these disclosures will be distributed with the annual termination form, resulting in no further clerical hour burden or postage cost. Electronic distribution will result in a de minimis cost, while the paper distribution will cost $28,000 in materials costs.

The Department received one comment suggesting that the burden analysis in the proposal did not account for any costs to compile data necessary to produce the quarterly transaction reports, annual statements, and report of commissions paid. In fact, this burden was taken into account in the proposal and has been updated here. The Department estimates that it will cost financial institutions $3.30 per plan,

[58] This estimate is from the 2011–2013 Form 5500 data sets. The Department is using new ERISA plans as a proxy for new non-ERISA plans and IRAs.

[59] This estimate has been increased from one hour of legal time per plan in the proposal in response to a public comment. The proposal did not take into account any burden for reviewing the pre-authorization disclosures.

[60] One commenter questioned the availability of the required materials necessary to create the pre-authorization disclosure. Because PTE 86–128 has been in existence for decades, systems are already in place to compile the materials into a disclosure. Further, many of the components of the disclosure also fulfill other regulatory requirements. Therefore, the Department believes that the pre-authorization disclosure can be compiled electronically at de minimis cost. The incremental costs to financial institutions of printing and distributing this disclosure to plans comprise the only additional burden associated with the pre-authorization disclosure.

[61] One commenter questioned the basis for this estimate. The Department worked with clerical staff to determine that most notices and disclosures can be printed and prepared for mailing in less than one minute per disclosure. Therefore, an estimate of two minutes per disclosure is a conservative estimate.

managed IRA, or non-ERISA plan, for each of the 161,000 plans and 2,000 managed IRAs and non-ERISA plans, to track and compile all the transactions data necessary to populate the quarterly transaction reports, the annual statements, and the report of commissions paid. This results in an IT tracking cost of $540,000.[62]

Recordkeeping Requirement

Section VI of PTE 86–128, as amended, and condition (e) of PTE 75–1, Part II, as amended, will require financial institutions to maintain or cause to be maintained for six years and disclosed upon request the records necessary for the Department, Internal Revenue Service, plan fiduciary, contributing employer or employee organization whose members are covered by the plan, participants and beneficiaries and managed IRA owners to determine whether the conditions of this exemption have been met.

The Department assumes that each financial institution will maintain these records in their normal course of business. Therefore, the Department has estimated that the additional time needed to maintain records consistent with the exemption will only require about one-half hour, on average, annually for a financial manager to organize and collate the documents or else draft a notice explaining that the information is exempt from disclosure, and an additional 15 minutes of clerical time to make the documents available for inspection during normal business hours or prepare the paper notice explaining that the information is exempt from disclosure. Thus, the Department estimates that a total of 45 minutes of professional time (30 minutes of financial manager time and 15 minutes of clerical time) per financial institution per year will be required for a total hour burden of 2,100 hours at an equivalent cost of $273,000.

In connection with the recordkeeping and disclosure requirement discussed above, Section VI(b) of PTE 86–128 and Section (f) of PTE 75–1, Part II, provide that parties relying on the exemption do not have to disclose trade secrets or other confidential information to members of the public (*i.e.,* plan fiduciaries, contributing employers or employee organizations whose members are covered by the plan, participants and beneficiaries and managed IRA owners), but that in the event a party refuses to disclose information on this basis, it must provide a written notice to the requester advising of the reasons for the refusal and advising that the Department may request such information. The Department's experience indicates that this provision is not commonly invoked, and therefore, the written notice is rarely, if ever, generated. Therefore, the Department believes the cost burden associated with this clause is de minimis. No other cost burden exists with respect to recordkeeping.

Overall Summary

Overall, the Department estimates that in order to meet the conditions of this amended class exemption, over 13,000 financial institutions and plans will produce 910,000 disclosures and notices during the first year and 906,000 disclosures and notices during subsequent years. These disclosures and notices will result in approximately 71,000 burden hours during the first year and 67,000 burden hours during subsequent years, at an equivalent cost of $8.7 million and $8.3 million respectively. This exemption will also result in a total annual cost burden of almost $736,000 during the first year and $734,000 during subsequent years.

These paperwork burden estimates are summarized as follows:

Type of Review: Revision of a Currently Approved Information Collection.

Agency: Employee Benefits Security Administration, Department of Labor.

Titles: (1) Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 86–128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; Amendment to and Partial Revocation of PTE 75–1, and (2) Final Investment Advice Regulation.

OMB Control Number: 1210–0059.

Affected Public: Businesses or other for-profits; not for profit institutions.

Estimated Number of Respondents: 13,445.

Estimated Number of Annual Responses: 910,063 during the first year, 905,632 during subsequent years.

Frequency of Response: Initially, Annually, When engaging in exempted transaction.

Estimated Total Annual Burden Hours: 70,516 hours during the first year, 67,434 hours during subsequent years.

Estimated Total Annual Burden Cost: $735,959 during the first year, $734,055 during subsequent years.

General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under ERISA section 408(a) and Code section 4975(c)(2) does not relieve a fiduciary or other party in interest or disqualified person with respect to a plan from certain other provisions of ERISA and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of ERISA section 404 which require, among other things, that a fiduciary discharge his or her duties respecting a plan solely in the interests of the participants and beneficiaries of the plan. Additionally, the fact that a transaction is the subject of an exemption does not affect the requirement of Code section 401(a) that the plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries;

(2) In accordance with ERISA section 408(a) and Code section 4975(c)(2), and based on the entire record, the Department finds that the amendments are administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of plan participants and beneficiaries and IRA owners;

(3) These amendments are applicable to a particular transaction only if the transaction satisfies the conditions specified in the amended exemptions; and

(4) These amended exemptions will be supplemental to, and not in derogation of, any other provisions of ERISA and the Code, including statutory or administrative exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

Amendment to PTE 86–128

Under section 408(a) of the Employee Retirement Income Security Act of 1974, as amended (ERISA) and section 4975(c)(2) of the Internal Revenue Code of 1986, as amended (the Code), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637, 66644 (October 27, 2011)), the Department amends and restated PTE 86–128 as set forth below:

Section I. Covered Transactions

(a) *Securities Transactions Exemptions.* If each of the conditions of Sections II and III of this exemption is either satisfied or not applicable under Section V, the restrictions of ERISA

[62] This estimate is based on feedback received from the industry in 2008 stating that service providers incur costs of about $3 per plan to compile statement and transaction data. This estimate has been inflated using the CPI to current dollars.

section 406(b) and the taxes imposed by Code section 4975(a) and (b) by reason of Code section 4975(c)(1)(E) or (F) shall not apply to—(1) A plan fiduciary's using its authority to cause a plan to pay a Commission directly to that person or a Related Entity as agent for the plan in a securities transaction, but only to the extent that the securities transactions are not excessive, under the circumstances, in either amount or frequency; and (2) A plan fiduciary's acting as the agent in an agency cross transaction for both the plan and one or more other parties to the transaction and the receipt by such person of a Commission from one or more other parties to the transaction.

(b) *Mutual Fund Transactions Exemption.* If each condition of Sections II and IV is either satisfied or not applicable under Section V, the restrictions of ERISA sections 406(a)(1)(A), 406(a)(1)(D) and 406(b) and the taxes imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A), (D), (E) and (F), shall not apply to a plan fiduciary's using its authority to cause the plan to purchase shares of an open end investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) (Mutual Fund) from such fiduciary, and to the receipt of a Commission by such person in connection with such transaction, but only to the extent that such transactions are not excessive, under the circumstances, in either amount or frequency; provided that, the fiduciary (1) is a broker-dealer registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) acting in its capacity as a broker-dealer, and (2) is not a principal underwriter for, or affiliated with, such Mutual Fund, within the meaning of sections 2(a)(29) and 2(a)(3) of the Investment Company Act of 1940.

(c) *Scope of these Exemptions.* (1) The exemption set forth in Section I(a) does not apply to a transaction if (A) the plan is an Individual Retirement Account and (B) the fiduciary engaging in the transaction is a fiduciary by reason of the provision of investment advice for a fee, described in Code section 4975(e)(3)(B) and the applicable regulations.

(2) The exemption set forth in Section I(b) does not apply to transactions involving IRAs.

Section II. Impartial Conduct Standards

If the fiduciary engaging in the covered transaction is a fiduciary within the meaning of ERISA section 3(21)(A)(i) or (ii), or Code section 4975(e)(3)(A) or (B), with respect to the assets involved in the transaction, the following conditions must be satisfied with respect to such transaction to the extent they are applicable to the fiduciary's actions:

(a) When exercising fiduciary authority described in ERISA section 3(21)(A)(i) or (ii), or Code section 4975(e)(3)(A) or (B), with respect to the assets involved in the transaction, the fiduciary acts in the Best Interest of the plan at the time of the transaction.

(b) All compensation received by the person and any Related Entity in connection with the transaction is not in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2).

(c) The fiduciary's statements about the transaction, fees and compensation, Material Conflicts of Interest, and any other matters relevant to a plan's investment decisions, are not materially misleading at the time they are made. For this purpose, a fiduciary's failure to disclose a Material Conflict of Interest relevant to the services the fiduciary is providing or other actions it is taking in relation to a plan's investment decisions is deemed to be a misleading statement.

Section III. Conditions Applicable to Transactions Described in Section I(a)

Except to the extent otherwise provided in Section V of this exemption, Section I(a) of this exemption applies only if the following conditions are satisfied:

(a) The person engaging in the covered transaction is not a trustee (other than a nondiscretionary trustee), an administrator of the plan, or an employer any of whose employees are covered by the plan. Notwithstanding the foregoing, this condition does not apply to a trustee that satisfies Section III(h) and (i).

(b)(1) The covered transaction is performed under a written authorization executed in advance by a fiduciary of each plan whose assets are involved in the transaction or, in the case of an IRA, the IRA owner. The plan fiduciary is independent of the person engaging in the covered transaction. The authorization is terminable at will by the plan, without penalty to the plan, upon receipt by the authorized person of written notice of termination.

(2) Notwithstanding subsection (1), with respect to IRA owners or non-ERISA plans that are existing customers as of the Applicability Date, a person relying on this exemption may satisfy this Section III(b) and Section III(d) if, no later than the Applicability Date, the person provides the disclosures required by Section III(d) and a form expressly providing an election to terminate the services arrangement, with instructions on the use of the form, to the IRA owner or plan fiduciary. The instructions for such form must include the following information:

(A) The arrangement is terminable at will by the IRA or non-ERISA plan, without penalty to the IRA or non-ERISA plan, when the authorized person receives (via first class mail, personal delivery, or email) from the IRA owner or plan fiduciary, a written notice of the intent of the IRA or non-ERISA plan to terminate the arrangement; and

(B) Failure to return the form or some other written notification of the IRA's or non-ERISA plan's intent to terminate the arrangement within thirty (30) days from the date the termination form is sent to the IRA owner or non-ERISA plan fiduciary will result in the continued authorization of the authorized person to engage in the covered transactions on behalf of the IRA or non-ERISA plan.

(c) The authorized person obtains annual reauthorization to engage in transactions pursuant to the exemption in the manner set forth in Section III(b). Alternatively, the authorized person may supply a form expressly providing an election to terminate the authorization described in Section III(b) with instructions on the use of the form to the authorizing fiduciary or IRA owner no less than annually. The instructions for such form must include the following information:

(1) The authorization is terminable at will by the plan, without penalty to the plan, when the authorized person receives (via first class mail, personal delivery, or email) from the authorizing fiduciary or other plan official having authority to terminate the authorization, or in the case of an IRA, the IRA owner, a written notice of the intent of the plan to terminate authorization; and

(2) Failure to return the form or some other written notification of the plan's intent to terminate the authorization within thirty (30) days from the date the termination form is sent to the authorizing fiduciary or IRA owner will result in the continued authorization of the authorized person to engage in the covered transactions on behalf of the plan.

(d) Within three months before an initial authorization is made pursuant to Section III(b), the authorizing fiduciary or, in the case of an IRA, the IRA owner is furnished with a copy of this exemption, the form for termination of authorization described in Section III(c), a description of the person's brokerage placement practices, and any other reasonably available information regarding the matter that the authorizing fiduciary or IRA owner requests.

(e) The person engaging in a covered transaction furnishes the authorizing fiduciary or IRA owner with either:

(1) A confirmation slip for each securities transaction underlying a covered transaction within ten business days of the securities transaction containing the information described in Rule 10b–10(a)(1–7) under the Securities Exchange Act of 1934; or

(2) at least once every three months and not later than 45 days following the period to which it relates, a report disclosing:

(A) A compilation of the information that would be provided to the plan pursuant to Section III(e)(1) during the three-month period covered by the report;

(B) the total of all securities transaction-related charges incurred by the plan during such period in connection with such covered transactions; and

(C) the amount of the securities transaction-related charges retained by such person, and the amount of such charges paid to other persons for execution or other services. For purposes of this paragraph (e), the words ''incurred by the plan'' shall be construed to mean ''incurred by the pooled fund'' when such person engages in covered transactions on behalf of a pooled fund in which the plan participates.

(f) The authorizing fiduciary or IRA owner is furnished with a summary of the information required under Section III(e)(1) at least once per year. The summary must be furnished within 45 days after the end of the period to which it relates, and must contain the following:

(1) The total of all securities transaction-related charges incurred by the plan during the period in connection with covered securities transactions.

(2) The amount of the securities transaction-related charges retained by the authorized person and the amount of these charges paid to other persons for execution or other services.

(3) A description of the brokerage placement practices of the person that is engaging in the covered transaction, if such practices have materially changed during the period covered by the summary.

(4)(A) A portfolio turnover ratio, calculated in a manner which is reasonably designed to provide the authorizing fiduciary with the information needed to assist in making a prudent determination regarding the amount of turnover in the portfolio. The requirements of this paragraph (f)(4)(A) will be met if the ''annualized portfolio turnover ratio,'' calculated in the manner described in paragraph (f)(4)(B), is contained in the summary.

(B) The ''annualized portfolio turnover ratio'' shall be calculated as a percentage of the plan assets consisting of securities or cash over which the authorized person had discretionary investment authority (the portfolio) at any time or times (management period(s)) during the period covered by the report. First, the ''portfolio turnover ratio'' (not annualized) is obtained by dividing (i) the lesser of the aggregate dollar amounts of purchases or sales of portfolio securities during the management period(s) by (ii) the monthly average of the market value of the portfolio securities during all management period(s). Such monthly average is calculated by totaling the market values of the portfolio securities as of the beginning and end of each management period and as of the end of each month that ends within such period(s), and dividing the sum by the number of valuation dates so used. For purposes of this calculation, all debt securities whose maturities at the time of acquisition were one year or less are excluded from both the numerator and the denominator. The ''annualized portfolio turnover ratio'' is then derived by multiplying the ''portfolio turnover ratio'' by an annualizing factor. The annualizing factor is obtained by dividing (iii) the number twelve by (iv) the aggregate duration of the management period(s) expressed in months (and fractions thereof). Examples of the use of this formula are provided in Section VIII.

(C) The information described in this paragraph (f)(4) is not required to be furnished in any case where the authorized person has not exercised discretionary authority over trading in the plan's account during the period covered by the report.

For purposes of this paragraph (f), the words ''incurred by the plan'' shall be construed to mean ''incurred by the pooled fund'' when such person engages in covered transactions on behalf of a pooled fund in which the plan participates.

(g) If an agency cross transaction to which Section V(a) does not apply is involved, the following conditions must also be satisfied:

(1) The information required under Section III(d) or Section V(c)(1)(B) of this exemption includes a statement to the effect that with respect to agency cross transactions, the person effecting or executing the transactions will have a potentially conflicting division of loyalties and responsibilities regarding the parties to the transactions;

(2) The summary required under Section III(f) of this exemption includes a statement identifying the total number of agency cross transactions during the period covered by the summary and the total amount of all commissions or other remuneration received or to be received from all sources by the person engaging in the transactions in connection with the transactions during the period;

(3) The person effecting or executing the agency cross transaction has the discretionary authority to act on behalf of, and/or provide investment advice to, either (A) one or more sellers or (B) one or more buyers with respect to the transaction, but not both.

(4) The agency cross transaction is a purchase or sale, for no consideration other than cash payment against prompt delivery of a security for which market quotations are readily available; and

(5) The agency cross transaction is executed or effected at a price that is at or between the independent bid and independent ask prices for the security prevailing at the time of the transaction.

(h) Except pursuant to Section V(b), a trustee (other than a non-discretionary trustee) may engage in a covered transaction only with a plan that has total net assets with a value of at least $50 million and in the case of a pooled fund, the $50 million requirement will be met if 50 percent or more of the units of beneficial interest in such pooled fund are held by plans having total net assets with a value of at least $50 million.

For purposes of the net asset tests described above, where a group of plans is maintained by a single employer or controlled group of employers, as defined in ERISA section 407(d)(7), the $50 million net asset requirement may be met by aggregating the assets of such plans, if the assets are pooled for investment purposes in a single master trust.

(i) The trustee described in Section III(h) engaging in a covered transaction furnishes, at least annually, to the authorizing fiduciary of each plan the following:

(1) The aggregate brokerage commissions, expressed in dollars, paid by the plan to brokerage firms affiliated with the trustee;

(2) the aggregate brokerage commissions, expressed in dollars, paid by the plan to brokerage firms unaffiliated with the trustee;

(3) the average brokerage commissions, expressed as cents per share, paid by the plan to brokerage firms affiliated with the trustee; and

(4) the average brokerage commissions, expressed as cents per share, paid by the plan (to brokerage firms unaffiliated with the trustee.

For purposes of this paragraph (i), the words ''paid by the plan'' shall be construed to mean ''paid by the pooled fund'' when the trustee engages in covered transactions on behalf of a pooled fund in which the plan participates.

(j) In the case of securities transactions involving shares of Mutual Funds, other than exchange traded funds, at the time of the transaction, the shares are purchased or sold at net asset value (NAV) plus a commission, in accordance with applicable securities laws and regulations.

IV. Conditions Applicable to Transactions Described in Section I(b)

Section I(b) of this exemption applies only if the following conditions are satisfied:

(a) The fiduciary engaging in the covered transaction customarily purchases and sells securities for its own account in the ordinary course of its business as a broker-dealer.

(b) At the time the transaction is entered into, the terms are at least as favorable to the plan as the terms generally available in an arm's length transaction with an unrelated party.

(c) Except to the extent otherwise provided in Section V, the requirements of Section III(a) through III(f), III(h) and III(i) (if applicable), and III(j) are satisfied with respect to the transaction.

Section V. Exceptions From Conditions

(a) Certain agency cross transactions. Section III of this exemption does not apply in the case of an agency cross transaction, provided that the person effecting or executing the transaction:

(1) Does not render investment advice to any plan for a fee within the meaning of ERISA section 3(21)(A)(ii) with respect to the transaction;

(2) is not otherwise a fiduciary who has investment discretion with respect to any plan assets involved in the transaction, *see* 29 CFR 2510.3–21(d); and

(3) does not have the authority to engage, retain or discharge any person who is or is proposed to be a fiduciary regarding any such plan assets.

(b) Recapture of profits. Sections III(a) and III(i) do not apply in any case where the person who is engaging in a covered transaction returns or credits to the plan all profits earned by that person and any Related Entity in connection with the securities transactions associated with the covered transaction.

(c) Special rules for pooled funds. In the case of a person engaging in a covered transaction on behalf of an account or fund for the collective investment of the assets of more than one plan (a pooled fund):

(1) Sections III(b), (c) and (d) of this exemption do not apply if—

(A) the arrangement under which the covered transaction is performed is subject to the prior and continuing authorization, in the manner described in this paragraph (c)(1), of a plan fiduciary with respect to each plan whose assets are invested in the pooled fund who is independent of the person. The requirement that the authorizing fiduciary be independent of the person shall not apply in the case of a plan covering only employees of the person, if the requirements of Section V(c)(2)(A) and (B) are met.

(B) The authorizing fiduciary is furnished with any reasonably available information that the person engaging or proposing to engage in the covered transaction reasonably believes to be necessary to determine whether the authorization should be given or continued, not less than 30 days prior to implementation of the arrangement or material change thereto, including (but not limited to) a description of the person's brokerage placement practices, and, where requested any other reasonably available information regarding the matter upon the reasonable request of the authorizing fiduciary at any time.

(C) In the event an authorizing fiduciary submits a notice in writing to the person engaging in or proposing to engage in the covered transaction objecting to the implementation of, material change in, or continuation of, the arrangement, the plan on whose behalf the objection was tendered is given the opportunity to terminate its investment in the pooled fund, without penalty to the plan, within such time as may be necessary to effect the withdrawal in an orderly manner that is equitable to all withdrawing plans and to the nonwithdrawing plans. In the case of a plan that elects to withdraw under this subparagraph (c)(1)(C), the withdrawal shall be effected prior to the implementation of, or material change in, the arrangement; but an existing arrangement need not be discontinued by reason of a plan electing to withdraw.

(D) In the case of a plan whose assets are proposed to be invested in the pooled fund subsequent to the implementation of the arrangement and that has not authorized the arrangement in the manner described in Section V(c)(1)(B) and (C), the plan's investment in the pooled fund is subject to the prior written authorization of an authorizing fiduciary who satisfies the requirements of subparagraph (c)(1)(A).

(2) Section III(a) of this exemption, to the extent that it prohibits the person from being the employer of employees covered by a plan investing in a pool managed by the person, does not apply if—

(A) The person is an ''investment manager'' as defined in section 3(38) of ERISA, and

(B) Either (i) the person returns or credits to the pooled fund all profits earned by the person and any Related Entity in connection with all covered transactions engaged in by the fund, or (ii) the pooled fund satisfies the requirements of paragraph V(c)(3).

(3) A pooled fund satisfies the requirements of this paragraph for a fiscal year of the fund if—

(A) On the first day of such fiscal year, and immediately following each acquisition of an interest in the pooled fund during the fiscal year by any plan covering employees of the person, the aggregate fair market value of the interests in such fund of all plans covering employees of the person does not exceed twenty percent of the fair market value of the total assets of the fund; and

(B) The aggregate brokerage commissions received by the person and any Related Entity, in connection with covered transactions engaged in by the person on behalf of all pooled funds in which a plan covering employees of the person participates, do not exceed five percent of the total brokerage commissions received by the person and any Related Entity from all sources in such fiscal year.

Section VI. Recordkeeping Requirements

(a) The plan fiduciary engaging in a covered transaction maintains or causes to be maintained for a period of six years, in a manner that is reasonably accessible for examination, the records necessary to enable the persons described in Section VI(b) to determine whether the conditions of this exemption have been met, except that:

(1) If such records are lost or destroyed, due to circumstances beyond the control of the such plan fiduciary, then no prohibited transaction will be considered to have occurred solely on the basis of the unavailability of those records; and

(2) No party in interest, other than such plan fiduciary who is responsible for complying with this paragraph (a), will be subject to the civil penalty that may be assessed under ERISA section

502(i) or the taxes imposed by Code section 4975(a) and (b), if applicable, if the records are not maintained or are not available for examination as required by paragraph (b) below; and

(b)(1) Except as provided below in subparagraph (2), or as precluded by 12 U.S.C. 484, and notwithstanding any provisions of ERISA section 504(a)(2) and (b), the records referred to in the above paragraph are reasonably available at their customary location for examination during normal business hours by—

(A) Any duly authorized employee or representative of the Department or the Internal Revenue Service;

(B) Any fiduciary of the plan or any duly authorized employee or representative of such fiduciary;

(C) Any contributing employer and any employee organization whose members are covered by the plan, or any authorized employee or representative of these entities; or

(D) Any participant or beneficiary of the plan or the authorized representative of such participant or beneficiary.

(2) None of the persons described in subparagraph (1)(B)–(D) above are authorized to examine privileged trade secrets or privileged commercial or financial information of such fiduciary or are authorized to examine records regarding a plan or IRA other than the plan or IRA with which they are the fiduciary, contributing employer, employee organization, participant, beneficiary or IRA owner.

(3) Should such plan fiduciary refuse to disclose information on the basis that such information is exempt from disclosure, such plan fiduciary must, by the close of the thirtieth (30th) day following the request, provide a written notice advising the requestor of the reasons for the refusal and that the Department may request such information.

(4) Failure to maintain the required records necessary to determine whether the conditions of this exemption have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions.

Section VII. Definitions

The following definitions apply to this exemption:

(a) The term ‘‘person’’ includes the person and affiliates of the person.

(b) An ‘‘affiliate’’ of a person includes the following:

(1) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with, the person;

(2) Any officer, director, partner, employee, or relative (as defined in ERISA section 3(15)), of the person; and

(3) Any corporation or partnership of which the person is an officer, director or in which such person is a partner.

A person is not an affiliate of another person solely because one of them has investment discretion over the other's assets. The term ‘‘control’’ means the power to exercise a controlling influence over the management or policies of a person other than an individual.

(c) An ‘‘agency cross transaction’’ is a securities transaction in which the same person acts as agent for both any seller and any buyer for the purchase or sale of a security.

(d) The term ‘‘covered transaction’’ means an action described in Section I of this exemption.

(e) The term ‘‘effecting or executing a securities transaction’’ means the execution of a securities transaction as agent for another person and/or the performance of clearance, settlement, custodial or other functions ancillary thereto.

(f) A plan fiduciary is ‘‘independent’’ of a person if it (1) is not the person, (2) does not receive or is not projected to receive within the current federal income tax year, compensation or other consideration for his or her own account from the person in excess of 2% of the fiduciary's annual revenues based upon its prior income tax year, and (3) does not have a relationship to or an interest in the person that might affect the exercise of the person's best judgment in connection with transactions described in this exemption. Notwithstanding the foregoing, if the plan is an individual retirement account not subject to title I of ERISA, and is beneficially owned by an employee, officer, director or partner of the person engaging in covered transactions with the IRA pursuant to this exemption, such beneficial owner is deemed ‘‘independent’’ for purposes of this definition.

(g) The term ‘‘profit’’ includes all charges relating to effecting or executing securities transactions, less reasonable and necessary expenses including reasonable indirect expenses (such as overhead costs) properly allocated to the performance of these transactions under generally accepted accounting principles.

(h) The term ‘‘securities transaction’’ means the purchase or sale of securities.

(i) The term ‘‘nondiscretionary trustee’’ of a plan means a trustee or custodian whose powers and duties with respect to any assets of the plan are limited to (1) the provision of nondiscretionary trust services to the plan, and (2) duties imposed on the trustee by any provision or provisions of ERISA or the Code. The term ‘‘nondiscretionary trust services’’ means custodial services and services ancillary to custodial services, none of which services are discretionary. For purposes of this exemption, a person does not fail to be a nondiscretionary trustee solely by reason of having been delegated, by the sponsor of a master or prototype plan, the power to amend such plan.

(j) The term ‘‘plan’’ means an employee benefit plan described in ERISA section 3(3) and any plan described in Code section 4975(e)(1) (including an Individual Retirement Account as defined in VII(k)).

(k) The terms ‘‘Individual Retirement Account’’ or ‘‘IRA’’ mean any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

(l) The term ‘‘Related Entity’’ means an entity, other than an affiliate, in which a person has an interest which may affect the person's exercise of its best judgment as a fiduciary.

(m) A fiduciary acts in the ‘‘Best Interest’’ of the plan when the fiduciary acts 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 plan, without regard to the financial or other interests of the fiduciary, its affiliate, a Related Entity or other party.

(n) The term ‘‘Commission’’ means a brokerage commission or sales load paid for the service of effecting or executing the transaction, but not a 12b–1 fee, revenue sharing payment, marketing fee, administrative fee, sub-TA fee or sub-accounting fee.

(o) A ‘‘Material Conflict of Interest’’ exists when a person has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a plan.

Section VIII. Examples Illustrating the Use of the Annualized Portfolio Turnover Ratio Described in Section III(f)(4)(B)

(a) M, an investment manager affiliated with a broker dealer that M uses to effect securities transactions for the accounts that it manages, exercises investment discretion over the account of plan P for the period January 1, 2014, though June 30, 2014, after which the relationship between M and P ceases. The market values of P's account with A at the relevant times (excluding debt securities having a maturity of one year or less at the time of acquisition) are:

Date	Market value ($ millions)
January 1, 2014	10.4
January 31, 2014	10.2
February 28, 2014	9.9
March 31, 2014	10.0
April 30, 2014	10.6
May 31, 2014	11.5
June 30, 2014	12.0
Sum of market value	74.6

Aggregate purchases during the 6-month period were $850,000; aggregate sales were $1,000,000, excluding in each case debt securities having a maturity of one year or less at the time of acquisition.

For purposes of Section III(f)(4) of this exemption, M computes the annualized portfolio turnover as follows:

A = $850,000 (lesser of purchases or sales)
B = $10,657,143 ($74.6 million divided by 7, *i.e.,* number of valuation dates)
Annualizing factor = C/D = 12/6 = 2
Annualized portfolio turnover ratio = 2 × (850,000/10,657,143) = 0.160 = 16.0 percent

(b) Same facts as (a), except that M manages the portfolio through July 15, 2014, and, in addition, resumes management of the portfolio on November 10, 2014, through the end of the year. The additional relevant valuation dates and portfolio values are:

Dates	Market value ($ millions)
July 15, 2014	12.2
November 10, 2014	9.4
November 30, 2014	9.6
December 31, 2014	9.8
Sum of market values	41.0

During the periods July 1, 2014, through July 15, 2014, and November 10, 2014, through December 31, 2014, there were an additional $650,000 of purchases and $400,000 of sales. Thus, total purchases were $1,500,000 (*i.e.,* $850,000 + $650,000) and total sales were $1,400,000 (*i.e.,* $1,000,000 + $400,000) for the management periods.

M now computes the annualized portfolio turnover as follows:
A = $1,400,000 (lesser of aggregate purchases or sales)
B = $10,509,091 ($10,509,091 ($115.6 million divided by 11)
Annualizing factor = C/D = 12/(6.5 + 1.67) = 1.47
Annualized portfolio turnover ratio = 1.47 × (1,400,000/10,509,091) = 0.196 = 19.6 percent.

Restatement of PTE 75–1, Part II

The Department is proposing to revoke Parts I(b), I(c) and II(2) of PTE 75–1. In connection with the proposed revocation of Part II(2), the Department is republishing Part II of PTE 75–1. Part II of PTE 75–1 shall read as follows:

The restrictions of section 406(a) of the Employee Retirement Income Security Act of 1974 (the Act) and the taxes imposed by section 4975(a) and (b) of the Internal Revenue Code of 1986 (the Code), by reason of section 4975(c)(1)(A) through (D) of the Code, shall not apply to any purchase or sale of a security between an employee benefit plan and a broker-dealer registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*), a reporting dealer who makes primary markets in securities of the United States Government or of any agency of the United States Government (Government securities) and reports daily to the Federal Reserve Bank of New York its positions with respect to Government securities and borrowings thereon, or a bank supervised by the United States or a State if the following conditions are met:

(a) In the case of such broker-dealer, it customarily purchases and sells securities for its own account in the ordinary course of its business as a broker-dealer.

(b) In the case of such reporting dealer or bank, it customarily purchases and sells Government securities for its own account in the ordinary course of its business and such purchase or sale between the plan and such reporting dealer or bank is a purchase or sale of Government securities.

(c) Such transaction is at least as favorable to the plan as an arm's length transaction with an unrelated party would be, and it was not, at the time of such transaction, a prohibited transaction within the meaning of section 503(b) of the Code.

(d) Neither the broker-dealer, reporting dealer, bank, nor any affiliate thereof has or exercises any discretionary authority or control (except as a directed trustee) with respect to the investment of the plan assets involved in the transaction, or renders investment advice (within the meaning of 29 CFR 2510.3–21(c)) with respect to those assets.

(e) The broker-dealer, reporting dealer, or bank engaging in the covered transaction maintains or causes to be maintained for a period of six years from the date of such transaction such records as are necessary to enable the persons described in paragraph (f) of this exemption to determine whether the conditions of this exemption have been met, except that:

(1) No party in interest other than the broker-dealer, reporting dealer, or bank engaging in the covered transaction, shall be subject to the civil penalty, which may be assessed under section 502(i) of the Act, or to the taxes imposed by section 4975(a) and (b) of the Code, if such records are not maintained, or are not available for examination as required by paragraph (f) below; and

(2) A prohibited transaction will not be deemed to have occurred if, due to circumstances beyond the control of the broker-dealer, reporting dealer, or bank, such records are lost or destroyed prior to the end of such six year period.

(f)(1) Notwithstanding anything to the contrary in subsections (a)(2) and (b) of section 504 of the Act, the records referred to in paragraph (e) are reasonably available for examination during normal business hours by:

(A) Any duly authorized employee or representative of the Department or the Internal Revenue Service;

(B) Any fiduciary of the plan or any duly authorized employee or representative of such fiduciary;

(C) Any contributing employer and any employee organization whose members are covered by the plan, or any authorized employee or representative of these entities; or

(D) Any participant or beneficiary of the plan, or IRA owner, or the duly authorized representative of such participant or beneficiary; and

(2) None of the persons described in subparagraph (1)(B)–(D) above shall be authorized to examine trade secrets or commercial or financial information of the broker-dealer, reporting dealer, or bank which is privileged or confidential, or records regarding a plan or IRA other than the plan or IRA with respect to which they are the fiduciary, contributing employer, employee organization, participant, beneficiary, or IRA owner.

(3) Should such broker-dealer, reporting dealer, or bank refuse to disclose information on the basis that such information is exempt from disclosure, the broker-dealer, reporting dealer, or bank shall, by the close of the thirtieth (30th) day following the request, provide a written notice advising that person of the reasons for the refusal and that the Department may request such information.

(4) Failure to maintain the required records necessary to determine whether the conditions of this exemption have been met will result in the loss of the

exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions.

For purposes of this exemption, the terms "broker-dealer," "reporting dealer" and "bank" shall include such persons and any affiliates thereof, and the term "affiliate" shall be defined in the same manner as that term is defined in 29 CFR 2510.3–21(e) and 26 CFR 54.4975–9(e).

Signed at Washington, DC, this 1st day of April, 2016.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

[FR Doc. 2016–07929 Filed 4–6–16; 11:15 am]

BILLING CODE 4510–29–P

DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

[Application Number D–11820]

ZRIN 1210–ZA25

Amendments to Class Exemptions 75–1, 77–4, 80–83 and 83–1

AGENCY: Employee Benefits Security Administration (EBSA), U.S. Department of Labor.

ACTION: Adoption of Amendments to Class Exemptions.

SUMMARY: This document contains amendments to prohibited transaction exemptions (PTEs) 75–1, 77–4, 80–83 and 83–1. Generally, the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (the Code) prohibit fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs) from engaging in self-dealing, including using their authority, control or responsibility to affect or increase their own compensation. These exemptions generally permit fiduciaries to receive compensation or other benefits as a result of the use of their fiduciary authority, control or responsibility in connection with investment transactions involving plans or IRAs. The amendments require the fiduciaries to satisfy uniform Impartial Conduct Standards in order to obtain the relief available under each exemption. The amendments affect participants and beneficiaries of plans, IRA owners, and fiduciaries with respect to such plans and IRAs.

DATES: *Issuance date:* These amendments are issued June 7, 2016.

Applicability date: These amendments are applicable to transactions occurring on or after April 10, 2017.

FOR FURTHER INFORMATION CONTACT: Brian Shiker, Linda Hamilton or Susan Wilker, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor, (202) 693–8824 (this is not a toll-free number).

SUPPLEMENTARY INFORMATION: The Department is amending the class exemptions on its own motion, pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637 (October 27, 2011)).

Executive Summary

Purpose of Regulatory Action

The Department grants these amendments to PTEs 75–1, 77–4, 80–83 and 83–1 in connection with its publication today, elsewhere in this issue of the **Federal Register**, of a final regulation defining who is a "fiduciary" of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries (Regulation). The Regulation also applies to the definition of a "fiduciary" of a plan (including an IRA) under the Code. The Regulation amends a prior regulation, dating to 1975, specifying when a person is a "fiduciary" under ERISA and the Code by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. The Regulation takes into account the advent of 401(k) 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 existing regulation was issued. In light of the extensive changes in retirement investment practices and relationships, the Regulation updates 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.

In connection with the adoption of the Regulation, PTEs 75–1, Part III, 75–1, Part IV, 77–4, 80–83 and 83–1 are amended to increase the safeguards of the exemptions. As amended, new "Impartial Conduct Standards" are made conditions of the exemptions. Fiduciaries are required to act in accordance with these standards in transactions permitted by the exemptions. The standards are incorporated in multiple class exemptions, including the exemptions that are the subject of this notice, other existing exemptions, and two new exemptions published elsewhere in this issue of the **Federal Register**, to ensure that fiduciaries relying on the exemptions are held to a uniform set of standards and that these standards are applicable to transactions involving both plans and IRAs. The amendments apply prospectively to fiduciaries relying on the exemptions.

ERISA section 408(a) specifically authorizes the Secretary of Labor to grant and amend administrative exemptions from ERISA's prohibited transaction provisions.[1] Regulations at 29 CFR 2570.30 to 2570.52 describe the procedures for applying for an administrative exemption. In amending these exemptions, the Department has determined that the amended exemptions are administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners.

Summary of the Major Provisions

This notice amends prohibited transaction exemptions 75–1, Part III,

[1] Code section 4975(c)(2) authorizes the Secretary of the Treasury to grant exemptions from the parallel prohibited transaction provisions of the Code. Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)) ("Reorganization Plan") generally transferred the authority of the Secretary of the Treasury to grant administrative exemptions under Code section 4975 to the Secretary of Labor. To rationalize the administration and interpretation of dual provisions under ERISA and the Code, the Reorganization Plan divided the interpretive and rulemaking authority for these provisions between the Secretaries of Labor and of the Treasury, so that, in general, the agency with responsibility for a given provision of Title I of ERISA would also have responsibility for the corresponding provision in the Code. Among the sections transferred to the Department were the prohibited transaction provisions and the definition of a fiduciary in both Title I of ERISA and in the Code. ERISA's prohibited transaction rules, 29 U.S.C. 1106–1108, apply to ERISA-covered plans, and the Code's corresponding prohibited transaction rules, 26 U.S.C. 4975(c), apply both to ERISA-covered pension plans that are tax-qualified pension plans, as well as other tax-advantaged arrangements, such as IRAs, that are not subject to the fiduciary responsibility and prohibited transaction rules in ERISA. Specifically, section 102(a) of the Reorganization Plan provides the Department of Labor with "all authority" for "regulations, rulings, opinions, and exemptions under section 4975 [of the Code]" subject to certain exceptions not relevant here. Reorganization Plan section 102. In President Carter's message to Congress regarding the Reorganization Plan, he made explicitly clear that as a result of the plan, "Labor will have statutory authority for fiduciary obligations. . . . Labor will be responsible for overseeing fiduciary conduct under these provisions." Reorganization Plan, Message of the President. This exemption provides relief from the indicated prohibited transaction provisions of both ERISA and the Code.

understanding, with respect to purchasing or selling securities or other property for the plan; or

(*2*) Renders any advice described in paragraph (j)(1)(i) of this section on a regular basis to the plan 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, that such services will serve as a primary basis for investment decisions with respect to plan assets, and that such person will render individualized investment advice to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.

(2) *Affiliate and control.* (i) For purposes of paragraph (j) of this section, an ''affiliate'' of a person shall include:

(A) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with such person;

(B) Any officer, director, partner, employee or relative (as defined in section 3(15) of the Act) of such person; and

(C) Any corporation or partnership of which such person is an officer, director or partner.

(ii) For purposes of this paragraph (j), the term ''control'' means the power to exercise a controlling influence over the management or policies of a person other than an individual.

(3) *Expiration date.* This paragraph (j) expires on April 10, 2017.

Signed at Washington, DC, this 1st day of April, 2016.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

[FR Doc. 2016–07924 Filed 4–6–16; 11:15 am]

BILLING CODE 4510–29–P

DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

[Application No. D–11712]

ZRIN 1210–ZA25

Best Interest Contract Exemption

AGENCY: Employee Benefits Security Administration (EBSA), U.S. Department of Labor.

ACTION: Adoption of Class Exemption.

SUMMARY: This document contains an exemption from certain prohibited transactions provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (the Code). The provisions at issue generally prohibit fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs) from engaging in self-dealing and receiving compensation from third parties in connection with transactions involving the plans and IRAs. The exemption allows entities such as registered investment advisers, broker-dealers and insurance companies, and their agents and representatives, that are ERISA or Code fiduciaries by reason of the provision of investment advice, to receive compensation that may otherwise give rise to prohibited transactions as a result of their advice to plan participants and beneficiaries, IRA owners and certain plan fiduciaries (including small plan sponsors). The exemption is subject to protective conditions to safeguard the interests of the plans, participants and beneficiaries and IRA owners. The exemption affects participants and beneficiaries of plans, IRA owners and fiduciaries with respect to such plans and IRAs.

DATES: *Issuance date:* This exemption is issued June 7, 2016.

Applicability date: This exemption is applicable to transactions occurring on or after April 10, 2017. See Section K of this preamble, *Applicability Date and Transition Rules,* for further information.

FOR FURTHER INFORMATION CONTACT: Brian Shiker or Susan Wilker, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor, (202) 693–8824 (this is not a toll-free number).

SUPPLEMENTARY INFORMATION:

Executive Summary

Purpose of This Regulatory Action

The Department grants this exemption in connection with its publication, elsewhere in this issue of the **Federal Register**, of a final regulation defining who is a ''fiduciary'' of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries (Regulation). The Regulation also applies to the definition of a ''fiduciary'' of a plan (including an IRA) under the Code. The Regulation amends a prior regulation, dating to 1975, specifying when a person is a ''fiduciary'' under ERISA and the Code by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. The Regulation takes into account the advent of 401(k) 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 existing regulation was issued. In light of the extensive changes in retirement investment practices and relationships, the Regulation updates 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.

This Best Interest Contract Exemption is designed to promote the provision of investment advice that is in the best interest of retail investors such as plan participants and beneficiaries, IRA owners, and certain plan fiduciaries, including small plan sponsors. ERISA and the Code 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 types of fees and compensation common in the retail market, 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. To facilitate continued provision of advice to such retail investors under conditions designed to safeguard the interests of these investors, the exemption allows investment advice fiduciaries, including investment advisers registered under the Investment Advisers Act of 1940 or state law, 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 Code.

Rather than create a set of highly prescriptive transaction-specific exemptions, which has been the Department's usual approach, the exemption flexibly accommodates a wide range of compensation practices, while minimizing the harmful impact of conflicts of interest on the quality of advice. As a condition of receiving compensation that would otherwise be prohibited, individual Advisers and the Financial Institutions that employ or otherwise retain them must adhere to conditions designed to mitigate the harmful impact of conflicts of interest. By taking a standards-based approach, the exemption permits firms to continue to rely on many common compensation and fee practices, as long as they adhere to basic fiduciary standards aimed at ensuring that their advice is in the best interest of their customers and take certain steps to minimize the impact of conflicts of interest.

ERISA section 408(a) specifically authorizes the Secretary of Labor to grant administrative exemptions from ERISA's prohibited transaction provisions.[1] Regulations at 29 CFR 2570.30 to 2570.52 describe the procedures for applying for an administrative exemption. In granting this exemption, the Department has determined that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners.

Summary of Major Provisions

This Best Interest Contract Exemption is broadly available for Advisers and Financial Institutions that make investment recommendations to retail "Retirement Investors," including plan participants and beneficiaries, IRA owners, and non-institutional (or "retail") fiduciaries. As a condition of receiving compensation that would otherwise be prohibited under ERISA and the Code, the exemption requires Financial Institutions to acknowledge their fiduciary status and the fiduciary status of their Advisers in writing. The Financial Institution and Advisers must adhere to enforceable standards of fiduciary conduct and fair dealing with respect to their advice. In the case of IRAs and non-ERISA plans, the exemption requires that the standards be set forth in an enforceable contract with the Retirement Investor. Under the exemption's terms, Financial Institutions are not required to enter into a contract with ERISA plan investors, but they are obligated to adhere to these same standards of fiduciary conduct, which the investors can effectively enforce pursuant to ERISA sections 502(a)(2) and (3). Likewise, "Level Fee" Fiduciaries that, with their Affiliates, receive only a Level Fee in connection with advisory or investment management services, do not have to enter into a contract with Retirement Investors, but they must provide a written statement of fiduciary status, adhere to standards of fiduciary conduct, and prepare a written documentation of the reasons for the recommendation.

The exemption is designed to cover a wide variety of current compensation practices, which would otherwise be prohibited as a result of the Department's Regulation extending fiduciary status to many investment professionals who formerly were not treated as fiduciaries. Rather than flatly prohibit compensation structures that could be beneficial in the right circumstances—such as commission accounts for investors that make infrequent trades—the exemption permits individual Advisers[2] and related Financial Institutions to receive commissions and other common forms of compensation, provided that they implement appropriate safeguards against the harmful impact of conflicts of interest on investment advice. The exemption strives to ensure that Advisers' recommendations reflect the best interest of their Retirement Investor customers, rather than the conflicting financial interests of the Advisers and their Financial Institutions. Protected Retirement Investors include plan participants and beneficiaries, IRA owners, and "retail" fiduciaries of plans or IRAs (generally persons who hold or manage less than $50 million in assets, and are not banks, insurance carriers, registered investment advisers or broker dealers), including small plan sponsors.

In order to protect the interests of the plan participants and beneficiaries, IRA owners, and plan fiduciaries, the exemption requires the Financial Institution to acknowledge fiduciary status for itself and its Advisers. The Financial Institutions and Advisers must adhere to basic standards of impartial conduct. In particular, under this standards-based approach, the Adviser and Financial Institution must give prudent advice that is in the customer's best interest, avoid misleading statements, and receive no more than reasonable compensation. Additionally, Financial Institutions generally must adopt policies and procedures reasonably designed to mitigate any harmful impact of conflicts of interest, and disclose basic information about their conflicts of interest and the cost of their advice. Level Fee Fiduciaries are subject to more streamlined conditions, including a written statement of fiduciary status, compliance with the standards of impartial conduct, and, as applicable, documentation of the specific reason or reasons for the recommendation of the Level Fee arrangement.

The exemption is calibrated to align the Adviser's interests with those of the plan or IRA customer, while leaving the Adviser and Financial Institution the flexibility and discretion necessary to determine how best to satisfy the exemption's standards in light of the unique attributes of their business.

Executive Order 12866 and 13563 Statement

Under Executive Orders 12866 and 13563, the Department must determine whether a regulatory action is "significant" and therefore subject to the requirements of the Executive Order and subject to review by the Office of Management and Budget (OMB). Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing and streamlining rules, and of promoting flexibility. It also requires federal

[1] Code section 4975(c)(2) authorizes the Secretary of the Treasury to grant exemptions from the parallel prohibited transaction provisions of the Code. Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)) (the Reorganization Plan) generally transferred the authority of the Secretary of the Treasury to grant administrative exemptions under Code section 4975 to the Secretary of Labor. To rationalize the administration and interpretation of dual provisions under ERISA and the Code, the Reorganization Plan divided the interpretive and rulemaking authority for these provisions between the Secretaries of Labor and of the Treasury, so that, in general, the agency with responsibility for a given provision of Title I of ERISA would also have responsibility for the corresponding provision in the Code. Among the sections transferred to the Department were the prohibited transaction provisions and the definition of a fiduciary in both Title I of ERISA and in the Code. ERISA's prohibited transaction rules, 29 U.S.C. 1106–1108, apply to ERISA-covered plans, and the Code's corresponding prohibited transaction rules, 26 U.S.C. 4975(c), apply both to ERISA-covered pension plans that are tax-qualified pension plans, as well as other tax-advantaged arrangements, such as IRAs, that are not subject to the fiduciary responsibility and prohibited transaction rules in ERISA. Specifically, section 102(a) of the Reorganization Plan provides the Department of Labor with "all authority" for "regulations, rulings, opinions, and exemptions under section 4975 [of the Code]" subject to certain exceptions not relevant here. Reorganization Plan section 102. In President Carter's message to Congress regarding the Reorganization Plan, he made explicitly clear that as a result of the plan, "Labor will have statutory authority for fiduciary obligations. . . . Labor will be responsible for overseeing fiduciary conduct under these provisions." Reorganization Plan, Message of the President. This exemption provides relief from the indicated prohibited transaction provisions of both ERISA and the Code.

[2] By using the term "Adviser," the Department does not intend to limit the exemption to investment advisers registered under the Investment Advisers Act of 1940 or under state law. As explained herein, an Adviser is an individual who can be a representative of a registered investment adviser, a bank or similar financial institution, an insurance company, or a broker-dealer.

agencies to develop a plan under which the agencies will periodically review their existing significant regulations to make the agencies' regulatory programs more effective or less burdensome in achieving their regulatory objectives.

Under Executive Order 12866, "significant" regulatory actions are subject to the requirements of the Executive Order and review by the OMB. Section 3(f) of Executive Order 12866, defines a "significant regulatory action" as an action that is likely to result in a rule (1) having an annual effect on the economy of $100 million or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as "economically significant" regulatory actions); (2) creating serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order. Pursuant to the terms of the Executive Order, OMB has determined that this action is "significant" within the meaning of Section 3(f)(1) of the Executive Order. Accordingly, the Department has undertaken an assessment of the costs and benefits of the proposal, and OMB has reviewed this regulatory action. The Department's complete Regulatory Impact Analysis is available at *www.dol.gov/ebsa.*

I. Background

The Department proposed this class exemption on its own motion, pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR art 2570, subpart B (76 FR 66637 (October 27, 2011)).

A. Regulation Defining a Fiduciary

As explained more fully in the preamble to the Regulation, ERISA is a comprehensive statute designed to protect the interests of plan participants and beneficiaries, the integrity of employee benefit plans, and the security of retirement, health, and other critical benefits. The broad public interest in ERISA-covered plans is reflected in its imposition of fiduciary responsibilities on parties engaging in important plan activities, as well as in the tax-favored status of plan assets and investments. One of the chief ways in which ERISA protects employee benefit plans is by requiring that plan fiduciaries comply with fundamental obligations rooted in the law of trusts. In particular, plan fiduciaries must manage plan assets prudently and with undivided loyalty to the plans and their participants and beneficiaries.[3] In addition, they must refrain from engaging in "prohibited transactions," which ERISA does not permit because of the dangers posed by the fiduciaries' conflicts of interest with respect to the transactions.[4] When fiduciaries violate ERISA's fiduciary duties or the prohibited transaction rules, they may be held personally liable for the breach.[5] In addition, violations of the prohibited transaction rules are subject to excise taxes under the Code.

The Code also has rules regarding fiduciary conduct with respect to tax-favored accounts that are not generally covered by ERISA, such as IRAs. In particular, fiduciaries of these arrangements, including IRAs, are subject to the prohibited transaction rules and, when they violate the rules, to the imposition of an excise tax enforced by the Internal Revenue Service. Unlike participants in plans covered by Title I of ERISA, IRA owners do not have a statutory right to bring suit against fiduciaries for violations of the prohibited transaction rules.

Under this statutory framework, the determination of who is a "fiduciary" is of central importance. Many of ERISA's and the Code's protections, duties, and liabilities hinge on fiduciary status. In relevant part, ERISA section 3(21)(A) and Code section 4975(e)(3) provide that a person is a fiduciary with respect to a plan or IRA to the extent he or she (i) exercises any discretionary authority or discretionary control with respect to management of such plan or IRA, or exercises any authority or control with respect to management or disposition of its assets; (ii) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan or IRA, or has any authority or responsibility to do so; or, (iii) has any discretionary authority or discretionary responsibility in the administration of such plan or IRA.

The statutory definition deliberately casts a wide net in assigning fiduciary responsibility with respect to plan and IRA assets. Thus, "any authority or control" over plan or IRA assets is sufficient to confer fiduciary status, and any persons who render "investment advice for a fee or other compensation, direct or indirect" are fiduciaries, regardless of whether they have direct control over the plan's or IRA's assets and regardless of their status as an investment adviser or broker under the federal securities laws. The statutory definition and associated responsibilities were enacted to ensure that plans, plan participants, and IRA owners can depend on persons who provide investment advice for a fee to provide recommendations that are untainted by conflicts of interest. In the absence of fiduciary status, the providers of investment advice are neither subject to ERISA's fundamental fiduciary standards, nor accountable under ERISA or the Code for imprudent, disloyal, or biased advice.

In 1975, the Department issued a regulation, at 29 CFR 2510.3–21(c)(1975), defining the circumstances under which a person is treated as providing "investment advice" to an employee benefit plan within the meaning of ERISA section 3(21)(A)(ii) (the "1975 regulation").[6] The 1975 regulation narrowed the scope of the statutory definition of fiduciary investment advice by creating a five-part test for fiduciary advice. Under the 1975 regulation, for advice to constitute "investment advice," an adviser must (1) render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property (2) on a regular basis (3) pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary that (4) the advice will serve as a primary basis for investment decisions with respect to plan assets, and that (5) the advice will be individualized based on the particular needs of the plan. The 1975 regulation provided that an adviser is a fiduciary with respect to any particular instance of advice only if he or she meets each and every element of the five-part test with respect to the particular advice recipient or plan at issue.

The market for retirement advice has changed dramatically since the Department first promulgated the 1975 regulation. Individuals, rather than large employers and professional money managers, have become increasingly responsible for managing retirement assets as IRAs and participant-directed plans, such as 401(k) plans, have supplanted defined benefit pensions. At

[3] ERISA section 404(a).

[4] ERISA section 406. ERISA also prohibits certain transactions between a plan and a "party in interest."

[5] ERISA section 409; *see also* ERISA section 405.

[6] The Department of Treasury issued a virtually identical regulation, at 26 CFR 54.4975–9(c), which interprets Code section 4975(e)(3).

the same time, the variety and complexity of financial products have increased, widening the information gap between advisers and their clients. Plan fiduciaries, plan participants and IRA investors must often rely on experts for advice, but are unable to assess the quality of the expert's advice or effectively guard against the adviser's conflicts of interest. This challenge is especially true of retail investors with smaller account balances who typically do not have financial expertise, and can ill-afford lower returns to their retirement savings caused by conflicts. The IRA accounts of these investors often account for all or the lion's share of their assets and can represent all of savings earned for a lifetime of work. Losses and reduced returns can be devastating to the investors who depend upon such savings for support in their old age. As baby boomers retire, they are increasingly moving money from ERISA-covered plans, where their employer has both the incentive and the fiduciary duty to facilitate sound investment choices, to IRAs where both good and bad investment choices are myriad and advice that is conflicted is commonplace. These rollovers are expected to approach $2.4 trillion cumulatively from 2016 through 2020.[7] These trends were not apparent when the Department promulgated the 1975 regulation. At that time, 401(k) plans did not yet exist and IRAs had only just been authorized.

As the marketplace for financial services has developed in the years since 1975, the five-part test has now come to undermine, rather than promote, the statutes' text and purposes. The narrowness of the 1975 regulation has allowed advisers, brokers, consultants and valuation firms to play a central role in shaping plan and IRA investments, without ensuring the accountability that Congress intended for persons having such influence and responsibility. Even when plan sponsors, participants, beneficiaries, and IRA owners clearly relied on paid advisers for impartial guidance, the 1975 regulation has allowed many advisers to avoid fiduciary status and disregard basic fiduciary obligations of care and prohibitions on disloyal and conflicted transactions. As a consequence, these advisers have been able to steer customers to investments based on their own self-interest (*e.g.,* products that generate higher fees for the adviser even if there are identical lower-fee products available), give imprudent advice, and engage in transactions that would otherwise be prohibited by ERISA and the Code without fear of accountability under either ERISA or the Code.

In the Department's amendments to the 1975 regulation defining fiduciary advice within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B), (the "Regulation") which are also published in this issue of the **Federal Register**, the Department is replacing the existing regulation with one that more appropriately distinguishes between the sorts of advice relationships that should be treated as fiduciary in nature and those that should not, in light of the legal framework and financial marketplace in which IRAs and plans currently operate.[8] The Regulation describes the types of advice that constitute "investment advice" with respect to plan or IRA assets for purposes of the definition of a fiduciary at ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B). The Regulation covers ERISA-covered plans, IRAs, and other plans not covered by Title I, such as Keogh plans, and health savings accounts described in Code section 223(d).

As amended, the Regulation provides that a person renders investment advice with respect to assets of a plan or IRA if, among other things, the person provides, directly to a plan, a plan fiduciary, plan participant or beneficiary, IRA or IRA owner, the following types of advice, for a fee or other compensation, whether 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; and

(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, selection of other persons to provide investment advice or investment management services, types of investment account arrangements (brokerage versus advisory), 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.

In addition, in order to be treated as a fiduciary, such person, either directly or indirectly (*e.g.,* through or together with any affiliate), must: Represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code with respect to the advice described; represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code; render 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 direct 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.

The Regulation also provides that as a threshold matter in order to be fiduciary advice, the communication must be a "recommendation" as defined therein. The Regulation, as a matter of clarification, provides that a variety of other communications do not constitute "recommendations," including non-fiduciary investment education; general communications; and specified communications by platform providers. These communications which do not rise to the level of "recommendations" under the Regulation are discussed more fully in the preamble to the final Regulation.

The Regulation also specifies certain circumstances where the Department has determined that a person will not be treated as an investment advice fiduciary even though the person's activities technically may satisfy the definition of investment advice. For example, the Regulation contains a provision excluding recommendations to independent fiduciaries with financial expertise that are acting on behalf of plans or IRAs in arm's length transactions, if certain conditions are met. The independent fiduciary must be a bank, insurance carrier qualified to do business in more than one state, investment adviser registered under the Investment Advisers Act of 1940 or by a state, broker-dealer registered under the Securities Exchange Act of 1934 (Exchange Act), or any other independent fiduciary that holds, or has under management or control, assets of at least $50 million, and: (1) The person

[7] Cerulli Associates, "Retirement Markets 2015."

[8] The Department initially proposed an amendment to its regulation defining a fiduciary within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) on October 22, 2010, at 75 FR 65263. It subsequently announced its intention to withdraw the proposal and propose a new rule, consistent with the President's Executive Orders 12866 and 13563, in order to give the public a full opportunity to evaluate and comment on the new proposal and updated economic analysis. The first proposed amendment to the rule was withdrawn on April 20, 2015, *see* 80 FR 21927.

making the recommendation must know or reasonably believe 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 (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition); (2) the person must fairly inform 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 must fairly inform the independent fiduciary of the existence and nature of the person's financial interests in the transaction; (3) the person must know or reasonably believe that the independent fiduciary of the plan or IRA is a fiduciary under ERISA or the Code, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition); and (4) the person cannot 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.

Similarly, the Regulation provides that the provision of any advice to an employee benefit plan (as described in ERISA section 3(3)) by a person who is a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, or a swap clearing firm in connection with a swap or security-based swap, as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a) and section 3(a) of the Exchange Act (15 U.S.C. 78c(a)) is not investment advice if certain conditions are met. Finally, the Regulation describes certain communications by employees of a plan sponsor, plan, or plan fiduciary that would not cause the employee to be an investment advice fiduciary if certain conditions are met.

B. Prohibited Transactions

The Department anticipates that the Regulation will cover many investment professionals who did not previously consider themselves to be fiduciaries under ERISA or the Code. Under the Regulation, these entities will be subject to the prohibited transaction restrictions in ERISA and the Code that apply specifically to fiduciaries. ERISA section 406(b)(1) and Code section 4975(c)(1)(E) prohibit a fiduciary from dealing with the income or assets of a plan or IRA in his own interest or his own account. ERISA section 406(b)(2), which does not apply to IRAs, provides that a fiduciary shall 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." ERISA section 406(b)(3) and Code section 4975(c)(1)(F) prohibit a fiduciary from receiving any consideration for his own personal account from any party dealing with the plan or IRA in connection with a transaction involving assets of the plan or IRA.

Parallel regulations issued by the Departments of Labor and the Treasury explain that these provisions impose on fiduciaries of plans and IRAs a duty not to act on conflicts of interest that may affect the fiduciary's best judgment on behalf of the plan or IRA.[9] The prohibitions extend to a fiduciary causing a plan or IRA to pay an additional fee to such fiduciary, or to a person in which such fiduciary has an interest that may affect the exercise of the fiduciary's best judgment as a fiduciary. Likewise, a fiduciary is prohibited from receiving compensation from third parties in connection with a transaction involving the plan or IRA.[10]

Investment professionals typically receive compensation for services to retirement investors in the retail market through a variety of arrangements, which would typically violate the prohibited transaction rules applicable to plan fiduciaries. 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. A fiduciary's receipt of such payments would generally violate the prohibited transaction provisions of ERISA section 406(b) and Code section 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.

C. Prohibited Transaction Exemptions

As the prohibited transaction provisions demonstrate, ERISA and the Code strongly disfavor conflicts of interest. In appropriate cases, however, the statutes provide exemptions from their broad prohibitions on conflicts of interest. For example, ERISA section 408(b)(14) and Code section 4975(d)(17) specifically exempt transactions involving the provision of fiduciary investment advice to a participant or beneficiary of an individual account plan or IRA owner if the advice, resulting transaction, and the adviser's fees meet stringent conditions carefully designed to guard against conflicts of interest.

In addition, the Secretary of Labor has discretionary authority to grant administrative exemptions under ERISA and the Code on an individual or class basis, but only if the Secretary first finds that the exemptions are (1) administratively feasible, (2) in the interests of plans and their participants and beneficiaries and IRA owners, and (3) protective of the rights of the participants and beneficiaries of such plans and IRA owners. Accordingly, fiduciary advisers may always give advice without need of an exemption if they avoid the sorts of conflicts of interest that result in prohibited transactions. However, when they choose to give advice in which they have a conflict of interest, they must rely upon an exemption.

Pursuant to its exemption authority, the Department has previously granted several conditional administrative class exemptions that are available to fiduciary advisers in defined circumstances. As a general proposition, these exemptions focused on specific advice arrangements and provided relief for narrow categories of compensation. In contrast to these earlier exemptions, this new Best Interest Contract Exemption is specifically designed to address the conflicts of interest associated with the wide variety of payments Advisers receive in connection with retail transactions involving plans and IRAs. Similarly, the Department has granted a new exemption for principal transactions, Exemption for Principal Transactions in Certain Assets between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, (Principal Transactions Exemption), also published in this issue of the **Federal Register**, that permits investment advice fiduciaries to sell or purchase certain debt securities and other investments in

[9] Subsequent to the issuance of these regulations, Reorganization Plan No. 4 of 1978, 5 U.S.C. App. (2010), divided rulemaking and interpretive authority between the Secretaries of Labor and the Treasury. The Secretary of Labor was given interpretive and rulemaking authority regarding the definition of fiduciary under both Title I of ERISA and the Internal Revenue Code. *Id.* section 102(a) ("all authority of the Secretary of the Treasury to issue [regulations, rulings opinions, and exemptions under section 4975 of the Code] is hereby transferred to the Secretary of Labor").

[10] 29 CFR 2550.408b–2(e); 26 CFR 54.4975–6(a)(5).

principal transactions and riskless principal transactions with plans and IRAs.

At the same time that the Department has granted these new exemptions, it has also amended existing exemptions to ensure uniform application of the Impartial Conduct Standards, which are fundamental obligations of fair dealing and fiduciary conduct, and include obligations to act in the customer's best interest, avoid misleading statements, and receive no more than reasonable compensation.[11] Taken together, the new exemptions and amendments to existing exemptions ensure that Retirement Investors are consistently protected by Impartial Conduct Standards, regardless of the particular exemption upon which the adviser relies.

The amendments also revoke certain existing exemptions, which provided little or no protections to IRA and non-ERISA plan participants, in favor of a more uniform application of the Best Interest Contract Exemption in the market for retail investments. With limited exceptions, it is the Department's intent that investment advice fiduciaries in the retail investment market rely on statutory exemptions or the Best Interest Contract Exemption to the extent that they receive conflicted forms of compensation that would otherwise be prohibited. The new and amended exemptions reflect the Department's view that Retirement Investors should be protected by a more consistent application of fundamental fiduciary standards across a wide range of investment products and advice relationships, and that retail investors, in particular, should be protected by the stringent protections set forth in the Best Interest Contract Exemption. When fiduciaries have conflicts of interest, they will uniformly be expected to adhere to fiduciary norms and to make recommendations that are in their customer's best interest.

These new and amended exemptions follow a lengthy public notice and comment process, which gave interested persons an extensive opportunity to comment on the proposed Regulation and exemption proposals. The proposals initially provided for 75-day comment periods, ending on July 6, 2015, but the Department extended the comment periods to July 21, 2015. The Department then held four days of public hearings on the new regulatory package, including the proposed exemptions, in Washington, DC from August 10 to 13, 2015, at which over 75 speakers testified. The transcript of the hearing was made available on September 8, 2015, and the Department provided additional opportunity for interested persons to comment on the proposals or hearing transcript until September 24, 2015. A total of over 3000 comment letters were received on the new proposals. There were also over 300,000 submissions made as part of 30 separate petitions submitted on the proposal. These comments and petitions came from consumer groups, plan sponsors, financial services companies, academics, elected government officials, trade and industry associations, and others, both in support and in opposition to the rule.[12] The Department has reviewed all comments, and after careful consideration of the comments, has decided to grant this Best Interest Contract Exemption.

II. Best Interest Contract Exemption

As finalized, the Best Interest Contract Exemption retains the core protections of the proposed exemption, but with revisions designed to facilitate implementation and compliance with the exemption's terms. In broadest outline, the exemption permits Advisers and the Financial Institutions that employ or otherwise retain them to receive many common forms of compensation that ERISA and the Code would otherwise prohibit, provided that they give advice that is in their customers' Best Interest and the Financial Institution implements basic protections against the dangers posed by conflicts of interest. In particular, to rely on the exemption, Financial Institutions generally must:

- Acknowledge fiduciary status with respect to investment advice to the Retirement Investor;
- Adhere to Impartial Conduct Standards requiring them to:
  - Give advice that is in the Retirement Investor's Best Interest (*i.e.,* prudent advice that is based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to financial or other interests of the Adviser, Financial Institution, or their Affiliates, Related Entities or other parties);
  - Charge no more than reasonable compensation; and
  - Make no misleading statements about investment transactions, compensation, and conflicts of interest;
- Implement policies and procedures reasonably and prudently designed to prevent violations of the Impartial Conduct Standards;
- Refrain from giving or using incentives for Advisers to act contrary to the customer's best interest; and
- Fairly disclose the fees, compensation, and Material Conflicts of Interest, associated with their recommendations.

Advisers relying on the exemption must adhere to the Impartial Conduct Standards when making investment recommendations.

The exemption takes a principles-based approach that permits Financial Institutions and Advisers to receive many forms of compensation that would otherwise be prohibited, including, inter alia, commissions, trailing commissions, sales loads, 12b–1 fees, and revenue-sharing payments from investment providers or other third parties to Advisers and Financial Institutions. The exemption is available for advice to retail "Retirement Investors," including IRA owners, plan participants and beneficiaries, and "retail fiduciaries" (including such fiduciaries of small participant-directed plans). All Financial Institutions relying on the exemption must notify the Department in advance of doing so, and retain records that can be made available to the Department and Retirement Investors for evaluating compliance with the exemption.

The exemption neither bans all conflicted compensation, nor permits Financial Institutions and Advisers to act on their conflicts of interest to the detriment of the Retirement Investors they serve as fiduciaries. Instead, it holds Financial Institutions and their Advisers responsible for adhering to fundamental standards of fiduciary conduct and fair dealing, while leaving them the flexibility and discretion necessary to determine how best to satisfy these basic standards in light of the unique attributes of their particular businesses. The exemption's principles-based conditions, which are rooted in the law of trust and agency, have the breadth and flexibility necessary to apply to a large range of investment and compensation practices, while ensuring that Advisers put the interests of Retirement Investors first. When Advisers choose to give advice to retail Retirement Investors pursuant to conflicted compensation structures, they must protect their customers from the dangers posed by conflicts of interest.

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[11] The amended exemptions, published elsewhere in this issue of the **Federal Register**, include Prohibited Transaction Exemption (PTE) 75–1; PTE 77–4; PTE 80–83; PTE 83–1: PTE 84–24; and PTE 86–128.

[12] As used throughout this preamble, the term "comment" refers to information provided through these various sources, including written comments, petitions and witnesses at the public hearing.

In order to ensure compliance with its broad protective standards and purposes, the exemption gives special attention to the enforceability of its terms by Retirement Investors. When Financial Institutions and Advisers breach their obligations under the exemption and cause losses to Retirement Investors, it is generally critical that the investors have a remedy to redress the injury. The existence of enforceable rights and remedies gives Financial Institutions and Advisers a powerful incentive to comply with the exemption's standards, implement policies and procedures that are more than window-dressing, and carefully police conflicts of interest to ensure that the conflicts of interest do not taint the advice.

Thus, in the case of IRAs and non-ERISA plans, the exemption generally requires the Financial Institution to commit to the Impartial Conduct Standards in an enforceable contract with Retirement Investor customers. The exemption does not similarly require the Financial Institution to execute a separate contract with ERISA investors (which includes plan participants, beneficiaries, and fiduciaries), but the Financial Institution must acknowledge its fiduciary status and that of its advisers, and ERISA investors can directly enforce their rights to proper fiduciary conduct under ERISA section 502(a)(2) and (3). In addition, the exemption safeguards Retirement Investors' enforcement rights by providing that Financial Institutions and Advisers may not rely on the exemption if they include contractual provisions disclaiming liability for compensatory remedies or waiving or qualifying Retirement Investors' right to pursue a class action or other representative action in court. However, the exemption does permit Financial Institutions to include provisions waiving the right to punitive damages or rescission as contract remedies to the extent permitted by other applicable laws. In the Department's view, the availability of make-whole relief for such claims is sufficient to protect Retirement Investors and incentivize compliance with the exemption's conditions.

While the final exemption retains the proposed exemption's core protections, the Department has revised the exemption to ease implementation in response to commenters' concerns about its workability. Thus, for example, the final exemption eliminates the contract requirement altogether in the ERISA context, simplifies the mechanics of contract-formation for IRAs and plans not covered by Title I of ERISA, and provides streamlined conditions for "Level Fee Fiduciaries" that give ongoing advice on a relatively un-conflicted basis. For new customers, the final exemption provides that the required contract terms may simply be incorporated in the Financial Institution's account opening documents and similar commonly-used agreements. The exemption additionally permits reliance on a negative consent process for existing contract holders; and provides a mechanism for Financial Institutions and Advisers to rely on the exemption in the event that the Retirement Investor does not open an account with the Adviser but nevertheless acts on the advice through other channels. The Department recognizes that Retirement Investors may talk to numerous Advisers in numerous settings over the course of their relationship with a Financial Institution. Accordingly, the exemption also simplifies execution of the contract by simply requiring the Financial Institution to execute the contract, rather than each of the individual Advisers from whom the Retirement Investor receives advice. For similar reasons, the exemption does not require execution of the contract at the start of Retirement Investors' conversations with Advisers, as long as it is entered into prior to or at the same time as the recommended investment transaction.

Other changes similarly facilitate reliance on the exemption by clarifying key terms, reducing compliance burden, increasing the exemption's availability with respect to the types of advice recipients and the types of investments that may be recommended, and streamlining and simplifying disclosure requirements. For example, in response to commenter's concerns, the final exemption clarifies that, subject to its conditions, the exemption provides relief for all of the categories of fiduciary recommendations covered by the Regulation, including advice on rollovers, distributions, and services, as well as investment recommendations concerning any asset, rather than a limited list of specified assets. Similarly, the exemption is broadly available to small plan fiduciaries, regardless of the type of plan, as well as to IRA owners, plan participants, and other Retirement Investors. Additionally, in response to concerns about the application of the Best Interest standard to Financial Institutions that limit investment recommendations to Proprietary Products and/or investments that generate Third Party Payments, the exemption includes a specific test for satisfying the Best Interest standard in these circumstances. Also in response to comments, the exemption makes clear that it does not ban commissions or mandate rigid fee-leveling (*e.g.,* by requiring identical fees for recommendations to invest in insurance products as to invest in mutual funds).

The Department also streamlined compliance for "Level Fee Fiduciaries"—fiduciaries that, together with their Affiliates, receive only a Level Fee in connection with advisory or investment management services with respect to plan or IRA assets (*e.g.,* investment advice fiduciaries that provide ongoing advice for a fee based on a fixed percentage of assets under management).

As a means of facilitating use of this exemption, the Department also reduced the compliance burden by eliminating some of the proposed conditions that were not critical to its protective purposes, and by expanding the scope of its coverage (*e.g.,* by covering all investment products and advice to retail fiduciaries of participant-directed plans). The Department eliminated the proposed requirement of adherence to other state and federal laws relating to advice as unduly expansive and duplicative of other laws; dropped a proposed data collection requirement that would have required collection and retention of specified data relating to the Financial Institution's inflows, outflows, holdings, and returns for retirement investments; and eliminated some of the more detailed proposed disclosure requirements, including the requirement for projections of the total cost of an investment at the point of sale over 1-, 5- and 10-year periods, as well as the annual disclosure requirement. In addition, the Department streamlined the disclosure conditions by simplifying them and requiring the most detailed customer-specific information to be disclosed only upon request of the customer. The Department also provided a mechanism for correcting good faith violations of the disclosure conditions, so that Financial Institutions would not lose the benefit of the exemption as a result of such good faith errors and would have an incentive to promptly correct them.

In making these adjustments to the exemption, the Department was mindful of public comments that expressed concern about the 2015 proposal's potential negative effects on small investors' access to affordable investment advice. In particular, the Department considered comments on the costs and benefits of the proposed Regulation and exemptions. As detailed in the Regulatory Impact Analysis accompanying this final rulemaking,[13] a number of comments on the Department's 2015 proposal, including those from consumer advocates, some independent researchers, and some independent financial advisers, largely endorsed its accompanying impact analysis, affirming that adviser conflicts cause avoidable harm and that the proposal would deliver gains for retirement investors that more than justify compliance costs, with minimal or no attendant unintended adverse consequences. In contrast, many other comments, including those from most of the financial industry (generally excepting only comments from independent financial advisers), strongly criticized the Department's analysis and conclusions. These comments variously argued that the Department's evidence was weak, that its estimates of conflicts' negative effects and the proposal's benefits were overstated, that its compliance cost estimates were understated, and that it failed to anticipate predictable adverse consequences including increases in the cost of advice and reductions in its availability to small investors, which the commenters said would depress savings and exacerbate rather than reduce investment mistakes. Some of these comments took the form of or were accompanied by research reports that variously offered direct, sometimes technical critiques of the Department's analysis, or presented new data and analysis that challenged the Department's conclusions. The Department took these comments into account in developing the final exemption. Many of these comments were grounded in practical operational concerns which the Department believes it has alleviated through revisions to the final exemption. At the same time, however, many suffered from analytic weaknesses that undermined the credibility of some of their conclusions.

Many comments anticipating sharp increases in the cost of advice neglected many of the costs currently attributable to conflicted advice including, for example, indirect fees. Many exaggerated the negative impacts (and neglected the positive impacts) of recent overseas reforms and/or the similarity of such reforms to the 2015 proposal. Many implicitly and without support assumed rigidity in existing business models, service levels, compensation structures and/or pricing levels, neglecting the demonstrated existence of low-cost solutions and potential for investor-friendly market adjustments. Many that predicted that only wealthier investors would be served appeared to neglect that once the fixed costs of serving these investors was defrayed only the relatively small marginal cost of serving smaller investors would remain for firms and investors to bear.

Many comments arguing that costlier advice will compromise savings exaggerated their case by presenting mere correlation (wealth and advisory services are found together) as evidence that advice causes large increases in saving. Some wrongly implied that earlier Department estimates of the potential for fiduciary advice to reduce retirement investment errors—when accompanied by very strong anti-conflict consumer protections—constituted an acknowledgement that conflicted advice yields large net benefits.

The negative comments that offered their own original analysis, and whose conclusions contradicted the Department's, also are generally unpersuasive on balance in the context of this present analysis. For example, these comments variously neglected important factors such as indirect fees, made comparisons without adjusting for risk, relied on data that is likely to be unrepresentative, failed to distinguish conflicted from independent advice, and/or presented as evidence median results when the problems targeted by the 2015 proposal and the proposal's expected benefits are likely to be concentrated on one side of the distribution's median.

In light of these weaknesses in the aforementioned negative comments, the Department found their arguments largely unpersuasive. Moreover, responsive changes to the 2015 proposal reflected in this final rulemaking further minimize any risk of an unintended negative impact on small investors' access to affordable advice. The Department therefore stands by its conclusions that adviser conflicts are inflicting large, avoidable losses on retirement investors, that appropriate, strong reforms are necessary, and this final rulemaking will deliver large net gains to retirement investors. The Department does not anticipate the substantial, long-term unintended consequences predicted in these negative comments.

To ease the transition for Financial Institutions and Advisers that are now more clearly recognized as fiduciaries under the Regulation, the Department has also expanded the "grandfathered" relief for compensation associated with investments made prior to the Regulation's Applicability Date. The final exemption also provides a transition period in Section IX under which prohibited transaction relief is available for Financial Institutions and Advisers during the period between the Applicability Date and January 1, 2018, subject to more limited conditions.

The comments on the Best Interest Contract Exemption, the Regulation, and related exemptions have helped the Department improve this exemption, while preserving and enhancing its protections. As described above, the Department has revised the exemption to facilitate implementation and compliance with the exemption, without diluting its core protections, which are critical to reducing the harm caused by conflicts of interest in the marketplace for advice. The tax-preferred investments covered by the exemption are critical to the financial security and physical health of investors. After consideration of the comments, the Department remains convinced of the importance of the exemption's core protections.

ERISA and the Code are rightly skeptical of the dangers posed by conflicts of interest, and generally prohibit conflicted advice. Before granting exemptive relief, the Department has a statutory obligation to ensure that the exemption is in the interests of plan and IRA investors and protective of their rights. Adherence to the fundamental fiduciary norms and basic protective conditions of this exemption helps ensure that investment recommendations are not driven by Adviser conflicts, but by the Best Interest of the Retirement Investor. Advisers can always give conflict-free advice. But if they choose to rely upon conflicted payment structures, they should be prepared to make an enforceable commitment to safeguard Retirement Investors from biased advice that is not in the investor's Best Interest. The conditions of this exemption are carefully calibrated to permit a wide variety of compensation structures, while protecting Retirement Investors' interest in receiving sound advice on vitally important investments. Based upon these protective conditions, the Department finds that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners.

The preamble sections that follow provide a much more detailed discussion of the exemption's terms, comments on the exemption, and the Department's responses to those comments. After a discussion of the exemption's scope and limitations, the preamble discusses the conditions of the

[13] *See* Regulatory Impact Analysis.

exemption, certain exclusions from relief, and the terms of subsidiary exemptions provided in this document, including an exemption providing grandfathered relief for certain pre-existing investments.

A. Scope of Relief in the Best Interest Contract Exemption

The exemption provides relief for the receipt of compensation by "Advisers" and "Financial Institutions," and their "Affiliates" and "Related Entities," as a result of their provision of investment advice within the meaning of ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B) to a "Retirement Investor." [14] These definitional terms are discussed below. The exemption broadly provides relief from the restrictions of ERISA section 406(b) and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(E) and (F). These provisions prohibit conflict of interest transactions and receipt of third-party payments by investment advice fiduciaries.[15] In general, the exemption is intended to provide relief for a wide variety of prohibited transactions related to the provision of fiduciary advice in the market for retail investments. The exemption permits many common compensation practices that result in prohibited transactions to continue notwithstanding the expanded definition of fiduciary advice, so long as the exemption's protective conditions are satisfied.

In response to commenters' concerns, the exemption expressly provides relief for all categories of fiduciary recommendations set forth in the Regulation. In addition to covering asset recommendations, for example, an Adviser and Financial Institution can provide investment advice regarding the rollover or distribution of assets of a plan or IRA; the hiring of a person to advise on or manage the assets; and the advisability of acquiring, holding, disposing, or exchanging certain common investments by Retirement Investors. These activities fall within the provisions of the Regulation identifying, as fiduciary conduct: (i) Recommendations 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 property is rolled over, transferred distributed from the plan or IRA, and (ii) recommendations as to the management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, selection of other persons to provide investment advice or investment management services, selection of investment account arrangements (*e.g.,* brokerage versus advisory); or recommendations with respect to rollovers, distributions, or transfers 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.

The exemption has also been revised to extend to recommendations concerning any investment product, rather than restricted to a specific list of defined "Assets," and to cover riskless principal transactions.

The exemption does not, however, provide relief for all transactions involving advice in the retail market. In particular, the exemption excludes advice rendered in connection with principal transactions that are not riskless principal transactions, advice from fiduciaries with discretionary authority over the recommended transaction, so-called robo-advice (unless provided by Level Fee Fiduciaries in accordance with Section II(h)), and specified advice concerning in-house plans. These exclusions, set forth in Section I(c), involve special circumstances that warrant a different approach than the one set forth in this exemption, and are discussed further below.

Commenters on the scope of the exemption, as proposed, primarily focused on six categories of issues: (1) The treatment of rollovers, distributions and services; (2) the definition of Retirement Investor; (3) the limits on the Asset recommendations covered by the exemption; (4) riskless principal transactions, (5) indexed annuities and variable annuities, and (6) the types of compensation that the Adviser or Financial Institution may receive. These issues are discussed below.

1. Relief for Rollovers, Distributions and Services

a. General

As proposed, the exemption would have applied to "compensation for services provided in connection with a purchase, sale or holding of an Asset by a plan, participant or beneficiary account, or IRA." A number of commenters requested clarification or revision of this language. These commenters questioned whether the exemption would cover recommendations regarding rollovers, distributions, or services such as managed accounts and advice programs. Although the Department had intended to cover these recommendations as part of its original proposal, commenters expressed concern that in some circumstances, the recommendations might not be considered sufficiently connected to the purchase, sale or holding of an Asset to meet the exemption's terms.

In this regard, some commenters stated that, while the proposed Regulation made clear that providing advice to take a distribution or to roll over assets from a plan or IRA, for a fee, was clearly fiduciary advice, it did not appear that relief for any resulting prohibited transactions was contemplated in the proposed exemption. More specifically, a few commenters argued that there are several steps to a rollover recommendation and that relief may be necessary at each step. For example, one commenter suggested that a rollover recommendation is best evaluated as including four separate recommendations: "(i) A recommendation to take a distribution 'from' the plan; (ii) a recommendation to hire the Adviser; (iii) the recommendation to rollover to an IRA; and (iv) the recommendation regarding how to invest the assets of the IRA once rolled over." Other commenters indicated that in their view recommendations of individuals to provide investment advisory or investment management services, also fiduciary conduct, was not clearly covered by the proposed exemption.

In response, the Department has revised the final exemption's description of covered transactions to more clearly coincide with the fiduciary conduct described in the Regulation. Although the Department also intended to cover these recommendations in its original proposal, it agrees that the exemption should more clearly state its broad applicability. The final exemption therefore broadly permits "Advisers, Financial Institutions, and their Affiliates and Related Entities to receive compensation as a result of their provision of investment advice within the meaning of ERISA section 3(21)(A)(ii) or Code Section 4975(e)(3)(B) to a Retirement Investor."

[14] While the Department uses the term "*Retirement* Investor" throughout this document, the exemption is not limited only to investment advice fiduciaries of employee pension benefit plans and IRAs. Relief would be available for investment advice fiduciaries of employee welfare benefit plans as well.

[15] Relief is also provided from ERISA section 406(a)(1)(D) and Code section 4975(c)(1)(D), which prohibit transfer of plan assets to, or use of plan assets for the benefit of, a party in interest (including a fiduciary).

In addition to questions about whether these types of recommendations were covered, commenters also asked how the conditions of the proposed exemption would apply to recommendations regarding rollovers, distributions and services. Commenters expressed the view that the proposed disclosure requirements were too focused on the costs associated with investments and therefore did not appear tailored to recommendations to rollover plan assets, take a distribution, or hire a provider of investment advisory or management services. Other commenters asked whether there were ongoing monitoring obligations, even when a recommendation involved only a discrete interaction between the Adviser and Retirement Investor. Many commenters indicated that due to the general burden of compliance with the exemption, Advisers and Financial Institutions might be unwilling to provide advice to Retirement Investors who were eligible to take a distribution from their employer's plan, and that left on their own, these investors might decide to take the money out of retirement savings.

In connection with these concerns, a few commenters requested separate exemptions for rollover and distribution recommendations, and services recommendations. One commenter asked the Department to create an exemption for rollovers subject only to the condition that the Adviser act in the Retirement Investor's Best Interest. Another commenter suggested an exemption based on disclosure, signed by the participant, of the options associated with a rollover. Others requested a safe harbor for rollovers based on the Financial Industry Regulatory Authority's (FINRA's) Regulatory Notice 13–45 (''Rollovers to Individual Retirement Accounts'').[16] Commenters also requested separate exemptions for advice programs, managed accounts and Advisers who would receive level fees after being hired.

Citing the critical importance of the decision to rollover plan assets or take a distribution, other commenters asserted that the protections of the exemption would be especially important in the rollover and distribution context, and could even be strengthened. Advisers and Financial Institutions frequently stand to earn compensation as a result of a rollover that they would not be able to earn if the money remains invested in an ERISA plan. In addition, rollovers from an ERISA plan to an IRA can involve the entirety of workers' savings over a lifetime of work. Because large and consequential sums are often involved, bad advice on rollovers or distributions can have catastrophic consequences with respect to such workers' financial security in retirement.

The Department has considered these comments and questions. Rather than adopt separate exemptions, as requested by some commenters, the approach taken in the final exemption is to retain the proposed exemption's core protections, while revising the exemption to reduce burden and facilitate compliance in a wide variety of contexts. Accordingly, as described in more detail below, the Department revised the disclosure and data retention requirements in this final exemption. The exemption does not require a pre-transaction disclosure that includes projections of the total costs of the investment over time, and no longer includes the proposed annual disclosure or data collection requirements. Rather than require up-front highly-customized disclosure, the exemption requires a more general statement of the Best Interest standard of care and the Advisers' and Financial Institutions' Material Conflicts of Interest, and related disclosures, with the provision of more specific, customized disclosure, only upon the Retirement Investor's request. The exemption also expressly clarifies that the parties involved in the transaction are generally free not to enter into an arrangement involving ongoing monitoring, so that a discrete rollover or distribution recommendation, or services recommendation, without further involvement by an Adviser or Financial Institution, does not necessarily create an ongoing monitoring obligation. As a result of these changes, Advisers and Financial Institutions can satisfy the disclosure conditions of the exemption with respect to transactions involving rollovers, distributions and services.[17]

b. Level Fee Fiduciaries

The final exemption provides streamlined conditions for ''Level Fee Fiduciaries.'' A Financial Institution and Adviser are Level Fee Fiduciaries if the only fee or compensation received by the Financial Institution, Adviser and any Affiliate in connection with the advisory or investment management services is a ''Level Fee'' that is disclosed in advance to the Retirement Investor. A Level Fee is defined in the exemption as 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.

In this regard, the Department believes that, by itself, the ongoing receipt of a Level Fee such as a fixed percentage of the value of a customer's assets under management, where such values are determined by readily available independent sources or independent valuations, typically would not raise prohibited transaction concerns for the Adviser or Financial Institution. Under these circumstances, the compensation amount depends solely on the value of the investments in a client account, and ordinarily the interests of the Adviser in making prudent investment recommendations, which could have an effect on compensation received, are aligned with the Retirement Investor's interests in increasing and protecting account investments. However, there is a clear and substantial conflict of interest when an Adviser recommends that a participant roll money out of a plan into a fee-based account that will generate ongoing fees for the Adviser that he would not otherwise receive, even if the fees going-forward do not vary with the assets recommended or invested. Similarly, the prohibited transaction rules could be implicated by a recommendation to switch from a low activity commission-based account to an account that charges a fixed percentage of assets under management on an ongoing basis.

Because the prohibited transaction in these examples is relatively discrete and the provision of advice thereafter generally does not involve prohibited transactions, the final exemption includes streamlined conditions to cover the discrete advice that requires the exemption.[18] This streamlined

[16] FINRA is registered with the Securities and Exchange Commission (SEC) as a national securities association and is a self-regulatory organization, as those terms are defined in the Exchange Act, which operates under SEC oversight.

[17] The Department notes that the exemption's relief applies to investment advice, but not to discretionary asset management. Accordingly, the exemption would provide relief for a recommendation on how plan or IRA assets should be managed, but would not extend relief to an investment manager's exercise of investment discretion over the assets. This is particularly relevant to ''Level Fee Fiduciaries'' as discussed in the next section.

[18] In general, after the rollover, the ongoing receipt of compensation based on a fixed percentage of the value of assets under management does not require a prohibited transaction exemption. However, certain practices involve violations that would not be eligible for the relief granted in this Best Interest Contract Exemption. For instance, if an Adviser compensated in this manner engaged in ''reverse churning,'' or recommended holding an asset solely to generate more fees for the Adviser,

Continued

exemption is broadly available for Advisers and Financial Institutions that give advice on a Level Fee basis, and focuses on the discrete recommendation that requires an exemption. Although ''robo-advice providers'' [19] are generally carved out of the Best Interest Contract Exemption, this streamlined exemption is available to them too to the extent they satisfy the definition of Level Fee Fiduciary and comply with the exemption's conditions.

Section II(h) establishes the conditions of the exemption for Level Fee Fiduciaries. It requires that the Financial Institution give the Retirement Investor the written fiduciary statement described in Section II(b) and that both the Financial Institution and any Adviser comply with the Impartial Conduct Standards described in Section II(c). Additionally, when recommending a rollover from an ERISA plan to an IRA, a rollover from another IRA, or a switch from a commission-based account to a fee-based account, the Level Fee Fiduciary must document the reasons why the level fee arrangement was considered to be in the Best Interest of the Retirement Investor.

When Level Fee Fiduciaries recommend rollovers from an ERISA plan, they must document their consideration of the Retirement Investor's alternatives to a rollover, including leaving the money in his or her current employer's plan, if permitted. Specifically, the documentation must take into account the fees and expenses associated with both the plan and the IRA; whether the employer pays for some or all of the plan's administrative expenses; and the different levels of services and different investments available under each option. In this regard, Advisers and Financial Institutions should consider the Retirement Investor's individual needs and circumstances, as described in FINRA Regulatory Notice 13–45. If a Level Fee arrangement is recommended as part of a rollover from another IRA, or a switch from a commission-based account, the Level Fee Fiduciary's documentation must include the reasons that the arrangement is considered in the Retirement Investor's Best Interest, including, specifically, the services that will be provided for the fee. The exemption does not specify any particular format or method for generating or retaining the documentation, which could be paper or electronic, but rather gives the Level Fee Fiduciary flexibility to determine what works best for its business model, so long as it meets the exemption's conditions.

It is important to note that the definition of Level Fee explicitly excludes receipt by the Adviser, Financial Institution or any Affiliate of commissions or other transaction-based payments. Accordingly, if either the Financial Institution or the Adviser or their Affiliates, receive any other remunerations (*e.g.,* commissions, 12b–1 fees or revenue sharing), beyond the Level Fee in connection with investment management or advisory services with respect to, the plan or IRA, the Financial Institution and Adviser will not be able to rely on these streamlined conditions in Section II(h). They will, however, be able to rely on the general conditions described in Sections II–V.[20]

As noted above, a number of commenters requested separate exemptions for fiduciaries that would only receive level fees after being retained. Some of these commenters indicated that more streamlined conditions would promote the receipt of rollover advice by plan participants. The commenters suggested a variety of conditions, including a contract, a best interest standard, and disclosure of compensation.

The provisions for Level Fee Fiduciaries in this exemption respond to those commenters by streamlining the conditions applicable to fiduciaries that provide advice on a Level Fee basis. Thus, for example, the exemption does not require Level Fee Fiduciaries to make the warranties required of other Advisers whose Financial Institutions will continue to receive compensation that varies with their investment recommendations. Similarly, because the most common scenario in which Level Fee Fiduciaries need an exemption is when they make a recommendation to rollover assets from an ERISA plan to an IRA, the final exemption does not require Level Fee Fiduciaries to enter into a contract. Instead, such Retirement Investors would be able to rely on their statutory rights under ERISA in the event the applicable standards are not met.

The Department did not adopt other streamlined or separate exemptions as requested by other commenters. In general, these separate exemptions suggested by commenters were not premised on the receipt of truly level fees, but would have permitted some variable compensation to occur based on the Retirement Investor's investment decisions after the fiduciary was retained. The Department determined that these transactions should occur in accordance with the general conditions of this exemption which provide additional safeguards for Retirement Investors in the context of such variable payments.

2. Relief Limited to Advice to ''Retirement Investors''

This exemption is designed to promote the provision of investment advice to retail investors that is in their Best Interest and untainted by conflicts of interest. The exemption permits receipt by Advisers and Financial Institutions, and their Affiliates and Related Entities, of compensation commonly received in the retail market, such as commissions, 12b–1 fees, and revenue sharing payments, subject to conditions specifically designed to protect the interests of retail investors. For consistency with these objectives, the exemption applies to the receipt of such compensation by Advisers, Financial Institutions, and their Affiliates and Related Entities, only when advice is provided to ''Retirement Investors,'' defined as participants and beneficiaries of a plan subject to Title I of ERISA or described in Code section 4975(e)(1)(A); IRA owners; and ''Retail Fiduciaries'' of plans or IRAs to the extent they act as fiduciaries with authority to make investment decisions for the plan. Unlike the proposed exemption, Retail Fiduciaries can include the fiduciaries of both participant-directed and non-participant directed plans. The Department also confirms that Retirement Investors can include plan participants and beneficiaries who invest through a self-directed brokerage window.

the Adviser's behavior would constitute a violation of ERISA section 406(b)(1) that is not covered by the Best Interest Contract Exemption or its Level Fee provisions. In its ''Report on Conflicts of Interest'' (Oct. 2013), p. 29, FINRA suggests a number of circumstances in which Advisers may recommend inappropriate commission- or fee-based accounts as means of promoting the Adviser's compensation at the expense of the customer (*e.g.,* recommending a fee-based account to an investor with low trading activity and no need for ongoing monitoring or advice; or first recommending a mutual fund with a front-end sales load, and shortly later, recommending that the customer move the shares into an advisory account subject to asset-based fees). Such abusive conduct, which is designed to enhance the Adviser's compensation at the Retirement Investor's expense, would violate the prohibition on self-dealing in ERISA section 406(b)(1) and Code section 4795(c)(1)(E), and fall short of meeting the Impartial Conduct Standards required for reliance on the Best Interest Contract Exemption and other exemptions.

[19] Robo-advice providers furnish investment advice to a Retirement Investor generated solely by an interactive Web site in which computer software-based models or applications make investment recommendations based on personal information each investor supplies through the Web site without any personal interaction or advice from an individual Adviser.

[20] Robo-advice providers, however, are carved out of the rest of the Best Interest Contract Exemption and could not rely upon Sections II–V.

The definition of Retail Fiduciary dovetails with provisions in the Regulation that permit persons to avoid fiduciary status when they provide advice to independent fiduciaries with financial expertise (described in paragraph (c)(1)(i) of the Regulation) under certain conditions.[21] As defined in the Regulation, such independent fiduciaries are financial institutions (including banks, insurance carriers, registered investment advisers and broker dealers) or persons that otherwise hold or have under management or control, total assets of $50 million or more. Retail Fiduciaries, by contrast, are fiduciaries that do not meet these characteristics.[22]

The exemption's definition of ''Retail Fiduciary'' is intended to work with the definition of independent fiduciary in the Regulation, so that if a person providing advice in the retail market cannot avoid fiduciary status under the Regulation because the advice recipient fails to meet the conditions for advice to independent fiduciaries under paragraph (c)(1)(i) of the rule, the person can rely on this exemption for advice to a Retirement Investor, if the conditions are satisfied.

As initially proposed, the definition of Retirement Investor was much more limited. It included only plan sponsors (and employees, officers and directors thereof) of non-participant directed plans with fewer than 100 participants. The proposal did not extend to small participant-directed plans, although the Department specifically sought comment on whether the exemption should be expanded in that respect. The definition of ''Retail Fiduciary'' in the final exemption effectively eliminates this limitation by covering the fiduciaries of such plans (including plan sponsors, employees, officers, and directors), unless they are institutional fiduciaries or fiduciaries that hold, manage, or control $50 million or more in assets.

The final exemption, like the proposal, is limited to retail investors, subject to the definitional changes described above. Persons making recommendations to independent institutional fiduciaries and large money managers in arm's length transactions have a ready means to avoid fiduciary status, and correspondingly less need for the exemption. Moreover, investment advice fiduciaries with respect to large ERISA plans have long acknowledged fiduciary status and operated within the constraints of prohibited transaction rules. As a result, extending this Best Interest Contract Exemption to such fiduciaries, and facilitating their receipt of otherwise prohibited compensation, could result in the promotion, rather than reduction, of conflicted investment advice.

Comments on the definition of Retirement Investor, and the Department's responses, are discussed in the next sections of this preamble.

a. Participant-Directed Plans

Commenters generally indicated that the exemption should extend to participant-directed plans. Many commenters expressed concern that excluding such plans as Retirement Investors would leave them without sufficient access to much needed investment advice, particularly on choosing the menu of investment options available to participants and beneficiaries, and might even discourage employers from adopting ERISA-covered plans. The U.S. Small Business Administration Office of Advocacy (SBA Office of Advocacy) commented that, according to the reports from small business owners, most small plans are participant-directed, and suggested that the exclusion of participant-directed plans would result in small business advisers to small plans being prevented from taking advantage of the exemption all together. Commenters noted that advisers to these plan fiduciaries could not avoid fiduciary status under the proposed Regulation's provision on counterparty transactions (the Seller's Exception), and the ''carve-out'' for platform providers in the Regulation did not permit individualized advice. While one commenter acknowledged that fiduciaries of participant-directed plans could receive investment advice under compensation arrangements that do not raise prohibited transactions issues, the commenter nevertheless supported extending the exemption to participant-directed plans to facilitate access to advice under a variety of compensation arrangements.

The Department also received comments on the aspect of the proposal that limited Retirement Investors to plan sponsors (and employees, officers and directors thereof) of plans. A few commenters asserted that all types of plan fiduciaries should be able to receive advice under the exemption. One commenter specifically identified ''trustees, fiduciary committees and other fiduciaries.''

The Department's expanded definition of Retail Fiduciaries in the final exemption applies generally to all fiduciaries who are not institutional fiduciaries or large money managers, regardless of whether they are fiduciaries of participant-directed plans or other plans. In addition, the exemption extends coverage to advice to all plan fiduciaries, not just plan sponsors and their employees, officers and directors. As noted above, the Department intends to cover all advisers, regardless of plan-type, who cannot avail themselves of the Regulation's exception for fiduciaries with financial expertise (*i.e.* independent institutional fiduciaries and fiduciaries holding, managing, or controlling $50 million or more in assets). These changes respond to the comments described above, including the comment from the SBA Office of Advocacy.

However, while the Department has expanded the exemption to cover Retail Fiduciaries with respect to participant-directed plans, it believes the commenters' concerns about a significant loss of advice and services to participant-directed plans were overstated. Investment advice providers who became fiduciaries under the Regulation would have been able to provide investment advice to all plans, as long as they did so under an arrangement that does not raise prohibited transactions issues, including by offsetting Third Party Payments against level fees.[23] In addition, under the Regulation, all plans can receive non-fiduciary education and services. Moreover, the exemption as proposed (and, of course, as finalized) covered advice to participants and

[21] 29 CFR 2510.3–21(c)(1)(i). In addition, the Regulation provides that persons do not act as fiduciaries simply by marketing or making available platforms of investment vehicles to participant-directed plans, without regard to the individualized needs of the plan or its participants and beneficiaries. *See* 29 CFR 2510.3–21(b)(2)(i).

[22] The $50 million threshold established in the Regulation is based, in part, on the definition of ''institutional account'' in FINRA Rule 4512(c)(3) to which the suitability rules of FINRA rule 2111 apply, and responds to the requests of commenters that the test for sophistication be based on market concepts that are well understood by brokers and advisors. Specifically, FINRA rule 2111(b) on suitability and FINRA's ''books and records'' Rule 4512(c) both use a definition of ''institutional account,'' which means the account of a bank, savings and loan association, insurance company, registered investment company, registered investment adviser or any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million. *Id.* at Q&A 8.1. In addition, the FINRA rule, but not this exemption, requires: (1) That the broker have ''a reasonable basis to believe the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities'' and (2) that ''the institutional customer affirmatively indicates that it is exercising independent judgment.''

[23] *See* Advisory Opinion 97–15A (May 22, 1997).

beneficiaries of participant-directed plans.

Nevertheless, the conditions of this final exemption have been carefully crafted to protect retail investors, including small, participant-directed plans. After considering the comments, the Department agrees that small plans would benefit from the protections of the exemption, and that expanding the scope of this exemption to all Retail Fiduciaries, including such fiduciaries of participant-directed plans, would better promote the provision of best interest advice to all retail Retirement Investors.

b. Plan Size

The Department also received comments regarding the proposed 100-participant threshold for plans to qualify as Retirement Investors. Some commenters requested that the Retirement Investor definition include fiduciaries of plans with more than 100 participants. These commenters saw no reason to distinguish between small and large plans, since ERISA applies equally to both. One commenter requested that the Department use an asset-based test rather than a test based on number of participants, as a method of determining which plans should be Retirement Investors under the exemption. The commenter expressed the view that plan size might not be a proxy for sophistication, as many large employers have multiple plans, some of which may have fewer than 100 participants. Other commenters asserted that it could be difficult for Advisers and Financial Institutions to keep track of the number of plan participants to determine whether a particular plan satisfied the Retirement Investor definition.

Other commenters supported the limitation to smaller plans, writing that larger plans have other means of access to high-quality advice, including the provision in the proposed Regulation for counterparties in arm's length transactions with an independent fiduciary with financial expertise, and so did not need the protections and constraints of the exemption.

One commenter suggested that the exemption be available for advice to IRAs only, because the exemption would reduce the existing protections for ERISA plans of all sizes. According to the commenter, investment advice fiduciaries to ERISA plans should rely instead on the statutory exemption in ERISA section 408(b)(14) for "eligible investment advice arrangements" as described in ERISA section 408(g). In the commenter's view, this exemption would undermine the protections of that exemption and the regulations thereunder. In the Department's judgment, however, the exemption's conditions strike an appropriate balance for small plan investors by facilitating the continued provision of advice in reliance on common fee structures, while mitigating the impact of the conflicts of interest on the quality of the advice.

The final exemption retains the limitation for advice to retail Retirement Investors. In determining whether a plan fiduciary is a Retirement Investor, however, the Department has revised the exemption to focus on characteristics of the advice recipient rather than plan size for determining whether a plan fiduciary is a Retirement Investor. As discussed above, the definition of Retail Fiduciary, therefore, generally focuses on the fiduciary's status as a financial institution or the amount of its assets under management.

This approach in effect still limits the exemption to smaller plans, as fiduciaries that hold, manage, or control $50 million or more in assets will generally be excluded as Retirement Investors. In many cases, persons making recommendations to large plans can avoid fiduciary status by availing themselves of the Rule's exception for transactions with sophisticated investor counterparties. But when they instead act as investment advice fiduciaries, the Department believes they are appropriately excluded from the scope of this exemption, which was designed for retail Retirement Investors. As discussed above, including larger plans within the definition of Retirement Investor could have the undesirable consequence of reducing protections provided under existing law to these investors, without offsetting benefits. In particular, it could have the undesirable effect of increasing the number and impact of conflicts of interest, rather than reducing or mitigating them. Accordingly the final exemption was not expanded to include larger plans as Retirement Investors.

c. SEPs, SIMPLEs, and Keogh Plans

Several commenters asked for clarification of the types of plans that could be represented by fiduciaries that are Retirement Investors. A few commenters requested that the exemption extend to Simplified Employee Pensions (SEPs) and Savings Incentive Match Plans for Employees (SIMPLEs). In the final exemption, the definition of Retail Fiduciary includes a fiduciary with respect to both ERISA plans and plans described in Code section 4975(e)(1)(A). This definition includes SEPs and SIMPLEs.[24]

Other commenters observed that Keogh plans were excluded from the proposed definition of Retirement Investor. While these plans are not subject to Title I of ERISA, they are defined in Code section 4975(e)(1)(A) and are covered under the prohibited transaction provisions of Code section 4975. The definition of Retail Fiduciary covers a fiduciary with respect to a plan described in Code section 4975(e)(1)(A). In addition, the Department has revised the definition of Retirement Investor to include participants and beneficiaries of plans described in Code section 4975(e)(1)(A). Conflicts of interest pose similar dangers to all retail investors, and the Department, accordingly, believes that all retail investors would benefit from the protections set forth in this Best Interest Contract Exemption.

3. No Limited Definition of "Asset"

The final exemption does not limit the types of investments that can be recommended by Advisers and Financial Institutions. The exemption is significantly broader in this respect than the proposal, which would have limited the investments that could be recommended as covered "Assets." Although the definition in the proposed exemption was quite expansive, it did not cover all "securities or other investment property" that could be the subject of an investment recommendation under the Regulation.

As proposed, the definition of Asset included the following investment products:

> Bank deposits, certificates of deposit (CDs), shares or interests in registered investment companies, bank collective funds, insurance company separate accounts, exchange-traded REITs, exchange-traded funds, corporate bonds offered pursuant to a registration statement under the Securities Act of 1933, agency debt securities as defined in FINRA Rule 6710(l) or its successor, U.S. Treasury securities as defined in FINRA Rule 6710(p) or its successor, insurance and annuity contracts, guaranteed investment contracts, and equity securities within the meaning of 17 CFR 230.405 that are exchange-traded securities within the meaning of 17 CFR 242.600. Excluded from this definition is any equity security that is a security future or a put, call, straddle, or other option or privilege of buying an equity security from or selling an equity security to another without being bound to do so.

[24] In addition to covering advice to these fiduciaries of SEPs and SIMPLEs, the exemption also covers advice to the participants and beneficiaries of such plans. ERISA plan participants and beneficiaries are uniformly treated as covered Retirement Investors under the terms of the exemption.

The Department viewed the limited definition of Asset in the proposal as part of the protective framework of the exemption. The intent in proposing a limited definition of Asset was to permit investment advice on of the types of investments that Retirement Investors typically rely on to build a basic diversified portfolio, under a uniform set of protective conditions, while avoiding potential issues with less common investments that may possess unusual complexity, illiquidity, risk, lack of transparency, high fees or commissions, or illusory tax "efficiencies." In the context of some of these investments, Retirement Investors may be less able to police the conduct of their Adviser or assess whether they are getting a good or bad deal. Accordingly, the Asset limitation was intended to work with the other safeguards in the exemption to ensure investment advice is provided in Retirement Investors' Best Interest.

Commenters representing the industry strenuously objected to the limited definition of "Asset." Commenters took the position that the limited definition would be inconsistent with the Department's historical approach of declining to create a "legal list" of investments for plan fiduciaries. Some commenters argued that Congress imposed only very narrow limits on the types of investments IRAs may make, and therefore the Department should not impose other limitations in an exemption.

Many commenters viewed the proposed limited definition of Asset as the Department substituting its judgment for that of the Adviser and stating which investments are permissible or "worthy." Some commenters believed that the Best Interest standard alone should guide the recommendations of specific investments. Some asserted that the limitations could even undermine Advisers' obligation to act in the best interest of Retirement Investors.

In the event that the Department determined to proceed with the limited definition of Asset, commenters argued that it should be expanded to include specific additional investments. Some examples of such additional investments include: Non-traded business development companies, cleared swaps and cleared security-based swaps, commodities, direct participation programs, energy and equipment leasing programs, exchange traded options, federal agency and government sponsored enterprise guaranteed mortgage-backed securities, foreign bonds, foreign currency, foreign equities, futures (including exchange-traded futures), hedge funds, limited partnerships, market linked CDs, municipal bonds, non-traded REITs, over-the-counter equities, precious metals, private equity, real estate, stable value wrap contracts, structured notes, structured products, and non-U.S. funds that are registered or listed on an exchange in their home jurisdiction.

Some commenters also asked how the exemption would be updated to accommodate new investments over time. One commenter suggested that, as an alternative to the definition of Asset, the exemption should establish a series of principles governing the types of investments that could be recommended. The principles suggested by the commenter included transparent pricing, sufficient liquidity, lack of excessive complexity and leverage, a sufficient track record to demonstrate its utility, and not providing a redundant or illusory tax benefit inside a retirement account.

Other commenters argued for an expansion of the types of investments that could be recommended to sophisticated investors. Commenters indicated that the definition of Asset could be expanded or eliminated entirely for these Retirement Investors, on the basis that alternative investments could be appropriate for them. These commenters suggested the Department could rely on the securities laws, specifically the accredited investor rules, to make sure that investors could bear the potential losses of their investments.

However, the Department also received comments supporting the proposed definition of Asset as an appropriate safeguard of the exemption. These commenters expressed the view that the list was sufficiently broad to allow an Adviser to meet a Retirement Investor's needs, while limiting the risks of other types of investments. Retirement Investors would still have access to these excluded investments under either pooled investment vehicles such as mutual funds, or pursuant to compensation models that do not involve conflicted advice. Some commenters expressed support for exclusion of specific investment products, such as non-traded Real Estate Investment Trusts (REITs), private placements, and other complex products, indicating these investments may be associated with extremely high fees. A commenter asserted that there have been significant problems with recommendations of non-traded REITs and private placements in recent years. Another commenter urged that the exemption not provide relief for the recommendation of variable annuity contracts, although they were in the proposed definition of Asset.

Likewise, some commenters opposed any different treatment of sophisticated investors. The commenters said that net worth of an individual is not a reliable measure of financial knowledge, and the thresholds under securities law may be too low to identify those who can risk substantial portions of their retirement savings.

After careful consideration of these comments, the Department eliminated the definition of Asset in the final exemption. In this regard, the Department ultimately determined that the other safeguards adopted in the final exemption—in particular, the requirement that Advisers and Financial Institutions provide investment advice in accordance with the Impartial Conduct Standards, the requirement that Financial Institutions adopt anti-conflict policies and procedures and the requirement that Financial Institutions disclose their Material Conflicts of Interest—were sufficiently protective to allow the exemption to apply more broadly to all securities and other investment property. If adhered to, these conditions should be protective with respect to all investments. It is not the Department's intent to foreclose fiduciaries, adhering to the exemption's standards, from recommending such investments if they prudently determine that they are the right investments for the particular customer and circumstances. For these same reasons, the Department has decided not to limit the exemption to investments meeting certain principles, as suggested by a commenter.

However, the fact that the exemption was broadened does not mean the Department is no longer concerned about some of the attributes of the investments that were not initially included in the proposed definition of Asset, such as unusual complexity, illiquidity, risk, lack of transparency, high fees or commissions, or tax benefits that are generally unnecessary in these tax preferred accounts. This broadening of the exemption for products with these attributes must be accompanied by particular care and vigilance on the part of Financial Institutions responsible for overseeing Advisers' recommendations of such products. Moreover, the Department intends to pay special attention to recommendations involving such products after the Applicability Date to ensure adherence to the Impartial Conduct Standards and verify that the exemption is sufficiently protective.

The Department expects that Advisers and Financial Institutions providing advice will exercise special care when assets are hard to value, illiquid, complex, or particularly risky. Financial Institutions responsible for overseeing recommendations of these investments must give special attention to the policies and procedures surrounding such investments and their oversight of Advisers' recommendations, if they are to properly discharge their fiduciary responsibilities. Financial Institutions should identify such investments and ensure that their policies and procedures are reasonably and prudently designed to ensure Advisers' compliance with the Impartial Conduct Standards when recommending them. In particular, Financial Institutions must ensure that Advisers are provided with information and training to fully understand all investment products being sold, and must similarly ensure that customers are fully advised of the risks. Additionally, when recommending such products, the Financial Institution and Adviser should take special care to prudently document the bases for their recommendation and for their conclusions that their recommendations satisfy the Impartial Conduct Standards.

Further, when determining the extent of the monitoring to be provided, as disclosed in the contract pursuant to Section II(e) of the exemption, such Financial Institutions should carefully consider whether certain investments can be prudently recommended to the individual Retirement Investor, in the first place, without a mechanism in place for the ongoing monitoring of the investment. This is particularly a concern with respect to investments that possess unusual complexity and risk, and that are likely to require further guidance to protect the investor's interests. Without an accompanying agreement to monitor certain recommended investments, or at least a recommendation that the Retirement Investor arrange for ongoing monitoring, the Adviser may be unable to satisfy the exemption's Best Interest obligation with respect to such investments. Similarly, the added cost of monitoring such investments should be considered by the Adviser and Financial Institution in determining whether the recommended investments are in the Retirement Investors' Best Interest.

4. Riskless Principal Transactions

The final exemption extends to compensation received in transactions that are ''riskless principal transactions.'' A riskless principal transaction is defined in Section VIII(p) as ''a transaction in which a Financial Institution, after having received an order from a Retirement Investor to buy or sell an investment product, purchases or sells the same investment product for the Financial Institution's own account to offset the contemporaneous transaction with the Retirement Investor.''

Apart from riskless principal transactions, Section I(c)(2) of the final exemption, which sets forth the exclusions from relief, states that the exemption does not apply to compensation that is received as a result of a principal transaction. A ''principal transaction'' is defined in Section VIII(k) as ''a purchase or sale of an investment product if an Adviser or Financial Institution is purchasing from or selling to a Plan, participant or beneficiary account, or IRA on behalf of the Financial Institution's own account or the account of a person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Financial Institution.'' The definition further states that a principal transaction does not include a riskless principal transaction as defined in Section VIII(p). Thus, the exemption draws a distinction between principal transactions and riskless principal transactions.

In the Department's view, principal transactions pose especially acute conflicts of interest because the investment advice fiduciary and Retirement Investor are on opposite sides of the transaction. As a result of the special risks posed by such transactions, the Department has proposed a separate exemption for investment advice fiduciaries to engage in principal transactions involving specified investments, but subject to additional protective conditions. That exemption is also adopted today, as published elsewhere in this issue of the **Federal Register**.

Commenters on the proposed Best Interest Contract Exemption and the proposed Principal Transactions Exemption asked about the treatment of riskless principal transactions. Some commenters asked the Department to expand the scope of the Best Interest Contract Exemption to include all riskless principal transactions. Commenters argued that riskless principal transactions are the functional equivalent of agency transactions. A commenter asserted that for this reason, riskless principal transactions would not involve the incentive to ''dump'' unwanted investments on Retirement Investors, which was one of the Department's concerns. The commenters indicated that many investment transactions occur on a ''riskless principal'' basis rather than a pure agency basis. One commenter stated that this is because counterparties may not want to assume settlement risk with an investor.

The commenters indicated that the proposed restriction in the Best Interest Contract Exemption applicable to all principal transactions, in conjunction with the limited scope of the Principal Transactions Exemption, as proposed, would cause valuable investments to be unavailable to plans and IRAs as a practical matter. Commenters also asked the Department to confirm that riskless principal transactions were covered within the scope of the Principal Transactions Exemption.

In response to comments, the Department has determined to provide broader relief with respect to recommended riskless principal transactions. The scope of the Best Interest Contract Exemption is expanded to extend to riskless principal transactions involving all investments. The Department accepts commenters' representations that the lack of broader relief for riskless principal transactions would result in unnecessarily limited investment choices for Retirement Investors. In addition, the Department also confirmed in the Principal Transactions Exemption that riskless principal transactions are included in the scope of that exemption as well for the specific investments covered therein.

This approach results in some overlap between coverage of riskless principal transactions in this Best Interest Contract Exemption and the Principal Transactions Exemption. With respect to a recommended purchase of an investment that occurs in a riskless principal transaction, the Principal Transactions Exemption is available for the specified investments that are covered in that exemption. The Best Interest Contract Exemption, however, provides broader relief for all recommended purchases. In addition, *sales* from a plan or IRA in riskless principal transactions can occur under either exemption.

This approach is intended to provide flexibility to Financial Institutions relying on the exemptions. The Department believes that some Financial Institutions have business models that involve only riskless principal transactions. These Financial Institutions may not, as a general matter, hold investments in inventory to sell in principal transactions, but they may execute certain transactions as riskless principal transactions. Financial Institutions that do not engage in principal transactions, as defined in the exemptions, do not have to rely on the Principal Transactions Exemption at all, and can organize their practices to comply with this Best Interest Contract Exemption alone.

On the other hand, Financial Institutions that engage in principal transactions may want to organize their practices to comply with the Principal Transactions Exemption. They may not be certain at the outset whether a particular purchase by a plan or IRA will be executed as a principal transaction or a riskless principal transaction. Those Financial Institutions can rely on the Principal Transactions Exemption for the specified assets that may be sold to plans and IRAs without concern whether the transaction is, in fact a riskless principal transaction or a principal transaction.

A discussion of comments on the treatment of specific investments as Principal Transactions is included in a later section of this preamble, explaining the definitions used in this exemption.

5. Indexed and Variable Annuities

The Department received many comments on the proposed exemption's approach to annuity contracts. The final exemption was not revised from the proposal with respect to the coverage of insurance and annuity products, although a number of changes were made to the exemption to make it more readily usable with respect to these products, as discussed below. Advisers and Financial Institutions are permitted to receive compensation in connection with the sale of all insurance and annuity contracts under the exemption.

However, in a companion Notice published elsewhere in this issue of the **Federal Register**, the Department limited relief available in another exemption, PTE 84–24,[25] to ''fixed rate annuity contracts,'' defined in the exemption as fixed annuity contracts issued by an insurance company that are either immediate annuity contracts or deferred annuity contracts that (i) satisfy applicable state standard nonforfeiture laws at the time of issue, or (ii) in the case of a group fixed annuity, guarantee return of principal net of reasonable compensation and provide a guaranteed declared minimum interest rate in accordance with the rates specified in the standard nonforfeiture laws in that state that are applicable to individual annuities; in either case, the benefits of which do not vary, in part or in whole, based on the investment experience of a separate account or accounts maintained by the insurer or the investment experience of an index or investment model. Fixed rate annuity contracts do not include variable annuities or indexed annuities or similar annuities. As a result, investment advice fiduciaries will generally rely on this Best Interest Contract Exemption for compensation received for the recommendation of variable annuities, indexed annuities, similar annuities, and any other annuities that do not satisfy the definition of fixed rate annuity contracts.

In response to the proposal, some commenters, expressing concern about the risks associated with variable annuities, commended the Department for proposing that they should be recommended under the conditions of this exemption rather than PTE 84–24. One commenter cited the provision of FINRA's Investor Alert, ''Variable Annuities: Beyond the Hard Sell,'' which says:

> Investing in a variable annuity within a tax-deferred account, such as an individual retirement account (IRA) may not be a good idea. Since IRAs are already tax-advantaged, a variable annuity will provide no additional tax savings. It will, however, increase the expense of the IRA, while generating fees and commissions for the broker or salesperson.[26]

Other commenters wrote that fixed annuities, particularly indexed annuities, should also be subject to the requirements of this Best Interest Contract Exemption rather than PTE 84–24. One commenter indicated that indexed and variable annuities raise similar issues with respect to conflicted compensation, and that different treatment of the two would create incentives to sell more indexed annuities subject to the less restrictive regulation.

Other commenters urged that Advisers and Financial Institutions should be able to rely on PTE 84–24 for all insurance products, rather than bifurcating relief between two exemptions. Commenters emphasized the benefit, for compliance purposes, of one exemption for all insurance products. These commenters highlighted the importance of lifetime income options, and the ways the Department, the Treasury Department and the IRS have worked to make annuities more accessible to Retirement Investors. They expressed concern that the approach to annuity contracts in the proposals could undermine those efforts.

In this regard, many commenters expressed concern that the disclosure requirements proposed in this exemption were inapplicable to insurance products and that they would not be able to satisfy the Best Interest and other Impartial Conduct Standards, or provide a sufficiently broad range of Assets to satisfy the conditions of Section IV of this exemption, as proposed. Several raised questions about how the proposed definition of ''Financial Institution'' would apply to insurance companies. According to these commenters, the conditions proposed for this exemption would be so difficult and costly that broker-dealers would stop selling variable annuities to certain IRA customers and retirement plans rather than comply.

Both the Securities and Exchange Commission (SEC) staff and FINRA have issued guidance on indexed annuities. In its 2010 Investor Alert, ''Equity-Indexed Annuities: A Complex Choice,'' FINRA explained the need for an Alert, as follows:

> Sales of equity-indexed annuities (EIAs) . . . have grown considerably in recent years. Although one insurance company at one time included the word 'simple' in the name of its product, EIAs are anything but easy to understand. One of the most confusing features of an EIA is the method used to calculate the gain in the index to which the annuity is linked. To make matters worse, there is not one, but several different indexing methods. Because of the variety and complexity of the methods used to credit interest, investors will find it difficult to compare one EIA to another.'' [27]

FINRA also explained that equity-indexed annuities ''give you more risk (but more potential return) than a fixed annuity but less risk (and less potential return) than a variable annuity.'' [28]

Similarly, in its 2011 ''Investor Bulletin: Indexed Annuities,'' the SEC staff stated ''You can lose money buying an indexed annuity. If you need to cancel your annuity early, you may have to pay a significant surrender charge and tax penalties. A surrender charge may result in a loss of principal, so that

[25] Class Exemption for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, Investment Companies and Investment Company Principal Underwriters, 49 FR 13208 (April 3, 1984), as amended, 71 FR 5887 (February 3, 2006), as amended elsewhere in this issue of the **Federal Register**.

[26] ''Variable Annuities: Beyond the Hard Sell,'' *available at http://www.finra.org/sites/default/files/InvestorDocument/p125846.pdf.* FINRA also has special suitability rules for certain investment products, including variable annuities. *See* FINRA Rule 2330 (imposing heightened suitability, disclosure, supervision and training obligations regarding variable annuities); *see also* FINRA rule 2360 (options) and FINRA rule 2370 (securities futures).

[27] ''Equity-Indexed Annuities: A Complex Choice'' *available at https://www.finra.org/investors/alerts/equity-indexed-annuities_a-complex-choice*

[28] *Id.*

an investor may receive less than his original purchase payments. Thus, even with a specified minimum value from the insurance company, it can take several years for an investment in an indexed annuity to 'break even.' " [29]

Given the risks and complexities of these investments, the Department has determined that indexed annuities are appropriately subject to the same protective conditions of the Best Interest Contract Exemption that apply to variable annuities. These are complex products requiring careful consideration of their terms and risks. Assessing the prudence of a particular indexed annuity requires an understanding, inter alia, of surrender terms and charges; interest rate caps; the particular market index or indexes to which the annuity is linked; the scope of any downside risk; associated administrative and other charges; the insurer's authority to revise terms and charges over the life of the investment; the specific methodology used to compute the index-linked interest rate; and any optional benefits that may be offered, such as living benefits and death benefits. In operation, the index-linked interest rate can be affected by participation rates; spread, margin or asset fees; interest rate caps; the particular method for determining the change in the relevant index over the annuity's period (annual, high water mark, or point-to-point); and the method for calculating interest earned during the annuity's term (*e.g.,* simple or compounded interest). Investors can all too easily overestimate the value of these contracts, misunderstand the linkage between the contract value and the index performance, underestimate the costs of the contract, and overestimate the scope of their protection from downside risk (or wrongly believe they have no risk of loss). As a result, Retirement Investors are acutely dependent on sound advice that is untainted by the conflicts of interest posed by Advisers' incentives to secure the annuity purchase, which can be quite substantial. Both categories of annuities, variable and indexed annuities, are susceptible to abuse, and Retirement Investors would equally benefit in both cases from the protections of this exemption, including the conditions that clearly establish the enforceable standards of fiduciary conduct and fair dealing as applicable to Advisers and Financial Institutions.

In response to comments, however, the final exemption has been revised so that the conditions identified by commenters are less burdensome and more readily complied with by all Financial Institutions, including insurance companies and distributors of insurance products. In particular, the Department has revised the pre-transaction disclosure so that it does not require a projection of the total cost of the recommended investment, which commenters indicated would be difficult to provide in the insurance context. The Department also did not adopt the proposed data collection requirement, which also posed problems for insurance products, according to commenters.

Further, the Department adjusted the language of the exemption in other places and addressed interpretive issues in the preamble to address the particular questions and concerns raised by the insurance industry. For example, the Department revised the "reasonable compensation" standard throughout the exemption to address comments from the insurance industry regarding the application of the standard to insurance transactions. Additionally, guidance is provided further in this preamble regarding the treatment of insurers as Financial Institutions, within the meaning of the exemption. Finally, the Department provided specific guidance in Section IV of the exemption on satisfaction of the Best Interest standard by Proprietary Product providers.

The Department notes that many insurance industry commenters stressed a desire for one exemption covering all insurance and annuity products. The Department agrees that efficient compliance with fiduciary norms could be promoted by a common set of requirements, but concludes, for the reasons set forth above, that this exemption is best suited to address the conflicts of interest associated with variable annuities, indexed annuities, and similar investments, rather than the less stringent PTE 84–24. Accordingly, the Department has limited the availability of PTE 84–24 to "fixed rate annuity contracts," while requiring Advisers recommending variable and indexed annuities to rely on this Best Interest Contract Exemption, which is broadly available for any kind of annuity or asset, subject to its specific conditions. In this manner, the final exemption creates a level playing field for variable annuities, indexed annuities, and mutual funds under a common set of requirements, and avoids creating a regulatory incentive to preferentially recommend indexed annuities.

The Department did, however, leave PTE 84–24 available for recommendations involving "fixed rate annuity contracts." The Department concluded that this approach in the final exemption and final amendment to PTE 84–24 draws the correct lines, applying protective conditions to particularly complex annuities while leaving in place a somewhat more streamlined exemption that would remain applicable to the recommendation of relatively simpler annuity products, which promote lifetime income. To illustrate the features of these products, the Department prepared a chart comparing fixed rate annuities, fixed indexed annuities and variable annuities, which is included as Appendix I.

A few commenters expressed concern that the requirements of this exemption, as proposed, would interfere with state insurance regulatory programs, which would lead to litigation. Commenters asserted that the Department's proposal ignored the role of state insurance regulators in providing consumer protections. The Department does not agree with these comments. In addition to meeting with and consulting with state insurance regulators and the NAIC as part of this project, the Department has also reviewed NAIC model laws and regulations and state reactions to those models in order to ensure that the requirements of this exemption work cohesively with the requirements currently in place. For example, in 2010 the NAIC adopted the Suitability in Annuity Transactions Model Regulation to establish suitability standards in annuity transactions. According to the NAIC, this regulation was adopted specifically to establish a framework under which insurance companies, not just the agent or broker, are "responsible for ensuring that the annuity transactions are suitable." [30] Much like the policies and procedures requirement of this exemption, the NAIC requires insurance companies to develop a system of supervision designed to achieve compliance with the suitability obligations.[31] This is not to say that the

[29] SEC Office of Investor Education and Advocacy Investor Bulletin: Indexed Annuities, *available at https://www.sec.gov/investor/alerts/secindexedannuities.pdf.*

[30] NAIC, Suitability in Annuity Transactions Model Regulation, Executive Summary—*http://www.naic.org/documents/committees_a_suitability_reg_guidance.pdf.*

[31] NAIC Model Regulations, section 6(F)(1) ("An insurer shall establish a supervision system that is reasonably designed to achieve the insurer's and its insurance producers' compliance with this regulations including, but not limited to the following: . . . (d) The insurer shall maintain procedures for review of each recommendation prior to issuance of an annuity that designed to ensure that there is a reasonable basis to determine that a recommendation is suitable. . . .") (2010); NAIC, Suitability in Annuity Transactions Model Regulation, Executive Summary,—*http://www.naic.org/documents/committees_a_suitability_reg_guidance.pdf.* Most states—35 states

requirements of this exemption are identical to those included in NAIC's model regulation. However, the Department has crafted the exemption so that it will work with, and complement, state insurance regulations. In addition, the Department confirms that it is not its intent to preempt or supersede state insurance law and enforcement, and that state insurance laws remain subject to the ERISA section 514(b)(2)(A) savings clause.[32]

6. Types of Compensation Covered by the Exemption

a. General

Further addressing the scope of the exemption, a number of commenters requested clear confirmation of the types of payments the exemption would permit. As the commenters requested, the Department confirms that this exemption provides relief for commissions paid directly by the plan or IRA, as well as commissions, trailing commissions, sales loads, 12b–1 fees, revenue sharing payments, and other payments by investment product manufacturers or other third parties to Advisers and Financial Institutions. The exemption also covers other compensation received by the Adviser, Financial Institution or their Affiliates and Related Entities as a result of an investment by a plan, participant or beneficiary account, or IRA, such as investment management fees and administrative services fees from an investment vehicle in which the plan, participant or beneficiary account, or IRA invests, and account type fees earned as a result of the Adviser's or Financial Institution's recommendations.

A few comments suggested that the Department should grant a more limited exemption with respect to certain fees, including 12b–1 fees and account maintenance fees. One commenter asserted that account maintenance fees tend to exceed reasonable compensation and should be further constrained by a condition requiring the terms of the transaction to be arm's length. The Department has not adopted this requirement, but rather has sought to draft conditions, including the reasonable compensation conditions, which should be broadly protective, without regard to the particular type of payment or business model.

b. Referral Fees Pursuant to Bank Networking Arrangements

The exemption also provides relief for referral fees received by banks and bank employees, pursuant to ''Bank Networking Arrangements.'' A Bank Networking Arrangement is defined in Section VIII(c) of the exemption as an arrangement for the referral of retail non-deposit investment products that satisfies applicable federal banking, securities and insurance regulations, under which bank employees refer bank customers to an unaffiliated investment adviser registered under the Investment Advisers Act of 1940 or under the laws of the state in which the adviser maintains its principal office and place of business, insurance company qualified to do business under the laws of a state, or broker or dealer registered under the Exchange Act, as amended. The exemption provides relief for the receipt of compensation by an Adviser who is a bank employee, and a Financial Institution that is a bank or similar financial institution supervised by the United States or state, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1)) (a bank), pursuant to a Bank Networking Arrangement in connection with their provision of investment advice to a Retirement Investor, provided the investment advice adheres to the Impartial Conduct Standards set forth in Section II(c).

The exemption's provisions regarding such payments were developed in response to a comment from the American Bankers Association (ABA) regarding such arrangements. The ABA stated that bank employees are permitted to receive a fee for referring bank customers to the bank's brokerage unit or unaffiliated third party under the Gramm-Leach-Bliley Act (GLBA), and indicated that such referrals could result in prohibited transactions if the employees are deemed fiduciaries. The ABA requested that the Department clarify in the final Regulation that referrals permitted under applicable federal banking and securities regulations do not result in fiduciary status in order to avoid potential prohibited transaction liability for an activity that is expressly permitted under federal banking laws.

The Department has considered the ABA's comment and has reviewed related banking, insurance and securities regulations regarding bank referral of retail nondeposit investment products.[33] It is the Department's understanding that bank employees may receive a fee that is generally limited to a nominal one-time cash fee of a fixed dollar amount for referring bank customers to retail non-deposit investment products, which include not only securities products but also insurance and investment advice services. Under the exception from federal securities laws registration created by GLBA, bank employees must perform only clerical or ministerial functions in connection with brokerage transactions including scheduling appointments with the associated persons of a broker or dealer, except that bank employees may forward customer funds or securities and may describe in general terms the types of investment vehicles available from the bank and broker-dealer under the arrangement.[34] Bank employees referring a customer to a broker-dealer under the exception may not provide investment advice concerning securities or make specific securities recommendations to the customer under OCC guidance.[35]

and the District of Columbia—have adopted some form of the NAIC's model regulations regarding suitability.

[32] A few commenters raised questions about the role of the McCarran-Ferguson Act and the Department's authority to regulate insurance products. The McCarran-Ferguson Act states that federal laws do not preempt state laws to the extent they relate to or are enacted for the purpose of regulating the business of insurance; it does not, however, prohibit federal regulation of insurance. *See John Hancock Mut. Life Ins. Co.* v. *Harris Trust & Sav. Bank,* 510 U.S. 86, 97–101 (1993) (holding that ''ERISA leaves room for complementary or dual federal or state regulation, and calls for federal supremacy when the two regimes cannot be harmonized or accommodated''). The Department has designed the exemption to work with and complement state insurance laws, not to invalidate, impair, or preempt state insurance laws. *See BancOklahoma Mortg. Corp.* v. *Capital Title Co., Inc.,* 194 F.3d 1089 (10th Cir. 1999) (stating that McCarran-Ferguson Act bars the application of a federal statute only if (1) the federal statute does not specifically relate to the business of insurance; (2) a state statute has been enacted for the purpose of regulating the business of insurance; and (3) the federal statute would invalidate, impair, or supersede the state statute); *Prescott Architects, Inc.* v. *Lexington Ins. Co.,* 638 F. Supp. 2d 1317 (N.D. Fla. 2009); *see also U.S.* v. *Rhode Island Insurers' Insolvency Fund,* 80 F.3d 616 (1st Cir. 1996). Specifically, the Supreme Court has made it clear that ''the McCarran-Ferguson Act does not surrender regulation exclusively to the States so as to preclude the applicable of ERISA to an insurer's actions.'' *John Hancock,* 510 U.S. at 98.

[33] *See* Interagency Statement on Retail Sales of Nondeposit Investment Products (Feb. 1994); 15 U.S.C. 78c(a)(4)(B) (Securities Exchange Act of 1934 exception from the term ''broker'' for certain bank activities); Regulation R, Securities Exchange Act Release No. 34–56501 (September 24, 2007), 72 FR 56514 (Oct. 3, 2007), *www.sec.gov/rules/final/2007/34-56501.pdf* and Securities Exchange Act Release No. 34–56502 (Sept. 24, 2007) 72 FR 56562 (Oct. 3, 2007), *www.sec.gov/rule/final/2007/34-56502.pdf;* 12 CFR parts 14, 208, 343 and 536 (Consumer Protection in Sales of Insurance); OCC Comptroller's Handbook, Retail Nondeposit Investment Products (January 2015); Federal Deposit Insurance Corporation ''Uninsured Investment Products: A Pocket Guide for Financial Institutions,'' available at: *https://www.fdic.gov/regulations/resources/financial/.*

[34] 15 U.S.C. 78c(a)(4)(B)(i)(I)–(V).

[35] See Federal Reserve Board and Securities Exchange Commission Release, Definitions of Terms and Exemptions Relating to the ''Broker''

Continued

Similar compensation restrictions exist with respect to bank employees' referrals regarding insurance products[36] and investment advisers.[37]

Because of the limitations on the activities of bank employees in making referrals, the Department believes in most cases such referrals will not constitute fiduciary investment advice because they will not constitute a "recommendation" within the meaning of the Regulation or because they will not involve a covered recommendation to hire a non-affiliated third party. However, to the extent banks do not choose to structure their operations to avoid providing fiduciary investment advice, the Department concurs with commenters that relief for bank referral compensation is appropriate as long as the arrangement satisfies applicable banking, securities and insurance regulations and the advice is provided in accordance with the Impartial Conduct Standards. In general, the Department is of the view that the existing regulatory structure governing referrals of retail nondeposit investment products provides significant protections to Retirement Investors.

However, should banks choose to provide investment advice within the meaning of the Regulation, the exemption requires that the advice satisfy the core fiduciary standards required under this exemption for conflicted investment advice—they must give prudent advice that is in the customer's best interest, avoid misleading statements, and receive no more than reasonable compensation.[38]

B. Conditions of the Exemption

Section I, discussed above, establishes the scope of relief provided by this Best Interest Contract Exemption. Sections II–V of the exemption set forth the conditions applicable to the exemption described in Section I. All applicable conditions must be satisfied in order to avoid application of the specified prohibited transaction provisions of ERISA and the Code. The Department finds that, subject to these conditions, the exemption is administratively feasible, in the interests of plans and of their participants and beneficiaries, and IRA owners and protective of the rights of the participants and beneficiaries of such plans and IRA owners. Under ERISA section 408(a), and Code section 4975(c)(2), the Secretary may not grant an exemption without making such findings. The conditions of the exemption, comments on those conditions, and the Department's responses, are described below.

1. Enforceable Right to Best Interest Advice (Section II)

Section II of the exemption sets forth the requirements that establish the Retirement Investor's enforceable right to adherence to the Impartial Conduct Standards and related conditions. For advice to certain Retirement Investors—specifically, advice regarding investments in IRAs, and plans that are not covered by Title I of ERISA ("non-ERISA plans"), such as Keogh plans—Section II(a) requires the Financial Institution and Retirement Investor to enter into a written contract that includes the provisions described in Section II(b)–(d) of the exemption and that also does not include any of the ineligible provisions described in Section II(f) of the exemption. Financial Institutions additionally must provide the disclosures set forth in Section II(e). As discussed further below, pursuant to Section II(g) of the exemption, advice to Retirement Investors regarding ERISA plans does not have to be subject to a written contract, but Advisers and Financial Institutions must comply with the substantive standards established in Section II(b)–(e) to avoid liability for a non-exempt prohibited transaction. Likewise, in Section II(h), Level Fee Fiduciaries do not have to provide a contract but must provide the written fiduciary acknowledgment, satisfy the Impartial Conducts and document the specific reasons for a recommendation of the level fee arrangement.

The contract with Retirement Investors regarding IRAs and non-ERISA plans must include the Financial Institution's acknowledgment of its fiduciary status and that of its Advisers, as required by Section II(b); the Financial Institution's agreement that it and its Advisers will adhere to the Impartial Conduct Standards, including a Best Interest standard, as required by Section II(c); the Financial Institution's warranty that it has adopted and will comply with anti-conflict policies and procedures reasonably and prudently designed to ensure that Advisers adhere to the Impartial Conduct standards, as required by Section II(d); and the Financial Institution's disclosure of information about its services and applicable fees and compensation, as required by Section II(e). Section II(f) generally provides that the exemption is unavailable if the contract includes exculpatory provisions or provisions waiving the rights and remedies of the plan, IRA or Retirement Investor, including their right to participate in a class action in court. The contract may, however, provide for binding arbitration of individual claims, and may waive contractual rights to punitive damages or rescission.

Of course, Advisers and Financial Institutions are not required to enter into the contract contemplated by this exemption in order to provide investment advice to these Retirement Investors. Advisers and Financial Institutions may always provide advice and receive compensation without the contract requirement if they work with IRAs and non-ERISA plans under circumstances that do not give rise to a prohibited transaction. The contract is required so that Advisers and Financial Institutions can receive the types of compensation as a result of their advice, such as commissions, that are otherwise prohibited by ERISA and the Code due to the significant conflicts of interest they create. To appropriately offset these conflicts, the Department has determined that the enforceable right to adherence to the Impartial Conduct Standards is a critical safeguard with respect to investments in IRAs and non-ERISA plans.

The contract between the IRA or non-ERISA plan, and the Financial Institution, forms the basis of the IRA's or non-ERISA plan's enforcement rights. The Department intends that all the contractual obligations imposed on the

Exceptions for Banks, 72 FR 56514 (Oct. 3, 2007); see also OCC Comptroller's Handbook, Retail Nondeposit Investment Products (January 2015).

[36] *See* 12 CFR parts 14, 208, 343 and 536 (Consumer Protection in Sales of Insurance).

[37] *See* OCC Comptroller's Handbook, Retail Nondeposit Investment Products ("While the provision of financial planning services and investment advice to bank customers is not a sale of an RNDIP, the OCC treats these services as if they were the sale of RNDIPs if provided to bank customers outside of a bank's trust department. Therefore, if a bank chooses to provide financial planning or investment advice through an RIA or other provider, in order to provide a high level of customer protection, the bank should meet all of the risk management standards contained in the Interagency Statement [on Retail Sales of Nondeposit Investment Products] and third-party relationship guidance contained in OCC Bulletin 2013–29, 'Third-Party Relationships: Risk Management Guidance.' ") (citing OCC Interpretive Letter #850, January 27, 1999).

[38] National banks are currently expected to implement an effective initial due diligence process when selecting a third party for the bank's networking sales programs, as well as adopt an effective ongoing due diligence process to monitor the third party's activities, which may include requiring the third party to provide various reports and provide access to the third party's sales program records. *See* OCC Comptroller's Handbook, Retail Nondeposit Investment Products; OCC Bulletin 2013–29. In addition, a bank's management is responsible for overseeing its vendors regardless of whether they are operating on or off-site. Typical oversight would include reviewing: (1) The types and volume of products being sold; (2) the number of opened and closed accounts; (3) new products being offered; (4) discontinued products; and (5) customer complaints and their resolution. *See* Federal Deposit Insurance Corporation. "Uninsured Investment Products: A Pocket Guide for Financial Institutions," available at: *https://www.fdic.gov/regulations/resources/financial/.*

Financial Institution (the Impartial Conduct Standards and warranties) will be actionable by the IRAs and non-ERISA plans. Because these standards are contractually imposed, an IRA or non-ERISA plan has a contract claim if, for example, its Adviser recommends an investment product that is not in the Best Interest of the IRA or other non-ERISA plan.

In the Department's view, these contractual rights serve a critical function for IRA owners and participants and beneficiaries of non-ERISA plans. Unlike participants and beneficiaries in plans covered by Title I of ERISA, IRA owners and participants and beneficiaries in non-ERISA plans do not have an independent statutory right to bring suit against fiduciaries for violation of the prohibited transaction rules. Nor can the Secretary of Labor bring suit to enforce the prohibited transactions rules on their behalf.[39] Thus, for investors in IRAs and plans not covered by Title I of ERISA, the contractual requirement creates a mechanism for investors to enforce their rights and ensures that they will have a remedy for misconduct. In this way, the exemption creates a powerful incentive for Financial Institutions and Advisers alike to oversee and adhere to basic fiduciary standards, without requiring the imposition of unduly rigid and prescriptive rules and conditions.

Under Section II(g), however, the written contract requirement does not apply to advice to Retirement Investors regarding investments in plans that are covered by Title I of ERISA (''ERISA plans'') in light of the existing statutory framework which provides a pre-existing enforcement mechanism for these investors and the Department. Instead, Advisers and Financial Institutions must simply satisfy the provisions in Section II(b)–(e) as conditions of the exemption when transacting with such Retirement Investors. Under the terms of the exemption, the Financial Institution must provide an acknowledgment of its and its Advisers fiduciary status, although it does not have to be part of a contract, as required by Section II(b); the Financial Institution and its Advisers must comply with the Impartial Conduct Standards, as required by Section II(c); the Financial Institutions must establish and comply with anti-conflict policies and procedures, as required by Section II(d); and they must provide the disclosures required by Section II(e).

If these conditions are not satisfied with respect to an ERISA plan in a transaction in which an Adviser or Financial Institution received prohibited compensation, the Adviser and Financial Institution would be unable to rely on the exemption for relief from ERISA's prohibited transactions restrictions. An Adviser's failure to comply with the exemption would result in a non-exempt prohibited transaction under ERISA section 406 and would likely constitute a fiduciary breach under ERISA section 404. As a result, a plan, plan participant or beneficiary would be able to sue under ERISA section 502(a)(2) or (3) to recover any loss in value to the plan (including the loss in value to an individual account), or to obtain disgorgement of any wrongful profits or unjust enrichment. In addition, the Secretary of Labor can enforce ERISA's prohibited transaction and fiduciary duty provisions with respect to these ERISA plans, and an excise tax under the Code, as described above, applies.

In this regard, under Section II(g)(5) of the exemption, the Financial Institution and Adviser may not rely on the exemption if, in any contract, instrument, or communication they purport to disclaim any responsibility or liability for any responsibility, obligation, or duty under Title I of ERISA to the extent the disclaimer would be prohibited by ERISA section 410, waive or qualify the right of the Retirement Investor to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution, or require arbitration or mediation of individual claims in locations that are distant or that otherwise unreasonably limit the ability of the Retirement Investors to assert the claims safeguarded by this exemption. The exemption's enforceability, and the potential for liability, are critical to ensuring adherence to the exemption's stringent standards and protections, notwithstanding the competing pull of the conflicts of interest associated with the covered compensation structures.

The Department expects claims of Retirement Investors regarding investments in ERISA plans to be brought under ERISA's enforcement provisions, discussed above. In general, Section 410 of ERISA invalidates instruments purporting to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under ERISA. Accordingly, provisions purporting to waive fiduciary obligations under ERISA serve only to mislead Retirement Investors about the scope of their rights. Additionally, the legislative intent of ERISA was, in part, to provide for ''ready access to federal courts.'' Accordingly, any recommended transaction covered by a contract or other instrument that waives or qualifies the right of the Retirement Investor to bring or participate in a class action or other representative action in court will not be eligible for relief under this exemption.

A number of comments were received on the contract requirement as it was proposed. The comments, and the Department's responses, are discussed below.

a. Contract Requirement Applicable to IRAs and Non-ERISA Plans

A number of commenters took the position that the consumer protections afforded by the contract requirement are an essential feature of the exemption, particularly in the IRA market. Commenters indicated that enforceability is critical in the IRA market because of IRA owners' lack of a statutory right to enforce prohibited transactions provisions. Commenters said that, in order to achieve the goal of providing meaningful new protections to Retirement Investors, the exemption must provide a mechanism by which Advisers and Financial Institutions can be held legally accountable for the retirement recommendations they make. More than one commenter specifically stated that due to the broad relief provided in the exemption, the contract requirement is necessary for the Department to make the required findings under ERISA section 408(a) and Code section 4975(c)(2) that the exemption is in the interests of and protective of Retirement Investors.

Many other commenters, however, raised significant objections to the contract requirement. Commenters pointed to certain conditions of the exemption that they found ambiguous or subjective and indicated that these conditions could form the basis of class action lawsuits by disappointed investors. Some commenters said the contract requirement and associated litigation exposure would cause investment advice providers to stop serving Retirement Investors or provide only fee-based accounts that do not vary on the basis of the advice provided, resulting in the loss of services to Retirement Investors with smaller account balances. These commenters stated that investment advice fiduciaries

[39] An excise tax does apply in the case of a violation of the prohibited transaction provisions of the Code, generally equal to 15% of the amount involved. The excise tax is generally self-enforced; requiring parties not only to realize that they've engaged in a prohibited transaction but also to report it and pay the tax. Parties who have participated in a prohibited transaction for which an exemption is not available must pay the excise tax and file Form 5330 with the Internal Revenue Service.

would not risk the anticipated legal liability for Retirement Investors, particularly with respect to small accounts.

In the final exemption, the Department retained the contract requirement with respect to IRAs and non-ERISA plans. The contractual commitment provides an administrable means of ensuring fiduciary conduct, eliminating ambiguity about the fiduciary nature of the relationship, and enforcing the exemption's conditions, thereby assuring compliance. The existence of enforceable rights and remedies gives Financial Institutions and Advisers a powerful incentive to comply with the exemption's standards, implement effective anti-conflict policies and procedures, and carefully police conflicts of interest. The enforceable contract gives clarity to the fiduciary nature of the undertaking, and ensures that Advisers and Financial Institutions do not subordinate the interests of the Retirement Investor to their own competing financial interests. The contract effectively aligns the interests of Retirement Investor, Advisers, and the Financial Institution, and gives the Retirement Investor the means to redress injury when violations occur.

Without a contract, the possible imposition of an excise tax provides an additional, but inadequate, incentive to ensure compliance with the exemption's standards-based approach. This is particularly true because imposition of the excise tax critically depends on fiduciaries' self-reporting of violations, rather than independent investigations and litigation by the IRS. In contrast, contract enforcement does not rely on conflicted fiduciaries' assessment of their own adherence to fiduciary norms or require the creation and expansion of a government enforcement apparatus. The contract provides an administrable way of ensuring adherence to fiduciary standards, broadly applicable to an enormous range of investments and advice relationships.

The enforceability of the exemption's provisions enables the Department to grant exemptive relief based upon broad protective standards, applicable to a wide range of investments and compensation structures, rather than rely exclusively upon highly prescriptive conditions applicable only to tightly-specified investments and compensation structures. In the context of this exemption, the risk of litigation and enforcement serves many of the same functions that it has for hundreds of years under the law of trust and agency. It gives fiduciaries a powerful incentive to adhere to broad, flexible, and protective standards applicable to an enormous range of transactions by imposing liability and providing a remedy when fiduciaries fail to comply with those standards.

In addition, a number of features of this final exemption, discussed more fully below, should temper concerns about the risk of excessive litigation. In particular, the exemption permits Advisers and Financial Institutions to require mandatory arbitration of individual claims, so that claims that do not involve systemic abuse or entire classes of participants can be resolved outside of court. Similarly, the exemption permits waivers of the right to obtain punitive damages or rescission based on violation of the contract. In the Department's view, make-whole compensatory relief is sufficient to incentivize compliance and redress injury caused by fiduciary misconduct.

The Department has also clarified a number of the exemption's conditions and simplified the disclosure and compliance obligations to facilitate adherence to the exemption's terms. The core principles of the exemption are well-established under trust law, ERISA and the Code, and have a long history of interpretations in court. Moreover, the Impartial Conduct standards are measured based on the circumstances existing at the time of the recommendation, not based on the ultimate performance of the investment with the benefit of hindsight. It is well settled as a legal matter that fiduciary advisers are not guarantors of the success of investments under ERISA or the Code, and this exemption does nothing to change that fact. Finally, the Department added several provisions enabling Advisers and Financial Institutions to correct good faith errors in disclosure, without facing loss of the exemption. These factors should ease commenters' concerns about loss of services to Retirement Investors with smaller account balances.[40]

One commenter asked the Department to address the interaction of the contract cause of action and state securities laws. In this connection, the Department confirms that it is not its intent to preempt or supersede state securities law and enforcement, and that state securities laws remain subject to the ERISA section 514(b)(2)(A) savings clause.

b. No Contract Requirement Applicable to ERISA Plans

Under Section II(g) of the exemption, there is no contract requirement for transactions involving ERISA plans, but Financial Institutions and their Advisers must satisfy the conditions of Section II(b)–(e), including the conditions requiring written fiduciary acknowledgment, adherence to Impartial Conduct Standards, anti-conflict policies and procedures, and disclosures. Likewise, in Section II(h), Level Fee Fiduciaries do not have to enter into a contract but must provide the written fiduciary acknowledgment, adhere to the Impartial Conduct Standards and document the specific reason or reasons for a recommendation to enter into the level fee arrangement.

The Department eliminated the proposed contract requirement with respect to ERISA plans in this final exemption in response to public comment on this issue. A number of commenters indicated that the contract requirement was unnecessary for ERISA plans due to the statutory framework that already provides enforcement rights to such plans, their participants and beneficiaries, and the Secretary of Labor. Some commenters additionally questioned the extent to which the contract provided additional rights or remedies, and whether state-law contract claims would be pre-empted under ERISA's pre-emption provisions.

In the Department's view, the requirement that a Financial Institution provide written acknowledgement of fiduciary status for itself and its Advisers provides protections in the ERISA plan context that are comparable to the contract requirement for IRAs and non-ERISA plans. As a result of the written acknowledgment of fiduciary status, the fiduciary nature of the relationship will be clear to the parties both at the time of the investment transaction, and in the event of subsequent disputes over the conduct of the Advisers or Financial Institutions. There will be far less cause for the parties to litigate disputes over fiduciary status, as opposed to the substance of the fiduciaries' recommendations and conduct.

2. Contract Operational Issues—Section II(a)

Section II(a) specifies the mechanics of entering into the contract and provides that the contract must be enforceable against the Financial Institution. In addition, the section provides that the contract may be a master contract covering multiple recommendations, and that it may cover advice rendered prior to execution of the contract as long as the contract is entered into prior to or at the same time as the execution of the recommended transaction.

[40] *See* Regulatory Impact Analysis.

Section II(a)(1) further describes the methods for obtaining customer assent to the contract. For "new contracts," the Retirement Investor's assent must be demonstrated through a written or electronic signature. The exemption provides flexibility by permitting the contract terms to be set forth in a standalone document or in an investment advisory agreement, investment program agreement, account opening agreement, insurance or annuity contract or application, or similar document, or amendment thereto.

For Retirement Investors with "existing contracts," the exemption permits assent to be evidenced either by affirmative consent, as described above, or by a negative consent procedure. Under the negative consent procedure, the Financial Institution delivers a proposed contract amendment along with the disclosure required in Section II(e) to the Retirement Investor prior to January 1, 2018, and if the Retirement Investor does not terminate the amended contract within 30 days, the amended contract is effective. If the Retirement Investor does terminate the contract within that 30-day period, this exemption will provide relief for 14 days after the date on which the termination is received by the Financial Institution. In that event, the Retirement Investor's account generally should be able to fall within the provisions of Section VII for pre-existing transactions. An existing contract is defined in the exemption as "an investment advisory agreement, investment program agreement, account opening agreement, insurance contract, annuity contract, or similar agreement or contract that was executed before the Applicability Date and remains in effect." If the Financial Institution elects to use the negative consent procedure, it may deliver the proposed amendment by mail or electronically, but it may not impose any new contractual obligations, restrictions, or liabilities on the Retirement Investor by negative consent.

The final exemption additionally provides a method of complying with the exemption in the event that the Retirement Investor does not open an account with the Adviser but nevertheless acts on the advice through other channels. In some circumstances, Retirement Investors could receive fee-generating advice, fail to open an account with the particular Adviser or Financial Institution, and nevertheless follow the advice in a way that generates additional compensation for the Financial Institution or an Affiliate or Related Entity. Commenters expressed concern that this could result in a prohibited transaction for which there was no relief because the Financial Institution would have been unable to execute the required contract with the Retirement Investor. Generally, commenters raised the issue in the context of mutual funds. For example, an Adviser affiliated with the mutual fund could recommend investment in that fund, which the Retirement Investor followed by executing the transaction through a separate institution unaffiliated with the mutual fund.

To address this concern, Section II(a)(1)(iii) provides conditions under which the exemption will continue to be available notwithstanding the Financial Institution's failure to affirmatively enter into a contract with a Retirement Investor who does not have an existing contract. These conditions are designed to ensure that the Financial Institution does not use Section II(a)(1)(iii) to evade the contract requirement. First, the individual Adviser making the recommendation may not receive compensation, directly or indirectly, as a result of the recommendation or the Retirement Investor's investment transaction. This means that the individual Adviser may not receive transaction-specific compensation, such as a commission or 12b–1 fee, that is tied to the particular Retirement Investor's investment. Second, the Financial Institution's policies and procedures must prohibit the Financial Institution and its Affiliates and Related Entities from providing compensation to the Adviser, in this circumstance, in lieu of compensation that is reasonably attributable to the Retirement Investor's investment transaction, including, but not limited to bonuses or prizes or other incentives, and the Financial Institution has to reasonably monitor such policies and procedures. Thus, the Financial Institution may not compensate Advisers, directly or indirectly, for providing advice as part of a scheme to avoid the contract requirement with respect to Retirement Investors. Third, the Adviser and Financial Institution must comply with the Impartial Conduct Standards set forth in Section II(c), the policies and procedures requirements of Section II(d) (except for the requirement of a warranty with respect to those policies procedures), the web disclosure requirements of Section III(b) and, as applicable, the conditions of Section IV(b)(3)–(6) (Conditions for Advisers and Financial Institution that restrict recommendations, in whole or part, to Proprietary Products or to investments that generate Third Party Payments) with respect to the recommendation. Finally, the Financial Institution's failure to enter into the contract must not be part of an effort, attempt, agreement, arrangement or understanding designed by the Adviser or the Financial Institution to avoid compliance with the exemption or enforcement of its conditions, including the contractual conditions set forth in subsections (i) and (ii). This provision of the exemption is intended for the narrow circumstances in which an Adviser and Financial Institution provide advice that comports with the conditions of the exemption but, due to circumstances generally outside of their control, the Financial Institution did not have the opportunity to enter into a contract with the Retirement Investor.

Finally, Section II(a)(2) of the exemption requires the Financial Institution to provide an electronic copy of the Retirement Investor's contract on its Web site that is accessible by the Retirement Investor. The condition ensures that the Retirement Investor has ready access to the terms of the contract, and reinforces the exemption's goals of clearly establishing the fiduciary status of the Adviser and Financial Institution and ensuring their adherence to the exemption's conditions.

Comments on specific contract operational issues are discussed below.

a. Contract Timing

As proposed, Section II(a) required that, "[p]rior to recommending that the plan, participant or beneficiary account, or IRA purchase, sell or hold the Asset, the Adviser and Financial Institution enter into a written contract with the Retirement Investor that incorporates the terms required by Section II(b)–(e)." A large number of commenters responded to various aspects of this proposed requirement.

Many commenters objected to the timing of the contract requirement. They said that requiring execution of a contract "prior to" any recommendations would be contrary to existing industry practices. The commenters indicated that preliminary discussions may evolve into recommendations before a Retirement Investor has decided to work with a particular Adviser and Financial Institution. Requiring a contract upfront could chill such preliminary discussions, unduly complicate the relationship between the Adviser and the Retirement Investor, and interfere with an investor's ability to shop around. Many commenters suggested that it would be better to time the requirement so that the contract would have to be entered into prior to the execution of the actual investment transaction, or even later, rather than before any advice was rendered. While some other commenters supported the proposed timing, noting the benefit of allowing Retirement Investors the chance to carefully review the contract prior to engaging in transactions, several commenters that strongly supported the contract requirement agreed that the timing could be adjusted without loss of protection to the Retirement Investor.

In the Department's view, the precise timing of the contract is not critical to the exemption, provided that the parties enter into a contract covering the advice (subject to the narrow exception above). The Department did not intend to chill developing advice relationships or limit investors' ability to shop around. Therefore, the Department adjusted the exemption on this point by deleting the proposed requirement that the contract be entered into prior to the advice recommendation. Instead, the exemption generally provides that the advice must be subject to an enforceable written contract entered into prior to or at the same time as the execution of the recommended transaction. However, in order for the exemption to be available to recommendations made prior to the contract's formation, the contract's terms must cover the prior recommendations.

A few commenters suggested that the Department require the contract to be a separate document, not combined with any other document. However, other commenters requested that the Department allow Financial Institutions to incorporate the contract terms into other account documents. While the Department believes the contract is critical to IRA and non-ERISA plan investors, the Department recognizes the need for flexibility in its implementation. Therefore, the exemption contemplates that the contract may be incorporated into other documents to the extent desired by the Financial Institution. Additionally, as requested by commenters, the Department confirms that the contract requirement may be satisfied through a master contract covering multiple recommendations and does not require execution prior to each additional recommendation.

b. Contract Parties

A number of commenters also questioned the necessity of the proposed requirement that Advisers be parties to the contract. These commenters indicated that the proposed requirement posed significant logistical challenges. For example, commenters stated that Advisers often work in teams and it would be difficult to obtain signatures from all such Advisers. Similarly, if call center representatives made recommendations, it could be hard to cover them under a contract. Over the course of a Retirement Investor's relationship with a Financial Institution, he or she could receive advice from a number of persons concerning a wide variety of transactions. Requiring that each such person execute a contract could prove difficult and unwieldy.

Based upon these objections, the Department has deleted the requirement that individual Advisers be parties to the contract. The Financial Institution must be a party to the contract and assume responsibility for advice provided by any of its Advisers. Such Advisers include call center representatives who provide investment advice within the meaning of the Regulation.

Several commenters asked about the circumstance in which two entities could satisfy the definition of Financial Institution with respect to the same Adviser and same transaction. This largely came up in the context of an insurance product that is offered by an insurance company but sold by a representative of a broker-dealer. Commenters asked whether multiple Financial Institutions would be required to be parties to the contract.

In response, the Department notes that there must always be a Financial Institution, as defined in the exemption, that is a party to the contract. That Financial Institution must take responsibility for satisfying the exemption's conditions, including the obligation to have policies and procedures reasonably and prudently designed to ensure that individual Advisers adhere to the Impartial Conduct Standards, and the obligation to insulate the Adviser from incentives to violate the Best Interest Standard.[41] If these conditions are not satisfied, the Adviser and Financial Institution are liable for a non-exempt prohibited transaction.

Some commenters suggested that the Department provide additional flexibility and allow the individual Adviser to be obligated under the contract instead of the Financial Institution. The Department has not adopted that suggestion. To ensure operation of the exemption as intended, the Financial Institution should be a party to the contract. The supervisory responsibility and liability of the Financial Institution is important to the exemption's protections. In particular, the exemption contemplates that the Financial Institution will adopt and monitor stringent anti-conflict policies and procedures; avoid financial incentives that undermine Advisers' compliance with the Impartial Conduct standards; and take appropriate measures to ensure that it and its representatives adhere to the exemption's conditions. The contract provides both a mechanism for imposing these obligations on the Financial Institution and creates a powerful incentive for the Financial Institution to take the obligations seriously in the management and supervision of investment recommendations.

c. Contract Signatures

Section II(a) of the exemption provides that the contract must be enforceable against the Financial Institution. As long as that is the case, the Financial Institution is not required to sign the contract. Section II(a) of the exemption further describes the methods through which customer assent may be achieved, and reflects commenters' requests for greater specificity on this point.

With respect to new contracts, a few commenters asked the Department to confirm that electronic execution by the Retirement Investor is sufficient. Another commenter asked about telephone assent. In the final exemption, the Department specifically permits electronic execution as a form of customer assent. The Department has not permitted telephone assent, however, because of the potential issues of proof regarding the existence and terms of a contract executed in that manner. It is the Department's goal that Retirement Investors obtain clear evidence of the contract terms and their applicability to the Retirement Investor's own account or contract. The exemption will best serve its purpose if the contractual commitments are clear to all the parties, and if ancillary disputes about the fiduciary nature of the advice relationship are avoided. For this same reason, the exemption requires that a copy of the applicable contract be maintained on a Web site accessible to the investor.

Commenters also asked for the ability to use a negative consent procedure with respect to existing customers to avoid the expense and difficulty associated with obtaining a large number of client signatures. The Department adjusted the exemption on

[41] *See* Section II(c)(1), setting forth the Best Interest standard, which specifically indicates that the interests of *Affiliates, Related Entities and other parties* may not be considered by the Adviser in making a recommendation.

this point to permit amendment of existing contracts by negative consent. The negative consent procedure involves delivery of an amended contract to the Retirement Investor with clear notice that the Retirement Investor's failure to terminate the relationship within 30 days constitutes assent. As this approach will still result in the Retirement Investor receiving clear evidence of the contract terms and their applicability to the Retirement Investor's own account or contract, the Department concurred with commenters on its use.

Treating the Retirement Investor's silence as consent after 30 days provides the Retirement Investor a reasonable opportunity to review the new terms and to reject them. The Financial Institution may not use the negative consent procedure, however, to impose new obligations, restrictions or liabilities on the Retirement Investor in connection with the Best Interest Contract. Any attempt by the Financial Institution to impose additional obligations, restrictions, or liabilities on the Retirement Investor must receive affirmative consent from the Retirement Investor, and cannot violate Section II(f).

A number of commenters also asked that the exemption authorize Financial Institutions to satisfy the contract requirement for all Retirement Investors—including new customers after the Applicability Date—through unilateral contracts or implied or negative consent. Some commenters suggested that the Department should not require a contract at all, but only a ''customer bill of rights'' or similar disclosure, without any additional signature requirement. Some commenters suggested that the requirement of obtaining signatures could delay execution of time sensitive investment strategies.

Although the final exemption accommodates a wide variety of concerns regarding contract operational issues, the Department did not adopt the alternative approaches suggested by some commenters, such as merely requiring delivery of a customer bill of rights, broader reliance on a unilateral contract approach, or increased reliance on negative consent. The Department intends that Retirement Investors that are new customers of the Financial Institution should enter into an enforceable contract under Section II(a)(1)(i). Consistent with the Department's goal that Retirement Investors obtain clear evidence of the contract terms and their applicability to the Retirement Investor's own account or contract, the exemption limits the negative consent option to existing customers as a form of transitional relief, so that Financial Institutions can avoid the burdens associated with obtaining signatures from a large number of already-existing customers.

Apart from this transitional relief, the Department does not believe it is appropriate to dispense with the clarity, enforceability and legal protections associated with an affirmative contract. Contracts are commonplace in a wide range of commercial transactions occurring in person, on the web, and elsewhere. The Department has facilitated the process by providing that Financial Institutions can incorporate the contract terms into commonplace account opening or similar documents that they already use; by permitting electronic signatures; and by revising the timing rules, so that the contract's execution can follow the provision of advice, as long as it precedes or occurs at the same time as the execution of the recommended transaction.

3. Fiduciary Acknowledgment—Section II(b)

Section II(b) of the exemption requires the Financial Institution to affirmatively state in writing that it and its Adviser(s) act as fiduciaries under ERISA or the Code, or both, with respect to the investment advice subject to the contract or, in the case of an ERISA plan, with respect to any investment advice regarding the plan or beneficiary or participant account.

With respect to IRAs and non-ERISA plans, if this acknowledgment of fiduciary status does not appear in a contract with a Retirement Investor, the exemption is not satisfied with respect to transactions involving that Retirement Investor. With respect to ERISA plans, this acknowledgment must be provided to the Retirement Investor prior to or at the same time as the execution of the recommended transaction, but not as part of a contract. This fiduciary acknowledgment is critical to ensuring clarity and certainty with respect to the fiduciary status of both the Adviser and Financial Institution under ERISA and the Code with respect to that advice.

The fiduciary acknowledgment provision received significant support from some commenters. Commenters described it as a necessary protection and noted that it would clarify the obligations of the Adviser. One commenter said that facilitating proof of fiduciary status should enhance investors' ability to obtain a remedy for Adviser misconduct in arbitration by eliminating ancillary litigation over fiduciary status. Rather than litigate over fiduciary status, the fiduciary acknowledgment would help ensure that such proceedings focused on the Advisers' compliance with fundamental fiduciary norms.

Some commenters opposed the fiduciary acknowledgment requirement in the proposal, as applicable to Financial Institution, on the basis that it could force Financial Institutions to take on fiduciary responsibilities, even if they would not otherwise be functional fiduciaries under ERISA or the Code. The commenters pointed out that, under the proposed Regulation, the acknowledgment of fiduciary status would have been a factor in imposing fiduciary status on a party. Therefore, Financial Institutions could become fiduciaries by virtue of the fiduciary acknowledgment. To address these concerns, a few commenters suggested language under which a Financial Institution would only be considered a fiduciary to the extent that it is ''an affiliate of the Adviser within the meaning of 29 CFR 2510.3–21(f)(7) that, with the Adviser, functions as a fiduciary.''

The Department has not adjusted the exemption as these commenters requested. The exemption requires as a condition of relief that a sponsoring Financial Institution accept fiduciary responsibility for the recommendations of its Adviser(s). The Financial Institution's role in supervising individual Advisers and overseeing their adherence to the Impartial Conduct Standards is a key safeguard of the exemption. The exemption's success critically depends on the Financial Institution's careful implementation of anti-conflict policies and procedures, avoidance of Adviser incentives to violate the Impartial Conduct Standards, and broad oversight of Advisers. Accordingly, Financial Institutions that wish to receive compensation streams that would otherwise be prohibited under ERISA and the Code must agree to take on these responsibilities as a condition of relief under the exemption. To the extent Financial Institutions do not wish to take on this role with its associated responsibilities and liabilities, they may structure their operations to avoid prohibited transactions and the resultant need of the exemption.

A commenter requested clarification of the circumstances in which a credit union shares employees with a broker-dealer. The commenter requested confirmation that the credit union would not have to comply with the exemption merely because it shared employees. Consistent with the approach set forth above, the

Department responds that the credit union would not have to act as the Financial Institution under the exemption but the broker-dealer would.

Other commenters expressed the view that the fiduciary acknowledgement would potentially require broker-dealers to satisfy the requirements of the Investment Advisers Act of 1940. As described by commenters, the Act does not require broker-dealers to register as investment advisers if they provide advice that is solely incidental to their brokerage services. Commenters expressed concern that acknowledging fiduciary status and providing advice in satisfaction of the Impartial Conduct Standards could call into question whether the advice provided was solely incidental.

The Department does not, however, require the Adviser or Financial Institution to acknowledge fiduciary status under the securities laws, but rather under ERISA or the Code or both. Neither does the Department require Advisers to agree to provide advice on an ongoing, rather than transactional, basis. An Adviser's status as an ERISA fiduciary is not dispositive of its obligations under the securities laws, and compliance with the exemption does not trigger an automatic loss of the broker-dealer exception under the separate requirements of those laws. A broker-dealer who provides investment advice under the Regulation is an ERISA fiduciary; acknowledgment of ERISA fiduciary status would not, by itself, cause the Adviser to lose the broker-dealer exception. Under the Regulation and this exemption, the primary import of fiduciary status is that the broker has to act in the customer's best interest when making recommendations; receive no more than reasonable compensation; and refrain from making misleading statements. Certainly, nothing in the securities laws precludes brokers from adhering to these basic standards, or forbids them from working for firms that implement appropriate policies and procedures to ensure that these standards are met.

The Department changed the fiduciary acknowledgment provision in response to several comments requesting revisions to clarify the required extent of the fiduciary acknowledgment. Accordingly, the Department has clarified that the acknowledgment can be limited to investment recommendations subject to the contract or, in the case of an ERISA plan, any investment recommendations regarding the plan or beneficiary or participant account. As discussed in more detail below, the exemption (including the required fiduciary acknowledgment) does not in and of itself, impose an ongoing duty to monitor on the Adviser or Financial Institution. However, there may be some investments which cannot be prudently recommended to the individual Retirement Investor, in the first place, without a mechanism in place for the ongoing monitoring of the investment.

4. Impartial Conduct Standards—Section II(c)

Section II(c) of the exemption requires that the Adviser and Financial Institution comply with fundamental Impartial Conduct Standards. Generally stated, the Impartial Conduct Standards require that Advisers and Financial Institutions provide investment advice in the Retirement Investor's Best Interest, not recommend transactions that they anticipate will result in more than reasonable compensation, and not make misleading statements to the Retirement Investor about recommended transactions. As defined in the exemption, a Financial Institution and Adviser act in the Best Interest of a Retirement Investor when they provide investment advice "that reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party."

The Impartial Conduct Standards represent fundamental obligations of fair dealing and fiduciary conduct. The concepts of prudence, undivided loyalty and reasonable compensation are all deeply rooted in ERISA and the common law of agency and trusts.[42] These longstanding concepts of law and equity were developed in significant part to deal with the issues that arise when agents and persons in a position of trust have conflicting loyalties, and accordingly, are well-suited to the problems posed by conflicted investment advice. The phrase "without regard to" is a concise expression of ERISA's duty of loyalty, as expressed in section 404(a)(1)(A) of ERISA and applied in the context of advice. It is consistent with the formulation stated in the common law, and it is consistent with the language used by Congress in Section 913(g)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act),[43] and cited in the Staff of U.S. Securities and Exchange Commission "Study on Investment Advisers and Broker-Dealers, As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act" (Jan. 2011)[44] (SEC staff Dodd-Frank Study). The Department notes, however, that the standard is not intended to outlaw Financial Institutions' provision of advice from investment menus that are restricted on the basis of Proprietary Products or generation of Third Party Payments; accordingly, in Section IV, the Department specifically operationalizes how such Financial Institutions can comply with the standard in those circumstances. Finally, the "reasonable compensation" obligation is already required under ERISA section 408(b)(2) and Code section 4975(d)(2)of service providers, including financial services providers, whether fiduciaries or not.[45]

Under ERISA section 408(a) and Code section 4975(c)(2), the Department cannot grant an exemption unless it first finds that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners. An exemption permitting transactions that violate the Impartial Conduct Standards would fail these standards.

The Impartial Conduct Standards are conditions of the exemption for the provision of advice with respect to all Retirement Investors. For advice to Retirement Investors on investments in IRAs and non-ERISA plans, the Impartial Conduct Standards must also

[42] *See generally* ERISA sections 404(a), 408(b)(2); Restatement (Third) of Trusts section 78 (2007), and Restatement (Third) of Agency section 8.01.

[43] Section 913(g) governs "Standard of Conduct" and subsection (1) provides that "The Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice."

[44] Available at *https://www.sec.gov/news/studies/2011/913studyfinal.pdf.*

[45] ERISA section 408(b)(2) and Code section 4975(d)(2) exempt certain arrangements between ERISA plans, IRAs, and non-ERISA plans, and service providers, that otherwise would be prohibited transactions under ERISA section 406 and Code section 4975. Specifically, ERISA section 408(b)(2) and Code section 4975(d)(2) provide relief from the prohibited transaction rules for service contracts or arrangements if the contract or arrangement is reasonable, the services are necessary for the establishment or operation of the plan or IRA, and no more than reasonable compensation is paid for the services.

be included as contractual commitments on the part of the Financial Institution and its Advisers. As noted above, there is no contract requirement for advice to Retirement Investors with respect to investments in ERISA plans or for Level Fee Fiduciaries.

Comments on each of the Impartial Conduct Standards are discussed below. Additionally, in response to commenters' assertion that the exemption is not administratively feasible due to uncertainty regarding some terms and requests for additional clarity, the Department has clarified some key terms in the text and provides additional interpretative guidance in the preamble discussion that follows. Finally, the Department discusses comments on whether the Impartial Conduct Standards should serve as both exemption conditions for all Retirement Investors as well as contractual representations with respect to IRAs and non-ERISA plans.

a. Best Interest Standard

Under Section II(c)(1), the Financial Institution must state that it and its Advisers will comply with a Best Interest standard when providing investment advice to the Retirement Investor, and, in fact, adhere to the standard. Advice in the Retirement Investor's Best Interest means advice that, at the time of the recommendation reflects:

> the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.

The Best Interest standard set forth in the final exemption is based on longstanding concepts derived from ERISA and the law of trusts. It is meant to express the concept, set forth in ERISA section 404, that a fiduciary is required to act ''solely in the interest of the participants . . . 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 a like character and with like aims.'' Similarly, both ERISA section 404(a)(1)(A) and the trust-law duty of loyalty require fiduciaries to put the interests of trust beneficiaries first, without regard to the fiduciaries' own self-interest. Under this standard, for example, an Adviser, in choosing between two investments, could not select an investment because it is better for the Adviser's or Financial Institution's bottom line, even though it is a worse choice for the Retirement Investor.[46]

A wide range of commenters indicated support for a broad ''best interest'' standard. Some comments indicated that the best interest standard is consistent with the way advisers provide investment advice to clients today. However, a number of these commenters expressed misgivings as to the definition used in the proposed exemption, in particular, the ''without regard to'' formulation. The commenters indicated uncertainty as to the meaning of the phrase, including: Whether it permitted the Adviser and Financial Institution to be paid and whether it permitted investment advice on Proprietary Products.

Other commenters asked the Department to use a different definition of Best Interest, or simply use the exact language from ERISA's section 404 duty of loyalty. Others suggested definitional approaches that would require that the Adviser and Financial Institution ''not subordinate'' their customers' interests to their own interests, or that the Adviser and Financial Institution ''put their customers' interests ahead of their own interests,'' or similar constructs.[47]

FINRA suggested that the federal securities laws should form the foundation of the Best Interest standard. Specifically, FINRA urged that the Best Interest definition in the exemption incorporate the ''suitability'' standard applicable to investment advisers and broker dealers under federal securities laws. According to FINRA, this would facilitate customer enforcement of the Best Interest standard by providing adjudicators with a well-established basis on which to find a violation.

Other commenters found the Best Interest Standard to be an appropriate statement of the obligations of a fiduciary investment advice provider and believed it would provide concrete protections against conflicted recommendations. These commenters asked the Department to maintain the Best Interest definition as proposed. One commenter wrote that the term ''best interest'' is commonly used in connection with a fiduciary's duty of loyalty and cautioned the Department against creating an exemption that failed to include the duty of loyalty. Others urged the Department to avoid definitional changes that would reduce current protections to Retirement Investors. Some commenters also noted that the ''without regard to'' language is consistent with the recommended standard in the SEC staff Dodd-Frank Study, and suggested that it had the added benefit of potentially harmonizing with a future securities law standard for broker-dealers.

The final exemption retains the Best Interest definition as proposed, with minor adjustments. The first prong of the standard was revised to more closely track the statutory language of ERISA section 404(a), and, is consistent with the Department's intent to hold investment advice fiduciaries to a prudent investment professional standard. Accordingly, the definition of Best Interest now requires advice that ''reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person *acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims,* based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor . . .'' The exemption adopts the second prong of the proposed definition, ''without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party,'' without change. The Department continues to believe that the ''without regard to'' language sets forth the appropriate, protective standard under which a fiduciary investment adviser should act. Although the exemption provides broad relief for Advisers and Financial Institutions to receive commissions and other payments based on their advice, the standard ensures that the advice will not be tainted by self-interest. Many of the alternative approaches suggested by commenters pose their own ambiguities and interpretive challenges, and lower standards run the risk of undermining this regulatory initiative's goal of reducing the impact of conflicts of interest on Retirement Investors.

The Department has not specifically incorporated the suitability obligation as an element of the Best Interest standard, as suggested by FINRA but many aspects of suitability are also elements of the Best Interest standard. An investment recommendation that is not suitable under the securities laws would not meet the Best Interest standard.

[46] The standard does not prevent Advisers and Financial Institutions from restricting their recommended investments to Proprietary Products or products that generate Third Party Payments. Section IV of the exemption specifically addresses how the standard may be satisfied under such circumstances.

[47] The alternative approaches are discussed in a separate section of the preamble, below.

Under FINRA's rule 2111(a) on suitability, broker-dealers ''must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer.'' The text of rule 2111(a), however, does not do any of the following: Reference a best interest standard, clearly require brokers to put their client's interests ahead of their own, expressly prohibit the selection of the least suitable (but more remunerative) of available investments, or require them to take the kind of measures to avoid or mitigate conflicts of interests that are required as conditions of this exemption.

The Department recognizes that FINRA issued guidance on rule 2111 in which it explains that ''in interpreting the suitability rule, numerous cases explicitly state that a broker's recommendations must be consistent with his customers' best interests,'' and provided examples of conduct that would be prohibited under this standard, including conduct that this exemption would not allow.[48] The guidance goes on to state that ''[t]he suitability requirement that a broker make only those recommendations that are consistent with the customer's best interests prohibits a broker from placing his or her interests ahead of the customer's interests.'' The Department, however is reluctant to adopt as an express standard such guidance, which has not been formalized as a clear rule and that may be subject to change. Additionally, FINRA's suitability rule may be subject to interpretations which could conflict with interpretations by the Department, and the cases cited in the FINRA guidance, as read by the Department, involved egregious fact patterns that one would have thought violated the suitability standard, even without reference to the customer's ''best interest.'' The scope of the guidance also is different than the scope of this exemption. For example, insurance providers who decide to accept conflicted compensation will need to comply with the terms of this exemption, but, in many instances, may not be subject to FINRA's guidance.

Moreover, suitability under SEC practice differs somewhat from the FINRA approach. According to the SEC staff Dodd-Frank Study, the SEC requirements are based on the anti-fraud provisions of the Securities Act Section 17(a), the Exchange Act Section 10(b) and Rule 10b–5 thereunder.[49] As a general matter, SEC Rule 10b–5 prohibits any person, directly or indirectly, from: (a) Employing any device, scheme, or artifice to defraud; (b) making untrue statements of material fact or omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances, not misleading; or (c) engaging in any act or practice or course of business which operates or that would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security. FINRA does not require scienter, but the weight of authority holds that violations of the Self-Regulatory Organization (SRO) rules, standing alone, do not give right to a private cause of action. Courts, however, allow private claims for violations of SEC Rule 10b–5 for fraud claims, including, among others unsuitable recommendations. The private plaintiff must establish that the broker's unsuitable recommendation involved a misrepresentation (or material omission) made with scienter. Accordingly, after review of the issue, the Department has decided not to accept the comment. The Department has concluded that its articulation of a clear loyalty standard within the exemption, rather than by reference to the FINRA guidance, will provide clarity and certainty to investors and better protect their interests.

The Best Interest standard, as set forth in the exemption, is intended to effectively incorporate the objective standards of care and undivided loyalty that have been applied under ERISA for more than forty years. Under these objective standards, the Adviser must adhere to a professional standard of care in making investment recommendations that are in the Retirement Investor's Best Interest. The Adviser may not base his or her recommendations on the Adviser's own financial interest in the transaction. Nor may the Adviser recommend the investment, unless it meets the objective prudent person standard of care. Additionally, the duties of loyalty and prudence embodied in ERISA are objective obligations that do not require proof of fraud or misrepresentation, and full disclosure is not a defense to making an imprudent recommendation or favoring one's own interests at the Retirement Investor's expense.

A few commenters also questioned the requirement in the Best Interest standard that recommendations be made without regard to the interests of the Adviser, Financial Institution, Affiliates, Related Entities, or ''*other parties*.'' The commenters indicated they did not know the purpose of the reference to ''other parties'' and asked that it be deleted. The Department intends the reference to make clear that an Adviser and Financial Institution operating within the Impartial Conduct Standards should not take into account the interests of any party other than the Retirement Investor—whether the other party is related to the Adviser or Financial Institution or not—in making a recommendation. For example, an entity that may be unrelated to the Adviser or Financial Institution but could still constitute an ''other party,'' for these purposes, is the manufacturer of the investment product being recommended.

Other commenters asked for confirmation that the Best Interest standard is applied based on the facts and circumstances as they existed at the time of the recommendation, and not based on hindsight. Consistent with the well-established legal principles that exist under ERISA today, the Department confirms that the Best Interest standard is not a hindsight standard, but rather is based on the facts as they existed at the time of the recommendation. Thus, the courts have evaluated the prudence of a fiduciary's actions under ERISA by focusing on the process the fiduciary used to reach its determination or recommendation—whether the fiduciary, ''at the time they engaged in the challenged transactions, employed the proper procedures to investigate the merits of the investment and to structure the investment.'' [50] The standard does not measure compliance by reference to how investments subsequently performed or turn Advisers and Financial Institutions into guarantors of investment performance, even though they gave advice that was prudent and loyal at the time of transaction.[51]

This is not to suggest that the ERISA section 404 prudence standard, or Best Interest standard, are solely procedural standards. Thus, the prudence standard, as incorporated in the Best Interest standard, is an objective standard of care that requires investment advice fiduciaries to investigate and evaluate

[48] FINRA Regulatory Notice 12–25, p. 3 (2012).

[49] SEC staff Dodd-Frank Study at 61.

[50] *Donovan* v. *Mazzola,* 716 F.2d 1226, 1232 (9th Cir. 1983).

[51] One commenter requested an adjustment to the ''prudence'' component of the Best Interest Standard, under which the standard would be that of a ''prudent person serving clients with similar retirement needs and offering a similar array of products.'' In this way, the commenter sought to accommodate varying perspectives and opinions on particular investment products and business practices. The Department disagrees with the comment, which could be read as qualifying the stringency of the prudence obligation based on the Financial Institution's or Adviser's independent decisions on which products to offer, rather than on the needs of the particular Retirement Investor. Therefore, the Department did not adopt this suggestion.

investments, make recommendations, and exercise sound judgment in the same way that knowledgeable and impartial professionals would. ''[T]his is not a search for subjective good faith—a pure heart and an empty head are not enough.'' [52] Whether or not the fiduciaries is actually familiar with the sound investment principles necessary to make particular recommendations, the fiduciary must adhere to an objective professional standard. Additionally, fiduciaries are held to a particularly stringent standard of prudence when they have a conflict of interest.[53] For this reason, the Department declines to provide a safe harbor based on ''procedural prudence'' as requested by a commenter.

The Department additionally confirms its intent that the phrase ''without regard to'' be given the same meaning as the language in ERISA section 404 that requires a fiduciary to act ''solely in the interest of'' participants and beneficiaries, as such standard has been interpreted by the Department and the courts. Therefore, the standard would not, as some commenters suggested, foreclose the Adviser and Financial Institution from being paid. In response to concerns about the satisfaction of the standard in the context of Proprietary Product recommendations or investment menus limited to Proprietary Products and/or investments that generate Third Party Payments, the Department has revised Section IV of the exemption to provide additional clarity and specific guidance on this issue.

Section IV specifically provides that Financial Institutions and Advisers that restrict their recommendations, in whole or in part, to Proprietary Products or to investments that generate Third Party Payments may rely on the exemption provided that the recommendation is prudent, the fees reasonable, the conflicts disclosed (so that the customer can fairly be said to have knowingly assented to the compensation arrangement), and the conflicts are managed through stringent policies and procedures that keep the Adviser's focus on the customer's Best Interest, rather than any competing financial interest of the Adviser or others.

In response to commenter concerns, the Department also confirms that the Best Interest standard does not impose an unattainable obligation on Advisers and Financial Institutions to somehow identify the single ''best'' investment for the Retirement Investor out of all the investments in the national or international marketplace, assuming such advice were even possible. Instead, as discussed above, the best interest standard set out in the exemption, incorporates two fundamental and well-established fiduciary obligations: The duties of prudence and loyalty. Thus, the advice fiduciary's obligation under the Best Interest standard is to give advice that adheres to professional standards of prudence, and to put the Retirement Investor's financial interests in the driver's seat, rather than the competing interests of the Adviser or other parties.

Finally, in response to questions regarding the extent to which the Best Interest standard or other provisions of the exemption impose an ongoing monitoring obligation on Advisers or Financial Institutions, the Department has added specific language in Section II(e) regarding monitoring. The text does not impose a monitoring requirement, but instead requires clarity. As suggested by FINRA, Section II(e) requires Advisers and Financial Institutions to disclose whether or not they will monitor the Retirement Investor's investments and alert the Retirement Investor to any recommended changes to those investments and, if so, the frequency with which the monitoring will occur and the reasons for which the Retirement Investor will be alerted. This is consistent with the Department's interpretation of an investment advice fiduciary's monitoring responsibility as articulated in the preamble to the Regulation.

The terms of the contract or disclosure along with other representations, agreements, or understandings between the Adviser, Financial Institution and Retirement Investor, will govern whether the nature of the relationship between the parties is ongoing or not. The preamble to the proposed exemption stated that adherence to a Best Interest standard did not mandate an ongoing or long-term relationship, but instead left that the determination of whether to enter into such a relationship to the parties.[54] The final exemption builds upon this and requires that the contract clearly state the nature of the relationship and whether there is any duty to monitor on the part of the Adviser or Financial Institution. Whether the Adviser and Financial Institution, in fact, have an obligation to monitor the investment and provide long-term advice depends on the parties' reasonable understandings, arrangements, and agreements in that regard.

b. Reasonable Compensation

The Impartial Conduct Standards also include the reasonable compensation standard, set forth in Section II(c)(2). Under this standard, the Financial Institution and its Advisers must not recommend a transaction that will cause the Financial Institution, Adviser, 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 section 408(b)(2) and Code section 4975(d)(2).

The obligation to pay no more than reasonable compensation to service providers is long recognized under ERISA and the Code. ERISA section 408(b)(2) and Code section 4975(d)(2) require that services arrangements involving plans and IRAs result in no more than reasonable compensation to the service provider. Accordingly, Advisers and Financial Institutions—as service providers—have long been subject to this requirement, regardless of their fiduciary status. At bottom, the standard simply requires that compensation not be excessive, as measured by the market value of the particular services, rights, and benefits the Adviser and Financial Institution are delivering to the Retirement Investor. Given the conflicts of interest associated with the commissions and other payments covered by the exemption, and the potential for self-dealing, it is particularly important that Advisers and Financial Institutions adhere to these statutory standards, which are rooted in common law principles.[55]

Several commenters supported this standard. The requirement that compensation be limited to what is reasonable is an important protection of the exemption and a well-established standard, they said. One commenter made the point that the reasonable compensation standard is particularly important in this exemption because it provides relief for Third Party Payments which may not be transparent to Retirement Investors. The commenter asserted that under current market

[52] *Donovan* v. *Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983), *cert. denied*, 467 U.S. 1251 (1984); *see also DiFelice* v. *U.S. Airways, Inc.*, 497 F.3d 410, 418 (4th Cir. 2007) (''Good faith does not provide a defense to a claim of a breach of these fiduciary duties; 'a pure heart and an empty head are not enough.'').

[53] *Donovan* v. *Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982) (''the[] decisions [of the fiduciary] must be made with an eye single to the interests of the participants and beneficiaries'') *see also Bussian* v. *RJR Nabisco, Inc.*, 223 F.3d 286, 298 (5th Cir. 2000); *Leigh* v. *Engle*, 727 F.2d 113, 126 (7th Cir. 1984).

[54] 80 FR 21969 (Apr. 20, 2015).

[55] *See generally* Restatement (Third) of Trusts section 38 (2003).

conditions, there can be large differences in compensation for identical services.

A number of other commenters requested greater specificity as to the meaning of the reasonable compensation standard. As proposed, the standard stated:

When providing investment advice to the Retirement Investor regarding the Asset, the Adviser and Financial Institution will not recommend an Asset if the total amount of compensation anticipated to be received by the Adviser, Financial Institution, Affiliates and Related Entities in connection with the purchase, sale or holding of the Asset by the Plan, participant or beneficiary account, or IRA, will exceed reasonable compensation in relation to the total services they provide to the Retirement Investor.

Some commenters stated that the proposed reasonable compensation standard was too vague. Because the language of the proposal did not reference ERISA section 408(b)(2) and Code section 4975(d)(2), commenters asked whether the standard differed from those statutory provisions. In particular, some commenters questioned the meaning of the proposed language "in relation to the total services they provide to the Retirement Investor." The commenters indicated that the proposal did not adequately explain this formulation of the reasonable compensation standard.

There was concern that the standard could be applied retroactively rather than based on the parties' reasonable beliefs as to the reasonableness of the compensation at the time of the recommendation. Commenters also indicated uncertainty as to how to comply with the condition and asked whether it would be necessary to survey the market to determine market rates. Some commenters requested that the Department include the words "and customary" in the reasonable compensation definition, to specifically permit existing compensation arrangements. One commenter raised the concern that the reasonable compensation determination raised antitrust concerns because it would require investment advice fiduciaries to agree upon a market rate and result in anti-competitive behavior.

Commenters also asked the Department to provide examples of scenarios that met the reasonable compensation standard and safe harbors and others requested examples of scenarios that would fail to meet these standards. FINRA and other commenters suggested that the Department incorporate existing FINRA rules 2121 and 2122, and NASD rule 2830 regarding the reasonableness of compensation for broker-dealers.[56]

Commenters also asked how the standard would be satisfied for Proprietary Products, particularly insurance and annuity contracts. In such a case, commenters indicated, the Retirement Investor is not only paying for a service, but also for insurance guarantees; a standard that appeared to focus solely on services appeared inapposite. Commenters asked about the treatment of the insurance company's spread, which was described, in the case of a fixed annuity, or the fixed component of a variable annuity, as the difference between the fixed return credited to the contract holder and the insurer's general account investment experience. One commenter indicated that the calculation should not include affiliates' or related entities' compensation as this would appear to put them at a comparative disadvantage.

Finally, a few commenters took the position that the reasonable compensation determination should not be a requirement of the exemption (or the contract). In their view, a plan fiduciary that is not the Adviser or Financial Institution should decide the reasonableness of the compensation. Another commenter suggested that if an independent plan fiduciary sets the menu this should be sufficient to comply with the reasonable compensation standard.

In response to comments on this requirement, the Department has retained the reasonable compensation standard as a condition of the exemption, and requires Financial Institutions to include the standard in their contracts with IRA and non-ERISA plan Retirement Investors. As noted above, the "reasonable compensation" obligation is a feature of ERISA and the Code under current law that has long applied to financial services providers, whether fiduciaries or not. The standard is also applicable to fiduciaries under the common law of agency and trusts. It is particularly important that Advisers and Financial Institutions adhere to these standards when engaging in the transactions covered under this exemption, so as to avoid exposing Retirement Investors to harms associated with conflicts of interest.

Although some commenters suggested that the reasonable compensation determination be made by another plan fiduciary, the contractual commitment (like the statutory obligation) obligates investment advice fiduciaries to avoid overcharging their Retirement Investor customers, despite the conflicts of interest associated with their compensation. Fiduciaries and other services providers may not charge more than reasonable compensation regardless of whether another fiduciary has signed off on the compensation. Nothing in the exemption, however, precludes Financial Institutions or others from seeking impartial review of their fee structures to safeguard against abuse, and they may well want to include such reviews in their policies and procedures.

Further, the Department disagrees that the requirement is inconsistent with antitrust laws. Nothing in the exemption contemplates or requires that Advisers or Financial Institutions agree upon a price with their competitors. The focus of the reasonable compensation condition is on preventing overcharges to Retirement Investors, not promoting anti-competitive practices. Indeed, if Advisers and Financial Institutions consulted with competitors to set prices, the agreed-upon prices could well violate the condition.

In response to comments, however, the operative text of the final exemption was clarified to adopt the well-established reasonable compensation standard, as set out in ERISA section 408(b)(2) and Code section 4975(d)(2), and the regulations thereunder. The reasonableness of the fees depends on the particular facts and circumstances at the time of the recommendation. Several factors inform whether compensation is reasonable including, *inter alia,* the market pricing of service(s) provided and the underlying asset(s), the scope of monitoring, and the complexity of the product. No single factor is dispositive in determining whether compensation is reasonable; the essential question is whether the charges are reasonable in relation to what the investor receives. Consistent with the Department's prior interpretations of this standard, the Department confirms that an Adviser and Financial Institution do not have to recommend the transaction that is the lowest cost or that generates the lowest fees without regard to other relevant factors. In this regard, the Department declines to specifically reference FINRA's standard in the exemption, but rather relies on ERISA's own longstanding reasonable compensation formulation.

In response to concerns about application of the standard to investment products that bundle together services and investment

[56] FINRA's comment letter described NASD rule 2830 as imposing specific caps on compensation with respect to investment company securities that broker-dealers may sell. While the Department views this cap as an important protection of investors, it establishes an outside limit rather than a standard of reasonable compensation.

guarantees or other benefits, such as annuities, the Department responds that the reasonable compensation condition is intended to apply to the compensation received by the Financial Institution, Adviser, Affiliates, and Related Entities in same manner as the reasonable compensation condition set forth in ERISA section 408(b)(2) and Code section 4975(d)(2). Accordingly, the exemption's reasonable compensation standard covers compensation received directly from the plan or IRA and indirect compensation received from any source other than the plan or IRA in connection with the recommended transaction.[57] In the case of a charge for an annuity or insurance contract that covers both the provision of services and the purchase of the guarantees and financial benefits provided under the contract, it is appropriate to consider the value of the guarantees and benefits in assessing the reasonableness of the arrangement, as well as the value of the services. When assessing the reasonableness of a charge, one generally needs to consider the value of all the services and benefits provided for the charge, not just some. If parties need additional guidance in this respect, they should refer to the Department's interpretations under ERISA section 408(b)(2) and Code section 4975(d)(2) and the Department will provide additional guidance if necessary.

A commenter urged the Department to provide that compensation received by an Affiliate or Related Entity would not have to be considered in applying the reasonable compensation standard. According to the commenter, including such compensation in the assessment of reasonable compensation would place Proprietary Products at a disadvantage. The Department disagrees with the proposition that a Proprietary Product would be disadvantaged merely because more of the compensation goes to affiliated parties than in the case of competing products, which allocate more of the compensation to non-affiliated parties. The availability of this Best Interest Contract Exemption, however, does not turn on how compensation is allocated between affiliates and non-affiliates. Certainly, the Department would not expect that a Proprietary Product would be at a disadvantage in the marketplace because it carefully ensures that the associated compensation is reasonable. As part of this exemption, the Department has provided specific provisions describing how Proprietary Products can meet the Best Interest standard. Assuming the Best Interest standard is satisfied and the compensation is reasonable, the exemption should not impede the recommendation of proprietary products. Accordingly, the Department disagrees with the commenter. The Department declines suggestions to provide specific examples of ''reasonable'' amounts or specific safe harbors. Ultimately, the ''reasonable compensation'' standard is a market based standard. As noted above, the standard incorporates the familiar ERISA section 408(b)(2) and Code section 4975(d)(2) standards. The Department is unwilling to condone all ''customary'' compensation arrangements and declines to adopt a standard that turns on whether the agreement is ''customary.'' For example, it may in some instances be ''customary'' to charge customers fees that are not transparent or that bear little relationship to the value of the services actually rendered, but that does not make the charges reasonable. Finally, the Department notes that all recommendations are subject to the overarching Best Interest standard, which incorporates the fundamental fiduciary obligations of prudence and loyalty. An imprudent recommendation for an investor to overpay for an investment transaction would violate that standard, regardless of whether the overpayment was attributable to compensation for services, a charge for benefits or guarantees, or something else.

c. Misleading Statements

The final Impartial Conduct Standard, set forth in Section II(c)(3), requires that statements by the Financial Institution and its Advisers 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, may not be materially misleading at the time they are made. In response to commenters, the Department adjusted the text to clarify that the standard is measured at the time of the representations, *i.e.*, the statements must not be misleading ''at the time they are made.'' Similarly, the Department added a materiality standard in response to comments.

The Department did not accept certain other comments, however. One commenter requested that the Department add a qualifier providing that the standard is violated only if the statement was ''reasonably relied'' on by the Retirement Investor. The Department rejected the comment. The Department's aim is to ensure that Financial Institutions and Advisers uniformly adhere to the Impartial Conduct Standards, including the obligation to avoid materially misleading statements, when they give advice. Whether a Retirement Investor relied on a particular statement may be relevant to the question of damages in subsequent arbitration or court proceedings, but it is not and should not be relevant to the question of whether the advice fiduciary violated the exemption's standards in the first place. Moreover, inclusion of a ''reasonable reliance'' standard runs the risk of inviting boilerplate disclaimers of reliance in contracts and disclosure documents precisely so the Adviser can assert that any reliance is unreasonable.

One commenter asked the Department to require only that the Adviser ''reasonably believe'' the statements are not misleading. The Department is concerned that this standard too could undermine the protections of this condition, by requiring Retirement Investors or the Department to prove the Adviser's actual belief rather than focusing on whether the statement is objectively misleading. However, to address commenters' concerns about the risks of engaging in a prohibited transaction, as noted above, the Department has clarified that the standard is measured at the time of the representations and has added a materiality standard.

The Department believes that Retirement Investors are best served by statements and representations that are free from material misstatements. Financial Institutions and Advisers best avoid liability—and best promote the interests of Retirement Investors—by ensuring that accurate communications are a consistent standard in all their interactions with their customers.

A commenter suggested that the Department adopt FINRA's ''Frequently Asked Questions regarding Rule 2210'' in this connection.[58] FINRA's Rule 2210, Communications with the Public, sets forth a number of procedural rules and standards that are designed to,

[57] Such compensation includes, for example charges against the investment, such as commissions, sales loads, sales charges, redemption fees, surrender charges, exchange fees, account fees and purchase fees, as well as compensation included in operating expenses and other ongoing charges, such as wrap fees, mortality, and expense fees. For purposes of this exemption, the ''spread'' is not treated as compensation. A commenter described the ''spread,'' in the case of a fixed annuity, or the fixed component of a variable annuity, as the difference between the fixed return credited to the contract holder and the insurer's general account investment experience.

[58] *Currently available at http://www.finra.org/industry/finra-rule-2210-questions-and-answers.*

among other things, prevent broker-dealer communications from being misleading. The Department agrees that adherence to FINRA's standards can promote materially accurate communications, and certainly believes that Financial Institutions and Advisers should pay careful attention to such guidance documents. After review of the rule and FAQs, however, the Department declines to simply adopt FINRA's guidance, which addresses written communications, since the condition of the exemption is broader in this respect. In the Department's view, the meaning of the standard is clear, and is already part of a plan fiduciary's obligations under ERISA. If, however, issues arise in implementation of the exemption, the Department will consider requests for additional guidance.

d. Other Interpretive Issues

Some commenters asserted that some of the exemption's terms were too vague and would result in the exemption failing to meet the ''administratively feasible'' requirement under ERISA section 408(a) and Code section 4975(c)(2). The Department disagrees with these commenters' suggestion that ERISA section 408(a) and Code section 4975(c)(2) fail to be satisfied by this exemption's principles-based approach, or that the exemption's standards are unduly vague. It is worth repeating that the Impartial Conduct Standards are built on concepts that are longstanding and familiar in ERISA and the common law of trusts and agency. Far from requiring adherence to novel standards with no antecedents, the exemption primarily requires adherence to basic, well-established obligations of fair dealing and fiduciary conduct. Moreover, as discussed above, the exemption's reliance on these familiar fiduciary standards is precisely what enables the Department to apply the exemption to the wide variety of investment and compensation practices that characterize the market for retail retirement advice, rather than to a far narrower category of transactions subject to much more detailed and highly-proscriptive conditions.

This section is designed to provide specific interpretations and responses to a number of specific issues raised in connection with a number of the Impartial Conduct Standards. In response to commenters, the Department specifically notes that the Impartial Conduct Standards (either as proposed or finalized) are not properly interpreted to foreclose the recommendation of Proprietary Products. The Department has revised Section IV of the exemption, in particular, as discussed below, to specifically address the application of the Best Interest Standard in the context of Proprietary Products and products that generate Third Party Payments. As Section IV makes clear, the exemption is fully available to such recommendations, provided that the Financial Institutions and Advisers adhere to appropriate standards and implement specified safeguards.

The Impartial Conduct Standards also are not properly interpreted to foreclose the receipt of commissions or other transaction-based payments. To the contrary, a significant purpose of granting this exemption is to continue to permit such payments, as long as Financial Institutions and Advisers are willing to adhere to Best Interest standards. The discussion of the policies and procedures in Section II(d) provides guidance on satisfying the exemption while preserving differential payments structures. In particular, the Department confirms that the receipt of a commission on an annuity product does not result in a per se violation of any of the Impartial Conduct Standards, or warranties or other conditions of the exemption, even though such a commission may be greater than the commission on a mutual fund purchase of the same amount as long as the commission meets the requirement of ''reasonable compensation'' and other applicable conditions.

One commenter asked that the Department make an explicit statement that ''offering products on which there are varying opinions within the industry (*e.g.,* variable annuities) does not violate the best interest standard.'' In response, the Department notes that it has not specified that any particular investment product or category is illegal or per se imprudent, or otherwise violates the Best Interest standard in the exemption. This includes, but is not limited to, the recommendation of a variable annuity. Instead, each recommendation is measured by the Impartial Conduct Standards set forth in the exemption.

Finally, the Department notes that the exemption, and in particular the requirement to adhere to a Best Interest Standard, does not mandate an ongoing or long-term advisory relationship, but rather leaves the duration of the relationship to the parties. The terms of the contract (if applicable), along with other representations, agreements, or understandings between the Adviser, Financial Institution and Retirement Investor, will govern whether the relationship between the parties is ongoing or not. Additionally, compliance with the exemption's conditions is necessary only with respect to transactions that otherwise would constitute prohibited transactions under ERISA and the Code. The exemption does not purport to impose conditions on the management of investments held outside of plans or IRAs covered by ERISA and defined in the Code. Accordingly, the conditions in the exemption are mandatory only with respect to investments held by ERISA plans, IRAs and non-ERISA plans.

e. Contractual Representation Versus Exemption Condition

Commenters expressed a variety of views on whether violations of the Impartial Conduct Standards with respect to advice to Retirement Investors regarding IRAs and non-ERISA plans should result in loss of the exemption, violation of the contract, or both.[59] Some commenters objected to the incorporation of the Impartial Conduct Standards as contract terms, generally, on the basis that the requirement would contribute to litigation risk. Some commenters preferred that the Impartial Conduct Standards only be required as a condition of the exemption, and not give rise to contract claims.

Other commenters advocated for the opposite result, asserting that the Impartial Conduct Standards should be required for contractual promises only, and not treated as exemption conditions. These commenters asserted that the Impartial Conduct Standards are too vague and would result in uncertainty as to whether an excise tax under the Code, which is self-assessed, is owed. There were also suggestions to limit the contractual representation to the Best Interest standard alone. One commenter asserted that the reasonable compensation requirement and the obligation not to make misleading statements fall within a Best Interest standard, and do not need to be stated separately. There were also suggestions that the Impartial Conduct Standards not apply to ERISA plans because fiduciaries to these plans already are required to adhere to similar statutory fiduciary obligations. In these commenters' view, requiring these standards in an exemption is redundant and inappropriately increases the consequences of any fiduciary breach by imposing an excise tax.

In response to comments, the Department has revised the language of the Impartial Conduct Standards and provided interpretive guidance to

[59] Commenters also asserted that the Department did not have the authority to condition the exemption on the Impartial Conduct Standards. Comments on the Department's jurisdiction are discussed in a separate Section E. of this preamble.

alleviate the commenters' concerns about uncertainty and litigation risk. However, the Department has concluded that failure to adhere to the Impartial Conduct Standards should be both a violation of the contract (where required) and the exemption. Accordingly, the Department has not eliminated any of the conduct standards or, for IRAs and non-ERISA plans, restricted them just to conditions of the exemption. In the Department's view, all the Impartial Conduct Standards form the baseline standards that should be applicable to fiduciaries relying on the exemption; therefore, the Department has not accepted comments suggesting that the contract representation be limited to the Best Interest standard. Making all the Impartial Conduct Standards required contractual promises for dealings with IRAs and other non-ERISA plans creates the potential for contractual liability, incentivizes Financial Institutions to comply, and gives injured Retirement Investors a remedy if those Financial Institutions do not comply. This enforceability is critical to the safeguards afforded by the exemption.

As previously discussed, the Impartial Conduct Standards are not unduly vague or unknown, but rather track longstanding concepts in law and equity. In response to interpretive questions posed in the comments, the Department has provided a series of requested interpretations in the preceding preamble section. Also, the Department has simplified execution of the contract, streamlined disclosure, and made certain language changes, such as the revisions discussed above to the reasonable compensation standard, to address legitimate concerns.

Similarly, the Department has not accepted the comment that the Impartial Conduct Standards should apply only to IRAs and non-ERISA plans. One of the Department's goals is to ensure equal footing for all Retirement Investors. The SEC staff Dodd-Frank Study found that investors were frequently confused by the differing standards of care applicable to broker-dealers and registered investment advisers. The Department hopes to minimize such confusion in the market for retirement advice by holding Advisers and Financial Institutions to similar standards, regardless of whether they are giving the advice to an ERISA plan, IRA, or a non-ERISA plan.

Moreover, inclusion of the standards in the exemption's conditions adds an important additional safeguard for ERISA and IRA investors alike because the party engaging in a prohibited transaction has the burden of showing compliance with an applicable exemption, when violations are alleged.[60] In the Department's view, this burden-shifting is appropriate because of the dangers posed by conflicts of interest, as reflected in the Department's Regulatory Impact Analysis and because of the difficulties Retirement Investors have in effectively policing such violations.[61] One important way for Financial Institutions to ensure that they can meet this burden is by implementing strong anti-conflict policies and procedures, and by refraining from creating incentives to violate the Impartial Conduct Standards. Thus, treating the Impartial Conduct Standards as exemption conditions creates an important incentive for Financial Institutions to carefully monitor and oversee their Advisers' conduct for adherence with fiduciary norms.

Moreover, as noted repeatedly, the language for the Impartial Conduct Standards borrows heavily from ERISA and the law of trusts, providing sufficient clarity to alleviate the commenters' concerns. Ensuring that fiduciary investment advisers adhere to the Impartial Conduct Standards and that all Retirement Investors have an effective legal mechanism to enforce the standards are central goals of this regulatory project.

5. Sales Incentives and Anti-Conflict Policies and Procedures—Section II(d)

Under Section II(d) of the exemption, the Financial Institution is required to adopt and comply with certain anti-conflict policies and procedures and to insulate Advisers from incentives to violate the Best Interest standard. In order for relief to be available under the exemption, a Financial Institution that meets the definition set forth in the exemption must provide oversight of Advisers' recommendations, as described in this section.

The Financial Institution must prepare a written document describing the Financial Institution's policies and procedures and make copies of the document readily available to Retirement Investors, free of charge, upon request as well as on the Financial Institution's Web site.[62] The written description must accurately describe or summarize key components of the policies and procedures relating to conflict-mitigation and incentive practices in a manner that permits Retirement Investors to make an informed judgment about the stringency of the Financial Institution's protections against conflicts of interest. The Department opted against requiring disclosure of the full policies and procedures to Retirement Investors to avoid giving them a potentially overwhelming amount of information that could run contrary to its purpose by alerting Advisers to the particular surveillance mechanisms employed by Financial Institutions. However, the exemption requires that the full policies and procedures must be made available to the Department upon request.

The policies and procedures obligations have several important components. First, the Financial Institution must adopt and comply with written policies and procedures reasonably and prudently designed to ensure that its Advisers adhere to the Impartial Conduct Standards set forth in Section II(c). Second, the Financial Institution in formulating its policies and procedures, must specifically identify and document its Material Conflicts of Interest; adopt measures reasonably and prudently designed to prevent Material Conflicts of Interest from causing violations of the Impartial Conduct Standards set forth in Section II(c); and designate a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards. For purposes of the exemption, a Material Conflict of Interest exists when an Adviser or Financial Institution has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor.

Finally, the Financial Institution's policies and procedures must require that neither the Financial Institution nor (to the best of its knowledge) its Affiliates or Related Entities use or rely on 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 Advisers to make recommendations that are not in the Best Interest of the Retirement Investor.

In this respect, however, the exemption makes clear that that requirement does not prevent the Financial Institution or its Affiliates, or Related Entities from providing Advisers with differential compensation (whether in type or amount, and including, but not limited to, commissions) based on investment

[60] *See e.g., Fish* v. *GreatBanc Trust Company,* 749 F.3d 671 (7th Cir. 2014).

[61] *See* Regulatory Impact Analysis.

[62] *See* Section III(b)(1)(iv) of the exemption.

decisions by plans, participant or beneficiary accounts, or IRAs, to the extent that the Financial Institution's policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of Advisers with the interests of the Retirement Investors they serve as fiduciaries.

The anti-conflict policies and procedures will safeguard the interests of Retirement Investors by causing Financial Institutions to consider the conflicts of interest affecting the provision of advice to Retirement Investors and to take action to mitigate the impact of such conflicts. In particular, under the final exemption, Financial Institutions must not use compensation and other employment incentives to the extent they are intended to or would reasonably be expected to cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. Financial Institutions must also establish a supervisory structure reasonably and prudently designed to ensure the Advisers will adhere to the Impartial Conduct Standards. This includes consideration of the incentives of branch managers and supervisors and their potential effect on Advisers' recommendations. Mitigating conflicts of interest by requiring greater alignment of the interests of the Adviser and Financial Institution, and the Retirement Investor, is necessary for the Department to make the findings under ERISA section 408(a) and Code section 4975(c)(2) that the exemption is in the interests of, and protective of, Retirement Investors. This warranty gives the Financial Institution a powerful incentive to ensure advice is provided in accordance with fiduciary norms, rather than risk litigation, including class litigation and liability.

Like the proposal, the final exemption does not specify the precise content of the anti-conflict policies and procedures, but rather sets out the overarching standards for assessing their adequacy. This flexibility is intended to allow Financial Institutions to develop policies and procedures that are effective for their particular business models, while prudently ensuring compliance with their and their Advisers' fiduciary obligations and the Impartial Conduct Standards. The policies and procedures requirement, if taken seriously, can also reduce Financial Institutions' litigation risk by minimizing incentives for Advisers to provide advice that is not in Retirement Investors' Best Interest.

As adopted in the final exemption, the policies and procedures requirement is a condition of the exemption for all Retirement Investors—in ERISA plans, IRAs and non-ERISA plans. Failure to comply could result in liability under ERISA for engaging in a prohibited transaction and the imposition of an excise tax under the Code, payable to the Treasury. Additionally, with respect to Retirement Investors in IRAs and non-ERISA plans, the requirement takes the form of a contractual warranty. The Financial Institution must warrant that it has adopted and will comply with the anti-conflict policies and procedures (including the obligation to avoid misaligned incentives). Failure to comply with the warranty could result in contractual liability.

Comments on the proposed policies and procedures requirement are discussed below.

a. Policies and Procedures Requirement Generally

Under the policies and procedures requirement, described in greater detail above, Financial Institutions must adopt and comply with anti-conflict policies and procedures. In addition, neither the Financial Institution nor (to the best of its knowledge) its Affiliates or Related Entities may use or rely on 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 Advisers to make recommendations that are not in the Best Interest of the Retirement Investor.

Some commenters were extremely supportive of the policies and procedures requirement as proposed. They expressed the view that the policies and procedures requirement, and in particular the restrictions on compensation and other employment incentives, was one of the most critical investor protections in the proposal because it would cause Financial Institutions to make specific and necessary changes to their compensation arrangements that would result in significant protections to Retirement Investors.

Some commenters believed the Department did not go far enough. These commenters indicated that flat compensation arrangements should be required, or at least that the rules applicable to differential compensation arrangements should be more specific and stringent. A few commenters also indicated that, in addition to focusing on the Adviser, the Financial Institution's policies and procedures need to consider the impact of compensation practices on branch managers. A commenter indicated that branch managers have responsibilities under FINRA's supervisory rules to ensure suitability and possibly approve individual transactions. The commenter asserted that branch managers financially benefit from Advisers' recommendations and have a variety of methods of influencing Adviser behavior.

Many others objected to the policies and procedures warranty, and requested that it be eliminated in the final exemption. Some commenters believed that compliance would require drastic changes to current compensation arrangements or could possibly result in the complete prohibition of commissions and other transaction-based compensation. Other commenters suggested that the requirement should be eliminated as it would be unnecessary in light of the exemption's Best Interest standard, and because it would unnecessarily increase litigation risk to Financial Institutions. Alternatively, there were requests to clarify specific provisions and provide safe harbors in the policies and procedures requirement.

In the final exemption, the Department has retained the general approach of the proposal. The Department concurs with commenters who view the policies and procedures requirement as an important safeguard for Retirement Investors, and as a necessary condition for the Department to make the findings under ERISA section 408(a) and Code section 4975(c)(2) that the exemption is in the interests of, and protective of, Retirement Investors. This provision will require Financial Institutions to take concrete and specific steps to ensure that its individual Advisers adhere to the Impartial Conduct Standards, and in particular, forego compensation practices and employment incentives (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 Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. Strong policies and procedures reduce the temptation (conscious or unconscious) to violate the Best Interest standard in the first place by ensuring that the Advisers' incentives are appropriately aligned with the interests of the customers they serve, and by ensuring appropriate monitoring and supervision of individual Advisers' conduct. While the Department views the Best Interest standard as critical to the protections of the exemption, the policies and procedures requirement is equally critical as a means of supporting Best Interest advice and protecting Retirement Investors from having to enforce the Best Interest standard after the advice has already been rendered and the damage done.

The Department has not made the requirements more stringent, as suggested by some commenters, so as to require completely level compensation. Different payments for different classes of investments may be appropriate based on differences in the time and expertise necessary to recommend them. Similarly, transaction-based compensation can be more cost effective for some investors who do not trade frequently. The exemption was designed to preserve commissions and other transaction-based compensation structures, thereby allowing Retirement Investors to choose the payment structure that works best for them.

In response to commenters who expressed the view that the exemption did not provide a clear path for the payment of differential compensation, the Department has elaborated below on its example of policies and procedures and compensation practices that could satisfy the requirement. In addition, the examples address branch manager incentives.

The Department also adopted the suggestion of one commenter that the exemption require the Financial Institution to designate a specific person to address Material Conflicts of Interest and monitor Advisers' adherence to the Impartial Conduct Standards.[63] In the proposal, the Department had already suggested that Financial Institutions consider this approach; however, the commenter suggested that it should be a specific requirement and indicated that most Financial Institutions already have a designated compliance officer. The Department concurs with the commenter and has included that requirement in the final exemption, based on the view that formalizing the process for identifying and monitoring these issues will result in increased protections to Retirement Investors.

b. Specific Language of Policies and Procedures Requirement

There were also questions and comments on the specific language of the proposed policies and procedures requirement. As proposed, the components of the policies and procedures requirement read as follows:

- The Financial Institution has adopted written policies and procedures reasonably designed to mitigate the impact of Material Conflicts of Interest and ensure that its individual Advisers adhere to the Impartial Conduct Standards set forth in Section II(c);
- In formulating its policies and procedures, the Financial Institution has specifically identified Material Conflicts of Interest and adopted measures to prevent the Material Conflicts of Interest from causing violations of the Impartial Conduct Standards set forth in Section II(c); and
- Neither the Financial Institution nor (to the best of its knowledge) any Affiliate or Related Entity uses quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives to the extent they would tend to encourage individual Advisers to make recommendations that are not in the Best Interest of the Retirement Investor.

A few commenters asked the Department to explain the difference between the first and second prongs of the policies and procedures requirement, as proposed. In response, the first prong of the requirement was intended to establish a general standard, while the second (and third) prongs provided specific rules regarding the policies and procedures requirement. This approach was also adopted in the final exemption. In addition, the language of Section II(d)(3) specifically provides that the third prong of the requirement, requiring Financial Institutions to insulate Advisers from incentives to violate the Best Interest standard, is part of the policies and procedures requirement.

There were also comments on (i) the definition and use of the term "Material Conflicts of Interest;" (ii) the language requiring the policies and procedures to be "reasonably designed" to mitigate the impact of such conflicts of interest, and (iii) the meaning of incentives that "tend to encourage" individual Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. In addition, comments from the insurance industry requested guidance on certain industry practices regarding employee benefits for statutory employees. These comments are discussed below.

i. Materiality

A number of commenters focused on the definition of Material Conflict of Interest used in the proposal. Under the definition as proposed, a Material Conflict of Interest exists when an Adviser or Financial Institution "has a financial interest that could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor." Some commenters took the position that the proposal did not adequately explain the term "material" or incorporate a "materiality" standard into the definition. A commenter wrote that the proposed definition was so broad that it would be difficult for Financial Institutions to comply with the various aspects of the exemption related to Material Conflicts of Interest, such as provisions requiring disclosures of Material Conflicts of Interest.

Another commenter indicated that the Department should not use the term "material" in defining conflicts of interest. The commenter believed that it could result in a standard that was too subjective from the perspective of the Adviser and Financial Institution, and could undermine the protectiveness of the exemption.

After consideration of the comments, the Department adjusted the definition of Material Conflict of Interest. In the final exemption, a Material Conflict of Interest exists when an Adviser or Financial Institution has a "financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor." This language responds to concerns about the breadth and potential subjectivity of the standard. The Department did not, as some commenters suggested, include the word "material" in the definition of Material Conflict of Interest, to avoid the potential circularity of that approach.

ii. "Reasonably Designed"

One commenter asked that the Department more broadly use the modifier "reasonably designed" in describing the standard the policies and procedures must meet so as to avoid a construction that required standards that ensured perfect compliance, a potentially unattainable standard. The Department has accepted the comment and adjusted the language in Sections II(d)(1) and (2) to generally use the phrase "reasonably and prudently designed." Other commenters asked for guidance on the proposed phrasing "reasonably designed to mitigate" the impact of Material Conflicts of Interest.

[63] One important consideration in addressing conflicts of interest is the Financial Institution's attentiveness to the qualifications and disciplinary history of the persons it employs to provide such advice. *See* Egan, Mark, Gregor Matvos and Amit Seru, *The Market for Financial Adviser Misconduct*, at 3 (February 26, 2016) ("Past offenders are five times more likely to engage in misconduct than the average adviser, even compared with other advisers in the same firm at the same point in time. The large presence of repeat offenders suggests that consumers could avoid a substantial amount of misconduct by avoiding advisers with misconduct records.").

The Department provides additional guidance in this respect in this preamble, which gives examples of some possible approaches to policies and procedures.

iii. "Tend to Encourage"

A number of commenters asked for clarification or revision of the proposed exemption's prohibition of incentives that "tend to encourage" violation of the Best Interest standard, generally to require a tight link between the incentives and the Advisers' recommendations. Commenters argued that the "tend to encourage" language established a standard that could be impossible to meet in the context of differential compensation. Accordingly, they requested that the Department use language such as "intended to encourage," "does encourage" "causes," or similar formulations.

In response to these commenters the Department has adjusted the condition's language as follows:

The Financial Institution's policies and procedures require that neither the Financial Institution nor (to the best of its knowledge) any Affiliate or Related Entity use or rely on 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 Advisers to make recommendations that are not in the Best Interest of the Retirement Investor (emphasis added).

This language more accurately captures the Department's intent, which was to require that procedures reasonably address Advisers' incentives, not guarantee perfection. The Department disagrees, however, with the suggestion that Financial Institutions should be permitted to tolerate or create incentives that would "reasonably be expected to cause such violations" unless the Retirement Investor can actually prove the Financial Institution's intent to cause violations of the standard or the Adviser's improper motivation in making the recommendation. The aim of the policies and procedures requirement is to require the Financial Institution to take prophylactic measures to ensure that Retirement Advisers adhere to the Impartial Conduct Standards, a goal completely at odds with the creation of incentives to violate the Best Interest Standard. In exchange for its continuing receipt of compensation that would otherwise be prohibited by ERISA and the Code, the Financial Institution's responsibility under the exemption is to protect Retirement Investors from conflicts of interest, not to promote or continue to offer incentives to violate the Best Interest standard. Moreover, absent extensive discovery or the ability to prove the motivations of individual Advisers, Retirement Investors would generally be in a poor position to prove such ill intent.

Similar adjustments were made to the language of the proposal that provided that the policies and procedures requirement does not:

[P]revent the Financial Institution or its Affiliates and Related Entities from providing Advisers with differential compensation based on investments by Plans, participant or beneficiary accounts, or IRAs, *to the extent such compensation would not encourage advice that runs counter to the Best Interest of the Retirement Investor (e.g., differential compensation based on such neutral factors as the difference in time and analysis necessary to provide prudent advice with respect to different types of investments would be permissible).*

Accordingly, in this final exemption, the language now provides that the policies and procedures requirement does not:

[P]revent the Financial Institution or its Affiliates or Related Entities from providing Advisers with differential compensation *(whether in type or amount, and including, but not limited to, commissions)* based on investment decisions by Plans, participant or beneficiary accounts, or IRAs, *to the extent that the Financial Institution's policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of Advisers with the interests of the Retirement Investors they serve as fiduciaries (such compensation practices can include differential compensation paid based on neutral factors tied to the differences in the services delivered to the investor with respect to the different types of investments, as opposed to the differences in the amounts of Third Party Payments the Financial Institution Receives in connection with particular investment recommendations).*

This language is designed to make clear that differential compensation is permitted but only if the Financial Institution's policies and procedures, as a whole are reasonably designed to avoid a misalignment of interests between Advisers and Retirement Investors. As discussed in greater detail below, the Financial Institution's payment of differential compensation should be based only on neutral factors.

iv. Insurance Company Statutory Employees

A number of commenters from the insurance industry asked for clarification or revision of the policies and procedures provision as applicable to statutory employees of insurance companies. Insurance companies explained that they often rely on the statutory employee rules of the Internal Revenue Code, specifically Code section 3121 and the regulations thereunder. Under these rules, an independent contractor is treated as a full-time employee if that individual "is devoted to the solicitation of life insurance or annuity contracts, or both, primarily for one life insurance company."[64] Insurance companies indicated that they often look at an agent's sales of Proprietary Products to determine whether the agent is acting primarily for one company, which in turn determines whether the agent is eligible for certain tax-qualified employee benefits, such as health insurance and access to retirement plans. Insurance companies were concerned that these benefits would be considered impermissible incentives under the Best Interest Contract Exemption.

These commenters requested clarification that the provision of employee benefits based on status as a statutory employee under the Internal Revenue Code (which, as explained, may involve evaluation of the amount of Proprietary Products sold) would not violate the exemption, and in particular, the policies and procedures requirement. The Department did not intend the exemption to effectively prohibit the receipt of these benefits. Accordingly, the Department confirms that the receipt by an Adviser who is an insurance agent of reasonable and customary deferred compensation or subsidized health or pension benefit arrangements such as typically provided to an "employee" as defined in Code section 3121(d)(3) does not, in and of itself, violate the policies and procedures requirement or the Impartial Conduct Standards. However, consistent with the standard, such Financial Institutions must ensure that their policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of Advisers with the interests of the Retirement Investors they serve as fiduciaries. In the Department's view, the satisfaction of the requirement involves an evaluation of the relevant facts and circumstances.

c. Substance of the Policies and Procedures Requirement

Under the exemption, a Financial Institution must have policies and procedures in place that are reasonably and prudently designed to ensure compliance with the Impartial Conduct Standards, and the Financial Institution is prohibited from relying on incentive structures that are intended or would

[64] 26 CFR 31.3121(d)–1(d)(3)(ii).

reasonably be expected to cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. Consistent with the general approach outlined in the proposal, the exemption does not mandate level fees or require any particular compensation or employment structure, as long as the Financial Institution complies with these overarching standards. Certainly, one approach to satisfying the exemption's requirements would be to adopt a compensation structure, in which Advisers' compensation does not vary based on the Adviser's particular investment recommendation. Under this approach, even if the Financial Institution received varying payments for different investment recommendations, individual Advisers could, for example, be compensated by a salary or on an hourly basis. The exemption is not limited to this one approach, however. Instead, it permits a wide range of practices, subject to the overarching obligation to comply with the Impartial Conduct Standards and to avoid misaligned incentives that are intended or could reasonably be expected to cause violations of the Best Interest standard.

Despite the Department's intent to permit a variety of commission and compensation structures many commenters questioned how a compensation structure that permitted differential compensation could be in compliance with the exemption's standards as proposed. For example, insurance industry commenters questioned whether Advisers could continue to receive different (typically higher) commissions for annuity contracts than for comparable mutual funds, which do not have an insurance component. The exemption was not intended to bar commissions or all forms of differential compensation. Accordingly, the Department has specifically revised the exemption's text to make clear that differential compensation is permissible, and has changed the prohibition on incentive structures that would "tend to encourage" violations of the Best Interest Standard to a prohibition on incentive structures "intended" or "reasonably expected" to cause such violations.

Thus, the final exemption specifically states that differential compensation is permissible, subject to policies and procedures "reasonably and prudently designed to prevent Material Conflicts of Interest from causing violations of the Impartial Conduct Standards," and subject to the requirement that the differentials are not "intended" and would not "reasonably be expected to cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. Compensation structures should be prudently designed to avoid a misalignment if the interests of Advisers and the Retirement Investors they serve, but may nevertheless provide for differential compensation. The exemption's goal is not to wring out every potential conflict, no matter how slight, but rather to ensure that Financial Institutions and Advisers put Retirement Investors' interests first, take care to minimize incentives to act contrary to investors' interests, and carefully police those conflicts that remain. Within this best interest framework, the exemption is designed to preserve commissions and other transaction-based compensation structures, thereby allowing Retirement Investors to choose the payment structure that works best for them.

The Department intends that Financial Institutions will identify Material Conflicts of Interest applicable to its and its Advisers' provision of investment advice and reasonably and prudently design policies and procedures to prevent those particular conflicts from causing violations of the Impartial Conduct Standards. The extent and contours of the policies and procedures will depend on the type of and pervasiveness of the conflicts in the Financial Institution's business. If, for example, the chief conflict of interest is a discrete conflict associated with advice on the rollover or distribution of plan assets, the Financial Institution's policies and procedures should focus on that conflict. In that context, the Financial Institution would exercise special care to ensure that the Adviser gives sufficient weight to consideration and documentation of any factors supporting leaving the investments in the plan, and not just any benefits of taking the distribution, which would generate fees for the Financial Institution and Adviser. On the other hand, a Financial Institution that compensates Advisers through a wide variety of commissions and other transaction-based payments and incentives would need to exercise great care in designing and policing the differential compensation structure. For example, the Financial Institution should give special attention to ensuring that supervisory mechanisms and procedures protect investors from recommendations to make excessive trades, or to buy investment products, annuities, or riders that are not in the customer's best interest or that tie up too much of the customer's wealth in illiquid or risky investments. In general, Financial Institutions should carefully focus on the particular aspects of their business model that potentially create misaligned incentives.

Accordingly, a Financial Institution could retain a structure in which Advisers receive differential compensation for different categories of investments, but are subject to policies and procedures that safeguard against the conflicts caused by the differential categories. For example, in many circumstances, it may require more time to explain the features of a complex annuity product than a relatively simpler mutual fund investment. Based on such neutral considerations, the Financial Institution's policies and procedures could permit the payment of greater commissions in connection with annuity sales, subject to appropriate controls and oversights as described below, including that the neutral factors be neutral in operation as well as selection. Differential compensation between categories of investments could be permissible as long as the compensation structure and lines between categories were drawn based on neutral factors that were not tied to the Financial Institution's own conflicts of interest, such as the time or complexity of the advisory work, rather than on promoting sales of the most lucrative products. In such cases, the policies and procedures would focus with particular care on adopting supervisory and monitoring mechanisms to police adviser's recommendations as they relate to investment products in differential categories, but the exemption would not prohibit the differentials. The Department also expects that Advisers and Financial Institutions providing advice will exercise special care when assets are hard to value, illiquid, complex, or particularly risky. Financial Institutions responsible for overseeing recommendations of these investments must give special attention to the policies and procedures surrounding such investments and their oversight of Advisers' recommendations.

As noted above, Financial Institutions also must pay attention to the incentives of branch managers and supervisors, and how the incentives potentially impact Adviser recommendations. Certainly, Financial Institutions must not provide incentives to branch managers or other supervisors that are intended to, or would reasonably be expected to cause such entities, in turn, to incentivize Advisers to make recommendations that do not meet the Best Interest standard. Financial

Institutions, therefore, should not compensate branch managers and other supervisors, or award bonuses or trips to such entities based on sales of certain investments, if such awards could not be made directly to Advisers under the standards set forth in the exemption. But even in the absence of such incentives, the standards of reasonableness and prudence set forth in the policies and procedures condition require the Financial Institution to affirmatively oversee the incentives that may be placed on Advisers by such entities to ensure that they do not undermine the protections of the exemption.

i. Examples

The examples set forth below are intended to illustrate some possible approaches that Financial Institutions could take to managing Adviser incentives. They are not intended to provide detailed descriptions of all the attributes of strong and effective policies and procedures, but rather to describe broad approaches to mitigating conflicts of interest. The examples are not intended to be an exhaustive list of permissible approaches or mutually exclusive, and range from examples that focus on eliminating or nearly eliminating compensation differentials to examples that permit, but police, the differentials. Moreover, these examples and the policies and procedures are not intended as mere ''check the box'' exercises, but rather must involve the adoption and monitoring of meaningful policies and procedures reasonably and prudently designed to ensure Advisers' adherence to the Impartial Conduct Standards. While the examples are intended to provide guidance regarding the design of policies and procedures, whether a specific set of policies and procedures is sufficient will depend on the specific facts and circumstances.

The preamble to the proposed exemption also included a series of examples. A number of commenters requested additional specificity, more examples and safe harbors with respect to the policies and procedures requirement. A few commenters made specific suggestions for safe harbors or additional examples. For example, one commenter suggested that compliance with policies and procedures requirements under existing securities laws should suffice. Another suggested a series of components of a safe harbor approach, based on controls and parameters to limit conflicts of interest (including a potential cap on fees for different product types) and other supervisory oversight. Another offered an example under which the Financial Institution would permit Advisers to receive either a commission that generally did not exceed the average commission for similar products, or asset-based compensation, but not both, with respect to any investment product, with additional limitations and requirements. Another offered an example focused on compliance with the terms of the exemption, but did not offer any specific provisions addressing compensation and other employment incentives.

The Department considered all the requests for additional examples and safe harbors. The Department views commenters' suggestions as outlining useful components of a Financial Institution's policies and procedures. However, the Department views the limitations on compensation and other employments incentives as a critical aspect of a Financial Institution's policies and procedures, and the examples offered by commenters generally did not demonstrate, in and of themselves, sufficient mitigation of Adviser-level conflicts of interest. Therefore, the Department did not adopt them as additional examples or safe harbors.

To the extent Financial Institutions decide they need additional guidance as to the adequacy of their policies and procedures as they move forward with implementation of the exemption's requirements, the Department is available to provide guidance on particular approaches. Each of the examples below assumes that the Financial Institution otherwise complies with all of the exemption's requirements; ensures that any compensation paid to the Firm and the Adviser (whether directly by the investor or indirectly by third parties) is reasonable in relation to the services delivered to the investor; and that it carefully supervises and oversees its Advisers' compliance with the Impartial Conduct Standards, disclosure obligations, and other requirements of the exemption.

Example 1: Independently certified computer models. The Adviser interacts directly with the Retirement Investor, but makes investment recommendations in accordance with an unbiased computer model created by an independent third party. Under this example, the Adviser could receive any form or amount of compensation so long as the advice is rendered in strict accordance with the model.[65]

Example 2: Asset-based compensation. The Financial Institution accepts differential compensation but pays the Adviser a percentage, which does not vary based on the types of investments, of the dollar amount of assets invested by the plans, participant and beneficiary accounts, and IRAs with the Adviser. The Adviser earns the same percentage on the same payment schedule, regardless of how the Retirement Investor's assets are allocated between different investments (*e.g.,* equity securities, proprietary mutual funds, and bonds underwritten by non-Related Entities), and the Financial Institution gives particular attention to recommendations that increase the Adviser's base (*e.g.,* advice to roll money out of a plan into IRA investments that generate fees for the Adviser).

Example 3: Fee offset. The Financial Institution establishes a fee schedule for its services and the services of its Advisers. The fees are competitive and reasonable in relation to the services provided to the Retirement Investor and are not themselves intended to nor would they reasonably be expected to cause Advisers to violate the Impartial Conduct Standards. The Financial Institution accepts transaction-based payments directly from the plan, participant or beneficiary account, or IRA, and/or from third party investment providers. To the extent the payments from third party investment providers exceed the established fee, the additional amounts are rebated to the plan, participant or beneficiary account, or IRA. To the extent Third Party Payments do not satisfy the established fee, the plan, participant or beneficiary account, or IRA is charged directly for the remaining amount due.[66] Regardless of the investment chosen, the Financial Institution and the Adviser retain only the compensation set forth in the fee schedule, which is not in excess of reasonable compensation.

Example 4: Commissions and stringent supervisory structure.[67] The Financial

[65] As previously noted, this exemption is not available for advice generated solely by a computer model and provided to the Retirement Investor electronically without live advice. Nevertheless, this exemption remains available in the hypothetical because the advice is delivered by a live Adviser. This example should not be read as retracting views the Department expressed in prior Advisory Opinions regarding how an investment advice fiduciary could avoid prohibited transactions that might result from differential compensation arrangements. Specifically, in Advisory Opinion 2001–09A, the Department concluded that the provision of fiduciary investment advice would not result in prohibited transactions under circumstances where the advice provided by the fiduciary is the result of the application of methodologies developed, maintained and overseen by a party independent of the fiduciary in accordance with the conditions set forth in the Advisory Opinion. A computer model also can be used as part of an advice arrangement that satisfies the conditions under the prohibited transaction exemption in ERISA section 408(b)(14) and (g), described above.

[66] Certain types of fee-offset arrangements may result in avoidance of prohibited transactions altogether. In Advisory Opinion Nos. 97–15A and 2005–10A, the Department explained that a fiduciary investment adviser could provide investment advice to a plan with respect to investment funds that pay it or an affiliate additional fees without engaging in a prohibited transaction if those fees are offset against fees that the plan otherwise is obligated to pay to the fiduciary.

[67] All three of the examples above could be used in connection with commission-based payment

Institution establishes a commission-based compensation schedule for Advisers in which all variation in commissions is eliminated for recommendations of investments within reasonably designed categories.[68] The Financial Institution establishes supervisory mechanisms to protect against conflicts of interest created by the transaction-based model and takes special care to ensure that any differentials that are retained are based on neutral factors, such as the time or complexity of the work involved, and that the differentials do not incentivize Advisers to violate the Impartial Conduct Standards or operate to transmit firm-level conflicts of interest to the Adviser (*e.g.,* by increasing compensation based on how much revenue or profits the investment products generate for the Financial Institution).[69] Accordingly, the Financial Institution does not provide an incentive for the Adviser to recommend one mutual fund over another, or to recommend one category of investments over another, based on the greater compensation the Financial Institution would receive. But it might, for example, draw a distinction between variable annuities and mutual funds based on the additional time it has determined is necessary for client communications and oversight with respect to these annuities. The Financial Institution adopts a stringent supervisory structure to ensure that Advisers' recommendations are based on the customer's financial interest, and not on the additional compensation the Adviser stands to make by recommending, for example, more frequent transactions or products for which greater compensation is provided. Examples of components of a prudent supervisory structure include:

• Establishment of a comprehensive system to monitor and supervise Adviser recommendations, evaluate the quality of the advice individual customers receive, properly train Advisers, and correct any identified problems. Particular attention is given to recommendations associated with higher compensation and recommendations at key liquidity events of an investor (*e.g.,* rollovers).

• Systems to evaluate whether Advisers recommend imprudent reliance on investment products sold by or through the Financial Institution. If the conditions of section IV(b)(3) of the exemption apply (relating to Proprietary Products and Third Party Payments), systems to assess the validity of any assumptions underlying the required written determination and mechanisms to ensure that Advisers provide advice consistent with the analysis, with particular attention to any assumptions or conclusions about how much money a prudent investor would invest in particular classes of products or products with certain features.

• The use of metrics for behavior (*e.g.,* red flags), comparing an Adviser's behavior against those metrics, and basing compensation in part on them. These metrics include measures aimed at preventing conflicts from transaction-based fees from biasing advice (*e.g.,* churning measures).

• Penalizing Advisers and supervisors (including the branch manager) by reducing compensation based on the receipt of customer complaints or indications that conflicts are not being carefully managed, and/or using clawback provisions to revoke some or all of deferred compensation based on the failure to properly manage conflicts of interest.

• Appointment of a committee to assess the risks and conflicts associated with new investment products, determine the prudence of the products for retirement investors, and assess the adequacy of the Financial Institution's procedures to police any associated conflicts of interest.

• Ensuring that no Adviser nor any supervisor (including the branch manager) participates in any revenue sharing from a ''preferred provider,'' earns more for the sale of a product issued by a ''preferred provider,'' or earns more for the sale of a Proprietary Product over other comparable products, and ensuring that the Adviser discloses to customers the payments that the Financial Institution and its Affiliates have received from a preferred provider or for a Proprietary Product.

• The Financial Institution periodically reviews, and revises as necessary, the policies and procedures to ensure that they are appropriately safeguarding proper fiduciary conduct, and that the factors used to justify any compensation differentials (*e.g.,* time) remain appropriate, that they reflect neutral factors tied to differences in the services delivered to the investor (as opposed to differences in the amounts paid to the Financial Institution by different mutual fund complexes), and that they are neutral in application as well as selection. In this regard, the Financial Institution needs to take special care in defining the categories to ensure that they reflect the application of such neutral factors to genuine differences in the nature of the advice relationship.

Example 5: Rewards for Best Interest Advice. The Financial Institution's policies and procedures establish a compensation structure that is reasonably designed to reward Advisers for giving advice that adheres to the Impartial Conduct Standards. For example, this might include compensation that is primarily asset-based, as discussed in Example 2, with the addition of bonuses and other incentives paid to promote advice that is in the Best Interest of the Retirement Investor. While the compensation would be variable, it would align with the customer's best interest.

As indicated above, these examples are meant to be illustrative, not exhaustive, and many other compensation and employment arrangements may satisfy the contractual warranties. The exemption imposes a broad standard for the warranty and policies and procedures requirement, not an inflexible and highly-prescriptive set of rules. The Financial Institution retains the latitude necessary to design its compensation and employment arrangements, provided that those arrangements promote, rather than undermine, the Best Interest and other Impartial Conduct Standards. Whether a Financial Institution adopts one of the specific approaches taken in the examples above or a different approach, the Department expects that it will engage in a prudent process to establish and oversee policies and procedures that will effectively mitigate conflicts of interest and ensure adherence to the Impartial Conduct Standards. It is important that the Financial Institution carefully monitor whether the policies and procedures are, in fact, working to prevent the provision of biased advice. The Financial Institution must correct isolated or systemic violations of the Impartial Conduct Standards and reasonably revise policies and procedures when failures are identified.

ii. Neutral Factors

A number of commenters addressed Example 4 in the preamble to the proposed exemption, which, like Example 4 above, illustrated a compensation structure for differential payments, such as commissions. In the proposal the example suggested a model permitting payment of differential compensation based on neutral factors, such as ''a reasonable assessment of the time and expertise necessary to provide prudent advice on the product or other reasonable and objective neutral factors.'' [70]

Some commenters expressed significant support for this approach and urged the Department to clearly limit the receipt of differential compensation in the final exemption to differential compensation based only on neutral factors. A commenter stated that a limitation to differential compensation based on neutral factors would be a significant improvement over the status quo. Other commenters indicated the

structures, as well as in connection with other compensation arrangements.

[68] As noted in the text, none of these examples are meant to be exclusive. For example, the exemption might also be satisfied if a Financial Institution adopted an arrangement under which Advisers are compensated by commissions with no variation at all, regardless of the category of investment.

[69] FINRA's ''Report on Conflicts of Interest'' (Oct. 2013) suggested that firms could use 'neutral compensation grids.' In constructing such grids, however, the firm would need to be careful to ensure that it was not simply transmitting firm-level conflicts to the Adviser by tying the Adviser's compensation directly to the profitability of a recommendation to the firm. Under the terms of this exemption, the firm may not use compensation practices that a reasonable person would view as encouraging persons to violate the best interest standard by, for example, favoring the firm's financial interest at the customers' expense.

[70] *See* Preamble to the proposed Best Interest Contract Exemption, 80 FR at 21971 (April 20, 2015).

view that differential compensation based on non-neutral factors would be likely to encourage advice that is not in Retirement Investors' Best Interest. Some of these commenters urged that the exemption explicitly prohibit differential compensation based on non-neutral factors, and that the Department make clear that the neutral factors had to be based on empirical assessments so as to ensure that the exemption afforded the desired protections to Retirement Investors.

Some industry commenters took issue with the neutral factors example. FINRA and other commenters asserted that while the exemption applied to differential compensation such as trailing commissions, 12b-1 fees and revenue sharing, it would not be easy for Financial Institutions to demonstrate that such payments are based on neutral factors. Commenters expressed the view that the example appeared to establish a subjective standard that could expose them to class action litigation, and there were requests for more certainty or a safe harbor regarding the compliance with the exemption for differential compensation. One commenter stated that prices are established by third party product manufacturers and the neutral factors analysis would require a complete overhaul of existing practices. The commenter indicated there might be antitrust concerns with such an approach. FINRA further suggested that the proposal permit Financial Institutions to choose between adopting stringent policies and procedures that address the conflicts of interest arising from differential compensation, or pay only neutral compensation to Advisers.

The Department has considered these competing comments and determined for purposes of this preamble to limit the example regarding differential compensation to one based on neutral factors. The Department agrees with the commenters that suggested that differential compensation based on non-neutral factors is likely to encourage advice that is not in Retirement Investors' Best Interest. While the policies and procedures requirement is intended to give necessary flexibility to Financial Institutions, the Department emphasizes that the policies must be reasonably and prudently designed to ensure that Advisers adhere to the Impartial Conduct Standards, and the compensation structures must be prudently designed to avoid an inappropriate misalignment of the Advisers' interests with the interests of the Retirement Investors they serve a fiduciaries. Thus, for example, it would be impermissible for a Financial Institution to use or permit ratcheted compensation thresholds that enable an Adviser to disproportionately increase the amount of his or her compensation based on a specific recommendation to an individual investor. Similarly, the Financial Institution and related parties could not use or permit the use of bonuses, prizes, travel, entertainment, cash or noncash compensation that a reasonable person would expect to cause the preferential recommendation of a specific investment product or feature, without regard to the best interest of the Retirement Investor (*e.g.,* by setting quotas or awarding trips or prizes for the sale of particular products or of investments in a particular mutual fund complex). After consideration, the Department does not agree that differential compensation based on neutral factors raises antitrust concerns. Such a compensation structure does not restrict the amount that a Financial Institution may receive from a third party product manufacturer, only the manner in which the Financial Institution compensates its Advisers. Nothing would require third party product manufacturers to collude, or even to pay Financial Institutions identically. Financial Institutions may pick different neutral factors as compared to other Financial Institutions, and may weigh such factors differently. Such unilateral business decisions do not require Financial Institutions to violate antitrust laws.

While differential payments are permitted, the differentials must reflect neutral factors, not the higher compensation the Financial Institution stands to gain by recommending one investment rather than another. Therefore, while pure mathematical precision is not necessary to justify differential payments, it would not be permissible to draw categories based on the differential compensation the Financial Institution receives from different mutual fund complexes, or differences in the amounts paid to the firm for different annuities or riders. Financial Institutions should be prepared to justify the reasons for differential payments to Advisers, to demonstrate that they are not based on what is more lucrative to the Financial Institution. In addition, the neutral factors must be neutral in application as well as in selection. Differentials based on neutral factors that operate in practice to encourage Advisers to violate the Impartial Conduct Standards are not permissible.

In addition to basing differential compensation on neutral factors, it is important for Financial Institutions that pay differential compensation to employ supervisory oversight structures. This is particularly necessary to ensure that Advisers are making recommendations between different categories based on the customer's financial interest, and not on the differential compensation the Adviser stands to make. But more fundamentally, Financial Institutions will not be able to ensure that their Advisers are providing advice in accordance with the Impartial Conduct Standards without appropriate supervision. Accordingly, the final exemption does not adopt FINRA's suggestion that the proposal permit Financial Institutions to choose between adopting stringent policies and procedures that address the conflicts of interest arising from differential compensation, or pay only neutral compensation to Advisers. Both are required.

d. Contractual Warranty Versus Exemption Condition

In the proposal, both the Adviser and Financial Institution had to give a warranty to the Retirement Investor about the adoption and implementation of anti-conflict policies and procedures. A few commenters indicated that the Adviser should not be required to give the warranty, and questioned whether the Adviser would always be in a position to speak to the Financial Institution's incentive and compensation arrangements. The Department agrees that the Financial Institution has the primary responsibility for design and implementation of the policies and procedures requirement and, accordingly, has limited the warranty requirement to the Financial Institution.

Some commenters believed that even if the Department included a policies and procedure requirement in the exemption, it should not require a warranty on implementation and compliance with the requirement. According to some of these commenters the warranty was unnecessary in light of the Best Interest standard, and would unduly contribute to litigation risk. A few commenters also suggested that a Financial Institution's failure to comply with the contractual warranty could give rise to a cause of action to Retirement Investors who had suffered no injuries from failure to implement or comply with appropriate policies and procedures. A few other commenters expressed concern that the provision of a "warranty" could result in tort liability, rather than just contractual liability.

Other commenters argued that the Department should require Financial Institutions not only to make an enforceable warranty as a condition of the exemption, but also require actual compliance with the warranty as a condition of the exemption. One such commenter argued that it would be difficult for Retirement Investors to prove that policies and procedures were not ''reasonably designed'' to achieve the required purpose.

As noted above, the final exemption adopts the required policies and procedures as a condition of the exemption. The policies and procedures requirement is a critical part of the exemption's protections. The risk of liability associated with a non-exempt prohibited transaction gives Financial Institutions a strong incentive to design protective policies and procedures in a way that is consistent with the purposes and requirements of this exemption.

In addition, the final exemption requires the Financial Institution to make a warranty regarding the policies and procedures in contracts with Retirement Investors regarding IRAs and other non-ERISA plans. The warranty, and potential liability associated with that warranty, gives Financial Institutions both the obligation and the incentive to tamp down harmful conflicts of interest and protect Retirement Investors from misaligned incentives that encourage Advisers to violate the Best Interest standard and other fiduciary obligations and ensures that there is a means to redress the failure to do so. While the warranty exposes Financial Institutions and Advisers to litigation risk, these risks are circumscribed by the availability of binding arbitration for individual claims and the legal restrictions that courts generally use to police class actions.

The Department does not share a commenter's view that it would be too difficult for Retirement Investors to prove that the policies and procedures were not ''reasonably designed'' to achieve the required purpose. The final exemption requires the Financial Institution to disclose Material Conflicts of Interest to Retirement Investors and to describe its policies and procedures for safeguarding against those conflicts of interest. These disclosures should assist Retirement Investors in assessing the care with which Financial Institutions have designed their procedures, even if they are insufficient to fully convey how vigorously the Financial Institution implements the protections. In some cases, a systemic violation, or the possibility of such a violation, may be apparent on the face of the policies. In other cases, normal discovery in litigation may provide the information necessary. Certainly, if a Financial Institution were to provide significant prizes or bonuses for Advisers to push investments that were not in the Best Interest of Retirement Investors, Retirement Investors would often be in a position to pursue the claim. Most important, however, the enforceable obligation to maintain and comply with the policies and procedures as set forth herein, and to make relevant disclosures of the policies and procedures and of Material Conflicts of Interest, should create a powerful incentive for Financial Institutions to carefully police conflicts of interest, reducing the need for litigation in the first place.

In response to commenters that expressed concern about the specific use of the term ''warranty,'' the Department intends the term to have its standard meaning as a ''promise that something in furtherance of the contract is guaranteed by one of the contracting parties.'' [71] The Department merely requires that the contract with IRA and non-ERISA plan investors include an express enforceable promise of compliance with the policies and procedures condition. As previously discussed, the potential liability for violation of the warranty is cabined by the availability of non-binding arbitration in individual claims, and the ability to waive claims for punitive damages and rescission to the extent permitted by applicable law.

Additionally, although the policies and procedure requirement applies equally to ERISA plans, the final exemption does not require Financial Institutions to make a warranty with respect to ERISA plans, just as it does not require the execution of a contract with respect to ERISA plans. For these plans, a separate warranty is unnecessary because Title I of ERISA already provides an enforcement mechanism for failure to comply with the policies and procedures requirement. Under ERISA sections 502(a), plan participants, fiduciaries, and the Secretary of Labor have ready means to enforce any failure to meet the conditions of the exemption, including a failure to comply with the policies and procedure requirement. A Financial Institution's failure to comply with the exemption's policies and procedure requirements would result in a non-exempt prohibited transaction under ERISA section 406 and would likely constitute a fiduciary breach under ERISA section 404. As a result, a plan participant or beneficiary, plan fiduciary, and the Secretary would be able to sue under ERISA section 502(a) to recover any loss in value to the plan (including the loss in value to an individual account), or to obtain disgorgement of any wrongful profits or unjust enrichment. Accordingly, the warranty is unnecessary in the context of ERISA plans.

e. Compliance With Laws Proposed Warranty

The proposed exemption also contained a requirement for the Adviser and Financial Institution to warrant that they and their Affiliates would comply with all applicable federal and state laws regarding the rendering of the investment advice, the purchase, sale or holding of the Asset and the payment of compensation related to the purchase, sale and holding. While the Department did receive some support for this condition in comments, several commenters opposed this warranty proposal as being overly broad, and urged that it be deleted. These commenters argued that the warranty could create contract claims based on a wide variety of state and federal laws, without regard to the limitations imposed on individual actions under those laws. In addition, commenters suggested that many of the violations associated with these laws could be quite minor or unrelated to the Department's concerns about conflicts of interest. In response to these concerns, the Department has eliminated this warranty from the final exemption.

6. Ineligible Provisions—Section II(f)

Under Section II(f) of the final exemption, relief is not available if a Financial Institution's contract with Retirement Investors regarding investments in IRAs and non-ERISA plans contains the following:

(1) Exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms;

(2) Except as provided in paragraph (f)(4), 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 Adviser or Financial Institution, or in an individual or class claim agrees to an amount representing liquidated damages for breach of the contract; provided that, the parties may 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; or

(3) Agreements 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 this exemption.

Section II(f)(4), provides that, in the event the provision on pre-dispute

[71] Black's Law Dictionary 10th ed. 2014.

arbitration agreements for class or representative claims in paragraph (f)(2) is ruled invalid by a court of competent jurisdiction, the provision shall not be a condition of the exemption with respect to contracts subject to the court's jurisdiction unless and until the court's decision is reversed, but all other terms of the exemption shall remain in effect.

The purpose of Section II(f) is to ensure that Retirement Investors receive the full benefit of the exemption's protections by preventing them from being contracted away. If an Adviser makes a recommendation, for a fee or other compensation, within the meaning of the Regulation, he or she may not disclaim the duties or liabilities that flow from the recommendation. For similar reasons, the exemption is not available if the contract includes provisions that purport to waive a Retirement Investor's right to bring or participate in class actions. However, contract provisions in which Retirement Investors agree to arbitrate any individual disputes are allowed to the extent permitted by applicable state law. Moreover, Section II(f) does not prevent Retirement Investors from voluntarily agreeing to arbitrate class or representative claims after the dispute has arisen.

The Department's approach in this respect is consistent with FINRA's rules permitting mandatory pre-dispute arbitration for individual claims, but not for class action claims.[72] This rule was adopted in 1992, in response to a directive, articulated by former SEC Chairman David Ruder, that investors have access to courts in appropriate cases.[73] Section 12000 of the FINRA manual establishes a Code of Arbitration Procedure for Customer Disputes which sets forth rules on, *inter alia,* filing claims, amending pleadings, prehearing conferences, discovery, and sanctions for improper behavior.

[72] FINRA Rule 12204(a) provides that class actions may not be arbitrated under the FINRA Code of Arbitration Procedures. FINRA Rule 2268(d)(3) provides that no predispute arbitration agreement may limit the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement. The FINRA Board of Governors has ruled that a broker's predispute arbitration agreement with a customer may not include a waiver of the right to file or participate in a class action in court. In *Dept. of Enforcement* v. *Charles Schwab & Co.,* Complaint No. 2011029760201 (Apr. 24, 2014).

[73] NASD Notice 92–65 SEC Approval of Amendments Concerning the Exclusion of Class-Action Matters from Arbitration Proceedings and Requiring that Predispute Arbitration Agreements Include a Notice That Class-Action Matters May Not Be Arbitrated, *available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=1660.*

A number of commenters addressed the proposed approach to arbitration and the other ineligible provisions in Section II(f). A discussion of the comments and the Department's responses follow.

a. Exculpatory Provisions

The Department included Section II(f)(1) in the final exemption without changes from the proposal. Commenters did, however, raise a few questions on the provision. In particular, commenters asked whether the contract could disclaim liability for acts or omissions of third parties, and whether there could be venue selection clauses. In addition, commenters asked whether the contract could require exhaustion of arbitration or mediation before filing in court.

Section II(f)(1) does not prevent a Financial Institution's contract with IRA and non-ERISA plan investors from disclaiming liability for acts or omissions of third parties to the extent permissible under applicable law. In addition, for individual claims, reasonable arbitration and mediation requirements are not prohibited. In response to questions about venue selection, the final exemption includes a new Section II(f)(3), which provides that investors may not be required to arbitrate or mediate their individual claims in unreasonable or distant venues that are distant or that otherwise unreasonably limit their ability to assert the claims safeguarded by this exemption.

The Department has not revised Section II(f) to address every provision that may or may not be included in the contract. While some commenters submitted specific requests regarding specific contract language, and others suggested the Department provide model contracts for Financial Institutions to use, the Department has declined to make these changes in the exemption. The Department notes that Section II(f)(1) prohibits all exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms, and Section II(g)(5) prohibits Financial Institutions and Advisers from purporting to disclaim any responsibility or liability for any responsibility, obligation, or duty under Title I of ERISA to the extent the disclaimer would be prohibited by Section 410 of ERISA. Therefore, in response to comments regarding choice of law provisions, modifying ERISA's statute of limitations, and imposing obligations on the Retirement Investor, the Financial Institutions must determine whether their specific provisions are exculpatory and would disclaim or limit their liability under ERISA, or that of their Advisers. If so, they are not permitted. The Department will provide additional guidance in response to questions and enforcement proceedings.

b. Arbitration

Section II(f)(2) of the final exemption adopts the approach, as proposed, that individual claims may be the subject of contractual pre-dispute binding arbitration. Class or other representative claims, however, must be allowed to proceed in court. The final exemption also provides that contract provisions may not limit recoveries to an amount representing liquidated damages for breach of the contract. However, the final exemption expressly permits Retirement Investors to knowingly waive their rights to obtain punitive damages or rescission of recommended transactions to the extent such waivers are permitted under applicable law.

Commenters on the proposed exemption were divided on the approach taken in the proposal, as discussed below. Some commenters objected to limiting Retirement Investors' right to sue in court on individual claims and specifically focused on FINRA's arbitration procedures. These commenters described FINRA's arbitration as an unequal playing field, with insufficient protections for individual investors. They asserted that arbitrators are not required to follow federal or state laws, and so would not be required to enforce the terms of the contract. In addition, commenters complained that the decision of an arbitrator generally is not subject to appeal and cannot be overturned by any court. According to these commenters, even when the arbitrators find in favor of the consumer, the consumers often receive significantly smaller recoveries than they deserve. Moreover, some asserted that binding pre-dispute arbitration may be contrary to the legislative intent of ERISA, which provides for "ready access to federal courts."

Some commenters opposed to arbitration indicated that preserving the right to bring or participate in class actions in court would not give Retirement Investors sufficient access to courts. According to these commenters, allowing Financial Institutions to require resolution of individual claims by arbitration would impose additional and unnecessary hurdles on investors seeking to enforce the Best Interest standard. One commenter warned that the Regulation would make it more difficult for Retirement Investors to pursue class actions because the individualized requirements for proving fiduciary status could undermine any claims about commonality. Commenters said that class action lawsuits tend to be expensive and protracted, and even where successful, investors often recover only a small portion of their losses.

Other commenters just as forcefully supported pre-dispute binding arbitration agreements. Some asserted that arbitration is generally quicker and less costly than judicial proceedings. They argued that FINRA has well-developed protections in place to protect the interests of aggrieved investors. One commenter pointed out that FINRA requires that the arbitration provisions of a contract be highlighted and disclosed to the customer, and that customers be allowed to choose an ''all-public'' panel of arbitrators.[74] FINRA rules also impose larger filing fees on the industry party than on the investor. Commenters also cited evidence that investors are as likely to prevail in arbitration proceedings as they are in court, and even argued that permitting mandatory arbitration for all disputes would be in investors' best interest.

A number of commenters argued that arbitration should be available for *all* disputes that may arise under the exemption, including class or representative claims. Some of these commenters favored arbitration of class claims due to concerns about costs and potentially greater liability associated with class actions brought in court. Some commenters took the position that the ability of the Retirement Investor to participate in class actions could deter Financial Institutions from relying on the exemption at all.

After consideration of the comments on this subject, the Department has decided to adopt the general approach taken in the proposal. Accordingly, contracts with Retirement Investors may require pre-dispute binding arbitration of individual disputes with the Adviser or Financial Institution. The contract, however, must preserve the Retirement Investor's right to bring or participate in a class action or other representative action in court in such a dispute in order for the exemption to apply.

The Department recognizes that for many claims, arbitration can be more cost-effective than litigation in court. Moreover, the exemption's requirement that Financial Institutions acknowledge their own and their Advisers' fiduciary status should eliminate an issue that frequently arises in disputes over investment advice. In addition, permitting individual matters to be resolved through arbitration tempers the litigation risk and expense for Financial Institutions, without sacrificing Retirement Investors' ability to secure judicial relief for systemic violations that affect numerous investors through class actions.

On the other hand, the option to pursue class actions in court is an important enforcement mechanism for Retirement Investors. Class actions address systemic violations affecting many different investors. Often the monetary effect on a particular investor is too small to justify pursuit of an individual claim, even in arbitration. Exposure to class claims creates a powerful incentive for Financial Institutions to carefully supervise individual Advisers, and ensure adherence to the Impartial Conduct Standards. This incentive is enhanced by the transparent and public nature of class proceedings and judicial opinions, as opposed to arbitration decisions, which are less visible and pose less reputational risk to firms or Advisers found to have violated their obligations.

The ability to bar investors from bringing or participating in such claims would undermine important investor rights and incentives for Advisers to act in accordance with the Best Interest standard. As one commenter asserted, courts impose significant hurdles for bringing class actions, but where investors can surmount these hurdles, class actions are particularly well suited for addressing systemic breaches. Although by definition communications to a specific investor generally must have a degree of specificity in order to constitute fiduciary advice, a class of investors should be able to satisfy the requirements of commonality, typicality and numerosity where there is a systemic or wide-spread problem, such as the adoption or implementation of non-compliant policies and procedures applicable to numerous Retirement Investors, the systematic use of prohibited or misaligned financial incentives, or other violations affecting numerous Retirement Investors in a similar way. Moreover, the judicial system ensures that disputes involving numerous retirement investors and systemic issues will be resolved through a well-established framework characterized by impartiality, transparency, and adherence to precedent. The results and reasoning of court decisions serve as a guide for the consistent application of that law in future cases involving other Retirement Investors and Financial Institutions.

This is consistent with the approach long adopted by FINRA and its predecessor self-regulatory organizations. FINRA Arbitration rule 12204 specifically bars class actions from FINRA's arbitration process and requires that pre-dispute arbitration agreements between brokers and customers contain a notice that class action matters may not be arbitrated. In addition, it provides that a broker may not enforce any arbitration agreement against a member of certified or putative class action, until the certification is denied, the class action is decertified, the class member is excluded from, or elects not participate in, the class. This rule was adopted by the National Association of Securities Dealers and approved by the SEC in 1992.[75] In the release announcing this decision, the SEC stated:

> [T]he NASD believes, and the Commission agrees, that the judicial system has already developed the procedures to manage class action claims. Entertaining such claims through arbitration at the NASD would be difficult, duplicative and wasteful. . . . The Commission agrees with the NASD's position that, in all cases, class actions are better handled by the courts and that investors should have access to the courts to resolve class actions efficiently.[76]

In 2014, the FINRA Board of Governors upheld this rule in reviewing an enforcement action.[77]

Additional Protections

One commenter suggested that if the Department preserved the ability of a Financial Institution to require arbitration of claims, it should consider requiring a series of additional safeguards for arbitration proceedings permitted under the exemption. The commenter suggested that the conditions could state that (i) the arbitrator must be qualified and independent; (ii) the arbitration must be held in the location of the person challenging the action; (iii) the cost of the arbitration must be borne by the Financial Institution; (iv) the Financial Institution's attorneys' fees may not be shifted to the Retirement Investor, even if the challenge is unsuccessful; (v) statutory remedies may not be limited or altered by the contract; (vi) access to adequate discovery must be permitted; (vii) there must be a written record and a written decision; (viii) confidentiality

[74] The term ''Public Arbitrator'' is defined in FINRA Rule 12100(u). According to FINRA, non-''Public Arbitrators'' are often referred to as ''industry'' arbitrators. *See* Final Report and Recommendations of the FINRA Dispute Resolution Task Force, released December 16, 2015.

[75] SEC Release No. 34–31371 (Oct. 28, 1992), 1992 WL 324491.

[76] Id.

[77] FINRA Decision, *Department of Enforcement* v. *Charles Schwab & Co.* (Complaint 2011029760201), p. 14 (Apr. 24, 2014).

requirements and protective orders which would prohibit the use of evidence in subsequent cases must be prohibited. The commenter said that some, but not all, of these procedures are currently required by FINRA.

The Department declines to mandate additional procedural safeguards for arbitration beyond those already mandated by other applicable federal and state law, or self-regulatory organizations. In the Department's view, the FINRA arbitration rules, in particular, provide significant safeguards for fair dispute resolution, notwithstanding the concerns raised by some commenters. FINRA's Code of Arbitration Procedures for Customer Disputes applies when required by written agreement between the FINRA member and the customer, or if the customer requests arbitration. The rules cover any dispute between the member and the customer that arises from the member's business activities, except for disputes involving insurance business activities of a member that is an insurance company.[78] FINRA's code of procedures also provide detailed instructions for initiating and pursuing an arbitration, including rules for selection of arbitrators (Rule 12400), for discovery of evidence (Rule 12505), and expungement of customer dispute information (Rule 12805), which are designed to allow access by investors and preserve fairness for the parties. In addition, Rule 12213 specifies that FINRA will generally select the hearing location closest to the customer. To the extent that the contracts provide for binding arbitration in individual claims, the Department defers to the judgment of FINRA and other regulatory bodies, such as state insurance regulators, responsible for determining the safeguards applicable to arbitration proceedings.

One commenter focused on dispute resolution processes engaged in by entities licensed as fraternal benefit societies under the laws of a State and exempt from federal income taxation under code section 501(c)(8). The commenter requested that these entities be carved out from the prohibitions of Section II(f) if they provided laws or rules for grievance or complaint procedures for members. The Department has declined to provide special provisions for specific parties based on mission or tax exempt status. Nothing in the legal structure relating to such organizations uniformly requires that their dispute-resolution processes adhere to stringent protective standards. Nevertheless, the Department notes that as long as Section II(f) and Section II(g)(5) are satisfied, the exemption would not be violated by a Financial Institution's adoption of additional protections for customers beyond the requirements of applicable regulators, such as payment of administrative costs of mediation and/or arbitration, as is the practice of some fraternal benefit societies.

Federal Arbitration Act

Some commenters asserted that the Department does not have the authority to include the exemption's provisions on class action waivers under the Federal Arbitration Act (FAA), which they said protects enforceable arbitration agreements and expresses a federal policy in favor of arbitration over litigation. Without clear statutory authority to restrict arbitration, these commenters said, the Department cannot include the provisions on class action waivers.

These comments misconstrue the effect of the FAA on the Department's authority to grant exemptions from prohibited transactions. The FAA protects the validity and enforceability of arbitration agreements. Section 2 of the FAA states: "[a] written provision in any . . . contract . . . to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." [79] This Act was intended to reverse judicial hostility to arbitration and to put arbitration agreements on an equal footing with other contracts.[80]

Section II(f)(2) of the exemption is fully consistent with the FAA. The exemption does not purport to render an arbitration provision in a contract between a Financial Institution and a Retirement Investor invalid, revocable, or unenforceable. Nor, contrary to the concerns of one commenter, does Section II(f)(2) prohibit such waivers. Both Institutions and Advisers remain free to invoke and enforce arbitration provisions, including provisions that waive or qualify the right to bring a class action or any representative action in court. Instead, such a contract simply does not meet the conditions for relief from the prohibited transaction provisions of ERISA and the Code. As a result, the Financial Institution and Adviser would remain fully obligated under both ERISA and the Code to refrain from engaging in prohibited transactions. In short, Section II(f)(2) does not affect the validity, revocability, or enforceability of a class-action waiver in favor of individual arbitration. This regulatory scheme is thus a far cry from the State judicially created rules that the Supreme Court has held preempted by the FAA,[81] and the National Labor Relations Board's attempt to prohibit class-action waivers as an "unfair labor practice." [82]

The Department has broad discretion to craft exemptions subject to its overarching obligation to ensure that the exemptions are administratively feasible, in the interests of plan participants, beneficiaries, and IRA owners, and protective of their rights. In this instance, the Department has concluded that the enforcement rights and protections associated with class action litigation are important to safeguarding the Impartial Conduct Standards and other anti-conflict provisions of the exemption. If a Financial Institution enters into a contract requiring binding arbitration of class claims, the Department would not purport to invalidate the provision, but rather would insist that the Financial Institution fully comply with statutory provisions prohibiting conflicted fiduciary transactions in its dealings with its Retirement Investment customers. The FAA is not to the contrary. It neither limits the Department's express grant of discretionary authority over exemptions, nor entitles parties that enter into arbitration agreements to a pass from the prohibited transaction rules.

While the Department is confident that its approach in the exemption does not violate the FAA, it has carefully considered the position taken by several commenters that the Department exceeded its authority in including provisions in the exemption on waivers of class and representative claims, and the possibility that a court might rule that the condition regarding arbitration of class claims in Section II(f)(2) of the exemption is invalid based on the FAA. Accordingly, in an abundance of caution, the Department has specifically provided that Section II(f)(2) can be severable if a court finds it invalid based on the FAA. Specifically, Section II(f)(4) provides that:

> In the event that the provision on pre-dispute arbitration agreements for class or representative claims in paragraph (f)(2) of this Section is ruled invalid by a court of

[78] FINRA Rule 12200.

[79] 9 U.S.C. 2.

[80] *See AT&T Mobility LLC* v. *Concepcion,* 563 U.S. 333, 342 (2011).

[81] *See American Express Co.* v. *Italian Colors Restaurant,* 133 S. Ct. 2304 (2013); *AT&T Mobility LLC* v. *Concepcion,* 563 U.S. 333 (2011).

[82] *See D.R. Horton, Inc.* v. *NLRB,* 737 F.3d 344 (5th Cir. 2013).

competent jurisdiction, this provision shall not be a condition of this exemption with respect to contracts subject to the court's jurisdiction unless and until the court's decision is reversed, but all other terms of the exemption shall remain in effect.

The Department is required to find that the provisions of an exemption are administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries and IRA owners. The Department finds that the exemption with Section II(f)(2) satisfies these requirements. The Department believes, consistent with the position of the SEC and FINRA, that the courts are generally better equipped to handle class claims than arbitration procedures and that the prohibition on contractual provisions mandating arbitration of such claims helps the Department makes the requisite statutory findings for granting an exemption.

Nevertheless, the Department has determined that, based on all the exemption's other conditions, it can still make the necessary findings to grant the exemption even without the condition prohibiting pre-dispute agreements to arbitrate class claims. In particular, if a court were to invalidate the condition, the Department would still find that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries, and protective of the rights of the participants and beneficiaries. It would be less protective, but still sufficient to grant the exemption.

The Department's adoption of the specific severability provision in Section II(f)(4) of the exemption should not be viewed as evidence of the Department's intent that no other conditions of this or the other exemptions granted today are severable if a court were to invalidate them. Instead, the Department intends that invalidated provisions of the rule and exemptions may be severed when the remainder of the rule and exemptions can function sensibly without them.[83]

c. Remedies

Some commenters asked whether the proposal's prohibition of exculpatory clauses would affect the parties' ability to limit remedies under the contract, particularly regarding liquidated damages, punitive damages, consequential damages and rescission. In response, the Department has added text to Section II(f)(2) in the final exemption clarifying that the parties, in an individual or class claim, may not agree to an amount representing liquidated damages for breach of the contract. However, the exemption, as finalized, expressly permits the parties to 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.

In the Department's view, it is sufficient to the exemptions' protective purposes to permit recovery of actual losses. The availability of such a remedy should ensure that plaintiffs can be made whole for any losses caused by misconduct, and provide an important deterrent for future misconduct. Accordingly, the exemption does not permit the contract to include liquidated damages provisions, which could limit Retirement Investors' ability to obtain make-whole relief.

On the other hand, the exemption permits waiver of punitive damages to the extent permissible under governing law. Similarly, rescission can result in a remedy that's disproportionate to the injury. In cases where an advice fiduciary breached its obligations, but there was no injury to the participant, a rescission remedy can effectively make the fiduciary liable for losses caused by market changes, rather than its misconduct. These new provisions in section II(f)(2) only apply to waiver of the contract claims; they do not qualify or limit statutory enforcement rights under ERISA. Those statutory remedies generally provide for make-whole relief and to rescission in appropriate cases, but they do not provide for punitive damages.

7. Disclosure Requirements

The exemption requires disclosure of Material Conflicts of Interest and basic information relating to those conflicts and the advisory relationship in Sections II and III. The exemption requires contract disclosures (Section II(e)), pre-transaction (or point of sale) disclosures (Section III(a)), and web-based disclosures (Section III(b)). One of the chief aims of the disclosures is to ensure that the Retirement Investor is fairly informed of the Adviser's and Financial Institution's conflicts of interest. The final exemption adopts a tiered approach, generally providing for automatic disclosure of basic information on conflicts of interest and the advisory relationship, but requiring more detailed disclosure, free of charge, upon request. As discussed below, the final exemption requires disclosure of the information Retirement Investors need to assess conflicts of interest and compensation structures, while reducing compliance burden.

Section II(e) obligates the Financial Institution to make specified disclosures to Retirement Investors. For advice to Retirement Investors regarding investments in IRAs and non-ERISA plans, the disclosures must be provided prior to or at the same time as the execution of the recommended transaction, either as part of the contract or in a separate written disclosure provided to the Retirement Investor with the contract. For advice to Retirement Investors regarding investments in ERISA plans, the disclosures must be provided prior to or at the same time as the execution of the recommended transaction. The disclosures require the provision of more general information upfront to the Retirement Investor accompanied by notice that more specific information is available free of charge, upon request. If the Retirement Investor makes a request for more specific information prior to the transaction, the information must be provided prior to the transaction. For requests made after the transaction, the information must be provided within 30 business days. Although the contract disclosure is a one-time disclosure, the Financial Institution must also post model disclosures on its Web site, and on a quarterly basis review and update the model disclosures as necessary for accuracy.

The pre-transaction disclosure in Section III(a) supplements the contract disclosure, and must be provided to all Retirement Investors (whether regarding an ERISA plan, non-ERISA plan or IRA) prior to or at the same time as the execution of a recommended transaction. The pre-transaction disclosure repeats certain information in the contract disclosure to ensure that the Retirement Investor has received the information sufficiently close to the time of the transaction, when the information is most relevant. Such disclosure is particularly important when the advisory relationship extends over time. To minimize burden, however, the Financial Institution does not need to repeat the pre-transaction disclosure more frequently than annually after the initial contract disclosure, or other transaction disclosures, with respect to additional recommendations regarding the same investment product.

The web-based disclosure in Section III(b) is intended to provide information about the Financial Institutions' arrangements with product

[83] *See Davis County Solid Waste Management* v. *United States Environmental Protection Agency,* 108 F.3d 1454, 1459 (D.C. Cir. 1997) (finding that severability depends on an agency's intent and whether the provisions can operate independently of one another).

manufacturers and other parties for Third Party Payments in connection with specific investments or classes of investments that are recommended to Retirement Investors, as well as a description of the Financial Institution's business model and its compensation and incentive arrangements with Advisers. The web disclosure is not limited to individual Retirement Investors with whom the Financial Institution has a contractual relationship, but rather is publicly available to promote comparison shopping and the overall transparency of the marketplace for retirement investment advice. Thus, financial services companies, consultants, and intermediaries may analyze the information and provide information to plan and IRA investors comparing the practices of different Financial Institutions.

The Department significantly revised the disclosures from the proposed exemption. Commenters responded to the Department's disclosure proposals and specific requests for comment with feedback on the cost, feasibility and utility of the proposed disclosures. The Department carefully considered the comments in order to formulate an approach in the final exemption that responded to commenters' legitimate concerns, while ensuring fair disclosure of important information to Retirement Investors.

In broad outline, the final exemption takes a ''two-tier'' approach, as suggested by some commenters,[84] under which the Financial Institution automatically gives simple disclosures of basic information with more specific information available on the web or upon request. Retirement Investors will be provided with information about their Advisers' and Financial Institutions' Material Conflicts of Interest both upon entering into an advisory relationship, and again, prior to or at the same time as, the execution of recommended transactions. They will not be overwhelmed by the amount of disclosure provided, which can render the disclosure ineffective. To the extent individual Retirement Investors wish to review additional information, the details will be available to them. This approach minimizes the burden on both the Financial Institution and the Retirement Investor, without reducing the protections of the disclosure.

The specific content requirements of the disclosure provisions, comments received on the proposals and the Department's responses are discussed below.

a. Contractual Disclosures—Section II(e)

Under Section II(e) of the exemption, the Financial Institution must clearly and prominently, in a single written disclosure:

(1) State the Best Interest standard of care owed by the Adviser and Financial Institution to the Retirement Investor; inform the Retirement Investor of the services provided by the Financial Institution and the Adviser; and describe how the Retirement Investor will pay for services, directly or through Third Party Payments. If, for example, the Retirement Investor will pay through commissions or other forms of transaction-based payments, the contract or writing must clearly disclose that fact;

(2) Describe Material Conflicts of Interest; disclose any fees or charges the Financial Institution, its Affiliates, or the Adviser imposes upon the Retirement Investor or the Retirement Investor's account; and state the types of compensation that the Financial Institution, its Affiliates, and the Adviser expect to receive from third parties in connection with investments recommended to Retirement Investors;

(3) Inform the Retirement Investor that the Investor has the right to obtain copies of the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d), as well as specific disclosure of costs, fees, and compensation, including Third Party Payments regarding recommended transactions, as set forth in Section III(a) of the exemption, described in dollar amounts, percentages, formulas or other means reasonably designed to present materially accurate disclosure of their scope, magnitude, and nature in sufficient detail to permit the Retirement Investor to make an informed judgment about the costs of the transaction and about the significance and severity of the Material Conflicts of Interest, and describe how the Retirement Investor can get the information, free of charge; provided that if the Retirement Investor's request is made prior to the transaction, the information must be provided prior to the transaction, and if the request is made after the transaction, the information must be provided within 30 business days after the request;

(4) Include a link to the Financial Institution's Web site as required by Section III(b), and inform the Retirement Investor that: (i) The model contract disclosures updated as necessary on a quarterly basis for accuracy are maintained on the Web site, and (ii) the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d) are available free of charge on the Web site;

(5) Disclose to the Retirement Investor whether the Financial Institution offers Proprietary Products or receives Third Party Payments with respect to any recommended transaction; and to the extent the Financial Institution or Adviser limits investment recommendations, in whole or part, to Proprietary Products or investments that generate Third Party Payments, notify the Retirement Investor of the limitations placed on the universe of investments that the Adviser may offer for purchase, sale, exchange, or holding by the Retirement Investor. The notice is insufficient if it merely states that the Financial Institution or Adviser ''may'' limit investment recommendations based on whether the investments are Proprietary Products or generate Third Party Payments, without specific disclosure of the extent to which recommendations are, in fact, limited on that basis.

(6) Provide contact information (telephone and email) for a representative of the Financial Institution that the Retirement Investor can use to contact the Financial Institution with any concerns about the advice or service they have received; and, if applicable, a statement explaining that the Retirement Investor can research the Financial Institution and its Advisers using FINRA's BrokerCheck database or the Investment Adviser Registration Depository (IARD), or other database maintained by a governmental agency or instrumentality, or self-regulatory organization; and

(7) Describe whether or not the Adviser and Financial Institution will monitor the Retirement Investor's investments and alert the Retirement Investor to any recommended change to those investments and, if so, the frequency with which the monitoring will occur and the reasons for which the Retirement Investor will be alerted.

By ''clearly and prominently in a single written disclosure,'' the Department means that the Financial Institution may provide a document prepared for this purpose containing only the required information, or include the information in a specific section of the contract in which the disclosure information is provided, rather than requiring the Retirement Investor to locate the relevant information in several places throughout a larger disclosure or series of disclosures.

Section II(e)(8) provides a mechanism for correcting disclosure errors, without losing the exemption. It provides that the Financial Institution will not fail to satisfy Section II(e), or violate a contractual provision based thereon, solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, provided the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. Section II(e)(8) further provides that to the extent compliance with the contract disclosure requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information

[84] *See* Financial Services Institute, Fidelity Investments, and the Consumer Federation of America.

and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

The proposal contained three elements of the contractual disclosure set forth in Section II(e). The Financial Institution would have been required to: Identify and disclose any Material Conflicts of Interest; inform the Retirement Investor of his or her right to obtain complete information about all the fees currently associated with Assets in which he or she is invested; and disclose to the Retirement Investor whether the Financial Institution offers Proprietary Products or receives Third Party Payments with respect to the purchase, sale or holding of any Asset, and of the address of the required Web site that discloses the Financial Institutions' and Advisers' compensation arrangements.

Several commenters supported the proposed disclosures. Commenters recognized that well-designed disclosure can serve multiple purposes, including facilitating informed investment decisions. However, even if investors do not carefully review the disclosures they receive, commenters perceived a benefit to investors from the greater transparency of public disclosure. For example, firms may change practices that run contrary to Retirement Investors' interests rather than disclose them publicly. The Department received a few questions and requests for clarification of these proposed disclosure requirements. One commenter requested that the Department clarify that, for purposes of the disclosure provisions, "direct" and "indirect" compensation had the same meanings as they did in ERISA section 408(b)(2). Several other commenters suggested that the Department rely to a greater extent on existing conflicts disclosure requirements applicable to investment advisers registered under the Investment Advisers Act of 1940. Additionally, there were questions as to how the information in the contractual disclosure should be updated.

As noted above, the Department modeled the final exemption's disclosure provisions, in part, on comments suggesting adoption of a "two-tier" approach, under which an investor would receive a "first tier" disclosure at the time of account opening, with a "second tier" of more in-depth information available on the Financial Institution's Web site and in other formats upon request. The Department adopted a number of these commenters' suggestions as part of the contractual disclosure set forth in Section II(e), viewing the contractual disclosure as similar to the first tier approach suggested by the commenters.

Specifically, the Department adopted commenters' suggestions that the disclosures: State the standard of care owed to the Retirement Investor; inform the Retirement Investor of the services to be provided; and inform the Retirement Investor of how he or she will pay for services. A commenter also suggested that the disclosure include any significant limitations on services provided by the Financial Institution, such as the sale of only propriety products. The suggestion was adopted in Section II(e)(5).

A commenter further suggested that the disclosure provide information on a representative of the Financial Institution that the Retirement Investor can contact with complaints, and a statement explaining that the Retirement Investor can research the Financial Institution and its Advisers using FINRA's BrokerCheck database or the Investment Adviser Registration Depository (IARD). The Department incorporated this suggestion in Section II(e)(6). Further, the commenter's suggestion that Retirement Investors should be informed of their ability to obtain additional more detailed information, free of charge, was adopted in Section II(e)(3).

FINRA's suggestion that the parties agree on the extent of monitoring of the Retirement Investor's investments was adopted, in Section II(e)(7). In making this determination, Financial Institutions should carefully consider whether certain investments can be prudently recommended to the individual Retirement Investor, in the first place, without a mechanism in place for the ongoing monitoring of the investment. Finally, a number of commenters requested relief for good faith inadvertent failures to comply with the exemption. A specific provision applicable to the Section II(e) disclosures is included in Section II(e)(8).

In response to a commenter's question regarding the meaning of direct versus indirect expenses, the Department has generally revised the exemption to refer to "Third Party Payments," rather than indirect expenses. The phrase "Third Party Payments" is a defined term in the exemption.

The Department has also addressed how the contractual disclosure must be updated. Under the exemption, the contract provides one-time disclosure, but the information must be maintained on the Web site and updated quarterly as necessary for accuracy. Additionally, the transaction disclosure required under Section III(a) must be accurate at the time it is provided, which will serve to provide the Retirement Investor with the most current information prior to or at the same time as the execution of a recommended transaction, essentially updating the contractual disclosure.

b. Transaction Disclosure

Section III(a) of the exemption requires that, prior to or at the same time as the execution of a recommended investment transaction, the Financial Institution must provide the Retirement Investor a disclosure that clearly and prominently, in a single written document:

(1) States the Best Interest standard of care owed by the Adviser and Financial Institution to the Retirement Investor; and describes any Material Conflicts of Interest;

(2) Informs the Retirement Investor that the Retirement Investor has the right to obtain copies of the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d), as well as specific disclosure of costs, fees and other compensation including Third Party Payments regarding recommended transactions. The costs, fees, and other compensation may be described in dollar amounts, percentages, formulas, or other means reasonably designed to present materially accurate disclosure of their scope, magnitude, and nature in sufficient detail to permit the Retirement Investor to make an informed judgment about the costs of the transaction and about the significance and severity of the Material Conflicts of Interest. The information required under this section must be provided to the Retirement Investor prior to the transaction, if requested prior to the transaction, and if the request occurs after the transaction, the information must be provided within 30 business days after the request; and

(3) Includes a link to the Financial Institution's Web site as required by Section III(b), and informs the Retirement Investor that: (i) Model contract disclosures updated as necessary on a quarterly basis are maintained on the Web site, and (ii) the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d) are available free of charge on the Web site.

This disclosure is required only at the time an investment is made, and does not have to be repeated if there is a recommendation to hold or sell the investment. By ''clearly and prominently, in a single written document,'' the Department means that the Financial Institution must provide the information in a single document prepared for this purpose with only the required information, or a specific section in a larger document, in which the disclosure information is provided, rather than requiring the Retirement Investor to locate the relevant information in several places throughout a larger disclosure or series of disclosures.

To reduce compliance burden, Section III(a)(4) provides that these disclosures do not have to be repeated for subsequent recommendations by the Adviser and Financial Institution of the same investment product within one year after the provision of the contract disclosure required by Section II(e) or a prior disclosure required by Section III(a), unless there are material changes in the subject of the disclosure. Additionally, in the final exemption, the Department makes clear that the Financial Institution is responsible for the required disclosures. This is consistent with a commenter that indicated that it is not industry practice for individual Advisers to prepare disclosures.

The Department revised the transaction disclosure in the final exemption based on input from commenters. In the proposed exemption, the transaction disclosure in Section III(a) would have required the provision to the Retirement Investor of a chart setting forth the ''total cost'' of the recommended investment for 1-, 5- and 10-year periods, expressed as a dollar amount, assuming an investment of the dollar amount recommended by the Adviser and reasonable assumptions about investment performance. In addition, an annual disclosure proposed under Section III(b) would have required an annual disclosure of investments purchased during the year, the total dollar amount of all fees and expenses paid by the investor and the total dollar amount of all compensation received by the Adviser and Financial Institution, directly or indirectly, from any party as a result of the investments. The disclosure was to be provided within 45 days of the end of the applicable year.

A few commenters indicated their support for a point of sale disclosure to Retirement Investors, which the commenters said is not currently required in many cases. Some commenters highlighted the importance of alerting Retirement Investors to the costs of an investment over time, which was the intent of the proposed transaction disclosure. Other commenters described the benefit of the annual disclosure as a means of showing actual costs paid, rather than the projections provided in the proposed transaction disclosure. Nonetheless, many supporters of the disclosures took the position that the disclosure requirements would be secondary in importance to the Impartial Conduct Standards and policies and procedures requirement set forth in Section II.

A number of other commenters raised significant objections to the disclosures proposed in Section III(a) and (b). These commenters generally indicated the disclosures would be costly to implement and Financial Institutions would need an extensive transition period in order to comply. In this vein, several commenters stated that Financial Institutions do not currently assemble or maintain all of the required information and that current systems could not deliver the disclosures. Commenters expressed concerns that the logistics of providing the disclosures were unduly burdensome. These logistics included the application of the disclosure provisions to all investment products, including annuities and insurance products, the specific formatting and wording of the disclosure, the acceptable means of providing the disclosure (whether verbal or electronic communications would be permitted), and the allocation of responsibilities between the Financial Institution and Adviser. One commenter stated that the burden was so great that only very large Financial Institutions would be able to continue to provide investment advice to Retirement Investors.

Some commenters questioned the substance of the proposed disclosure requirements. According to some commenters, it would be difficult to provide specific dollar amounts of indirect compensation received on an account or transaction level. Comments from the insurance industry stated that the transactional disclosures were a poor fit for insurance transactions, in particular. Commenters also specifically objected to the obligation to project investment performance for purposes of calculating costs over 1-, 5-, and 10-year holding periods. Commenters, including FINRA, stated that requirement would conflict with FINRA Rule 2210, which generally prohibits broker-dealers from including projections of performance in communications with the public. A few comments suggested that the Department could instead proceed with the proposed point of sale disclosure using hypothetical amounts that would comply with the FINRA rule.

A number of commenters urged the Department to rely on existing disclosure requirements, including required disclosures under ERISA sections 404 and 408(b)(2), state insurance law, the SEC's Form ADV for registered investment advisers, or product-specific information such as a prospectus or summary prospectus. Several commenters observed that the Department recently implemented a series of disclosure requirements under ERISA sections 404 and 408(b)(2), and relying on these disclosures would avoid additional investment in costly technology and procedures.

Other commenters suggested specific alternative disclosures that are not currently required by law. For example, a commenter suggested a so-called ''20/20 disclosure,'' showing the effect of fees on a $20,000 initial investment over a 20-year period. The commenter further suggested an ''annual retirement receipt,'' that indicates the percentage and dollar amount of fees by fund in addition to compensation received.[85] Another commenter suggested the Department rely on a ''consumer warning'' and short form disclosure. Another offered disclosure of direct compensation, a narrative disclosure of indirect compensation and a cigarette-style warning (discussed below).

Other commenters took the position that the disclosures would not be helpful to Retirement Investors or would contribute to information overload. In this connection, one commenter noted the Department's own skepticism in its Regulatory Impact Analysis of the effectiveness of disclosure. According to one commenter, regarding the annual disclosure, customers' accounts typically include a mix of investments and reflect a range of transactions, only some of which are the result of a recommendation, and it may not be possible to distinguish the two. Therefore, the annual statement would reflect all transactions in the account, and would not provide meaningful information about compensation or Material Conflicts of Interest with respect to investment advice.

[85] This same commenter suggested the disclosures should be required for all retirement savings products, even beyond the scope of the Regulation and this exemption. As explained above, the Department selected the two-tier approach to appropriately allow the Retirement Investor to focus on the most important information about the Financial Institution's and Adviser's conflicts of interest in a way that is neither too technical nor overwhelming. The commenter's suggestion to expand the disclosures beyond the exemption is beyond the scope of this project.

Several commenters raised questions about the timing of the disclosures. Some commenters argued that transaction disclosure should be provided sufficiently in advance of the transaction (or before entering into the relationship at all) so that the Retirement Investor has the time needed to review the materials provided. Other commenters expressed concern that the proposal would have required the disclosure to be provided too early; as a result, the transaction disclosure requirements could the delay the investment or cause the Retirement Investor to miss the opportunity entirely. Some commenters warned that the specific prices required to be disclosed may not be knowable at the time of the required disclosure. Regarding the annual disclosure, commenters were also concerned that 45 days following the end of the applicable year was not enough time to collect a detailed accounting of the dollars attributable to each asset and prepare the disclosure.

In response to commenters, the Department has significantly revised the disclosure requirements to reduce the burden, focus on pre-transaction disclosure of the most salient information about the contractual relationship and conflicts of interest, and facilitate more detailed disclosure, upon request, to Retirement Investors specifically interested in more detail. The contract and transaction disclosures provide basic information that is critical to the Retirement Investor's understanding of the nature of the relationship and the scope of the conflicts of interest. Without these disclosures, it cannot be fairly said that the Investor has entered into the investment or the advisory relationship with eyes open.

It is true that the final exemption does not chiefly rely on disclosure as a means of protection, but rather on the imposition of fiduciary standards of conduct, anti-conflict policies and procedures, and the prohibition of misaligned incentive structures. Nevertheless, disclosure can serve a salutary purpose in the right circumstances and is critical to obtaining the Retirement Investor's knowing assent to the conflicted advisory relationship. In addition, the public web disclosure is intended as much for intermediaries, consumer watchdogs, and other third parties who can use it to force competitive forces to work on conflicted structures. Similarly, the Department has calibrated the contract and transaction disclosures to focus on the most important information about conflicts of interest and the contractual relationship in a way that is neither too technical nor overwhelming. Thus, more detailed information is available upon request for consumers who are interested in digging deeper and who are presumably better able to use the information.

In this regard, the Department has limited the individual disclosures under Section III to a transaction-based disclosure, focusing on the Financial Institution's Material Conflicts of Interest with respect to the recommended transaction, and the availability upon request, free of charge, of more specific information about the costs, fees and other compensation associated with the investment. The Department has intentionally provided flexibility on the timing of disclosure, as long as it is provided prior to or at the same time as the execution of the recommended investment. Similarly, while the Department proposed a specific model form for the transaction disclosure, in this final exemption it has determined to provide flexibility on the format. In response to concerns about burden, cost, and utility, discussed above, the Department did not adopt the annual disclosure requirement in the final exemption.

The Department did not attempt to revise the transaction disclosure to use hypotheticals, permitted under FINRA rule 2210, because such disclosure would not achieve the desired goal of informing Retirement Investors in a specific way of the costs of the investment over time. The Department also declined to merely duplicate existing disclosure requirements under ERISA sections 404 and 408(b)(2), but rather to focus on the specific disclosures related to the anti-conflict goals of this project. The Department also did not adopt the other specific disclosure suggestions by commenters, as it was persuaded that the two-tier approach most efficiently achieved the Department's objectives. As noted above, the disclosure requirements in the final exemption minimize the burden on both the Financial Institution and the Retirement Investor, without reducing the protections of the disclosure. Additionally, in response to commenters, the Department has included a good faith compliance provision applicable to the Section III disclosures. Section III(c) provides that the Financial Institution will not fail to satisfy the transaction disclosure requirement if, acting in good faith and with reasonable diligence, it makes an error or omission in disclosing the required information, provided the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. This approach enables and incentivizes the Financial Institution to correct good faith errors without losing the benefit of the exemption.

Section III(c) further provides that, to the extent compliance with the Section III disclosures requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

Some commenters also responded to the suggestion in the proposal that the transaction disclosure could be replaced with a "cigarette warning"-style disclosure, such as the following:

> Investors are urged to check loads, management fees, revenue-sharing, commissions, and other charges before investing in any financial product. These fees may significantly reduce the amount you are able to invest over time and may also determine your adviser's take-home pay. If these fees are not reported in marketing materials or made apparent by your investment adviser, do not forget to ask about them.

Several commenters wrote that this, perhaps in combination with an existing disclosure, would be preferable to the specific proposed requirements. Other commenters opposed the proposal. Some were concerned that such a general disclosure would not provide Retirement Investors with the information they needed to understand their investments. The Department is similarly skeptical about the utility of such a general warning, and believes that the goals of the warning are better served by the contract and transaction disclosures contained in the final exemption. Accordingly, the Department declines to mandate the additional disclosure.

c. Web Disclosure

Under Section III(b) of the exemption, the Financial Institution is required to maintain a Web site, freely accessible to the public and updated no less than quarterly, which contains:

(i) A discussion of the Financial Institution's business model and the Material Conflicts of Interest associated with that business model;

(ii) A schedule of typical account or contract fees and service charges;

(iii) A model contract or other model notice of the contractual terms (if applicable) and required disclosures described in Section II(b)–(e), which are reviewed for accuracy no less frequently than quarterly and updated within 30 days if necessary;

(iv) A written description of the Financial Institution's policies and procedures that accurately describes or summarizes key components of the policies and procedures relating to conflict-mitigation and incentive practices in a manner that permits Retirement Investors to make an informed judgment about the stringency of the Financial Institution's protections against conflicts of interest;

(v) To the extent applicable, a list of all product manufacturers and other parties with whom the Financial Institution maintains arrangements that provide Third Party Payments to either the Adviser or the Financial Institution with respect to specific investment products or classes of investments recommended to Retirement Investors; a description of the arrangements, including a statement on whether and how these arrangements impact Adviser compensation, and a statement on any benefits the Financial Institution provides to the product manufacturers or other parties in exchange for the Third Party Payments; and

(vi) Disclosure of the Financial Institution's compensation and incentive arrangements with Advisers including, if applicable, any incentives (including both cash and non-cash compensation or awards) to Advisers for recommending particular product manufacturers, investments or categories of investments to Retirement Investors, or for Advisers to move to the Financial Institution from another firm or to stay at the Financial Institution, and a full and fair description of any payout or compensation grids, but not including information that is specific to any individual Adviser's compensation or compensation arrangement.

Section III(b)(1)(vii) clarifies that the Web site may describe the above arrangements with product manufacturers, Advisers, and others by reference to dollar amounts, percentages, formulas, or other means reasonably calculated to present a materially accurate description of the arrangements. Similarly, the Web site may group disclosures based on reasonably defined categories of investment products or classes, product manufacturers, Advisers, and arrangements, and it may disclose reasonable ranges of values, rather than specific values, as appropriate. By permitting Financial Institutions to present information in reasonably-defined categories and in reasonable ranges of values, the Department does not intend to permit disclosures that are so broad as to obscure significant conflicts of interest. A broad category covering all mutual funds, or insurance products, for example, would not be sufficiently detailed unless the Financial Institution maintained the same compensation arrangement with all such mutual funds or insurance products. Likewise, disclosing a very broad range of compensation structures applicable to all the Financial Institution's Advisers would not be sufficient if in fact there are material differences among adviser compensation. However constructed, the Web site must fairly disclose the scope, magnitude, and nature of the compensation arrangements and Material Conflicts of Interest in sufficient detail to permit visitors to the Web site to make an informed judgment about the significance of the compensation practices and Material Conflicts of Interest with respect to transactions recommended by the Financial Institution and its Advisers. Section III(b)(1)(vi) clarifies that the disclosure also must include incentives the Financial Institution offers to Advisers to move to or stay the firm. These disclosures need not contain amounts paid to specific individuals, but instead should be a reasonable description of the incentives paid and factors considered by the Financial Institution. This change is intended to clarify and narrow the requirement in the proposal that the Web site include "indirect material compensation payable to the Adviser."

Additionally, Section III(b)(2) makes clear that, to the extent the information required by this section is provided in other disclosures which are made public, including those required by the SEC and/or the Department such as a Form ADV, Part II, the Financial Institution may satisfy Section III(b) by posting such disclosures to its Web site with an explanation that the information can be found in the disclosures and a link to precisely where it can be found. Further, Section III(b)(3) provides that the Financial Institution is not required to disclose information on the web if such disclosure is otherwise prohibited by law. Section III(b)(4) requires that, in addition to providing the written descriptions of the Financial Institution's policies and procedures on its Web site, as required by under Section III(b)(1)(iv), Financial Institutions must provide their complete policies and procedures, adopted pursuant to Section II(d), to the Department upon request. Finally, Section III(b)(5) requires that, in the event that a Financial Institution determines to group disclosures as described above, it must retain the data and documentation supporting the group disclosure during the time that it is applicable to the disclosure on the Web site, and 6 years after that, and make the data and documentation available to the Department within 90 days of the Department's request.

Finally, Section III(c) contains a good faith exception in the event of an error or omission in disclosing the required information, or if the Web site is temporarily inaccessible. The Financial Institution will not fail to satisfy the exemption provided it discloses the correct information as soon as practicable, but, in the case of an error or omission on the web, not later than 7 days after the date on which it discovers or reasonably should have discovered the error or omission, and in the case of an error or omission with respect to the transaction disclosure, not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. The periods differ because of the likelihood that errors or omissions on the Web site will have a greater impact than an error in an individual disclosure, due to the wider audience. Moreover, the Web site should be able to be updated more quickly than an individual disclosure; the 30-day period for correction of transaction disclosures builds in time to provide the corrected disclosure to the Retirement Investor through a variety of means, including mailing.

In addition, to the extent compliance with the disclosure requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, the exemption provides that they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

The good faith provisions apply to the requirement that the Financial Institution retain the data and documentation supporting the disclosure during the time that it is applicable to the disclosure on the Web site and provide it to the Department upon request. In addition, if such records are lost or destroyed due to circumstances beyond the control of the Financial Institution, then no prohibited transaction will be considered to have occurred solely on the basis of the unavailability of those records; and no party, other than the Financial Institution responsible for complying with subsection (b)(1)(vii) will be subject to the civil penalty that may be assessed under ERISA section 502(i) or the taxes imposed by Code section 4975(a) and (b), if applicable, if the records are not maintained or provided to the Department within the required timeframes.

In the proposed exemption, the Web site disclosure focused on the direct and indirect material compensation payable to the Adviser, Financial Institution and any Affiliate for services provided in connection with recommended investments available for purchase, holding or sale within the last 365 days, as well as the source of the compensation, and how the compensation varied within and among Assets. The proposal indicated that the compensation disclosure could be expressed as a monetary amount, formula or percentage of the assets involved in the purchase, sale or holding. Under the proposal, the Financial Institution's Web site was required to provide access to the information in a machine readable format.

The Department's intent in proposing the web disclosure was to provide broad transparency about the pricing and compensation structures adopted by Financial Institutions and Advisers. The Department contemplated that the data could be used by financial information companies to analyze and provide information comparing the practices of different Advisers and Financial Institutions. This information would allow Retirement Investors to evaluate and compare the practices of particular Advisers and Financial Institutions. A few commenters expressed support for the proposed web disclosure as an effort to increase transparency and use market forces to positively affect industry practices.

A number of other commenters viewed the proposed web disclosure as too costly, burdensome, and unlikely to be used by individual Retirement Investors, or expressed confidentiality and privacy concerns. In particular, commenters opposed disclosure of Adviser-level compensation. A few commenters misinterpreted the proposal to require disclosure of the precise total compensation amounts earned by each individual Adviser, and strongly opposed such disclosure. Other commenters took the position that the requirements of the proposed web disclosure would violate other legal or regulatory requirements applicable to advertising and antitrust law.

Other commenters expressed concerns about the logistics of the Web site. For example, they argued that the requirement that the Financial Institution describe compensation received in connection with each asset available for purchase, holding or sale within the past 365 days could require constant updating. Some commenters also raised questions about the meaning of the requirement that the data on the site be ''machine readable,'' although others expressed support for the requirement, which could have made the information more easily accessible to the public.

In the final exemption, the web disclosure requirement has been reworked as a more principles-based approach to avoid commenters' concerns. The Department accepted the suggestion of a commenter that the web disclosure should contain: A schedule of typical account or contract fees and service charges, and a list of product manufacturers with whom the Financial Institution maintains arrangements that provide payments to the Adviser and Financial Institution, including whether the arrangements impact Adviser compensation. Another commenter suggested that the Department require disclosure of the Financial Institution's business model and the Material Conflicts of Interest associated with the model. The commenter further suggested the Department should require disclosure of the Financial Institution's compensation practices with respect to Advisers, including payout grids and non-cash compensation and rewards. The Department has adopted these suggestions as well. However, with respect to the level of detail required, the Department has qualified the requirements of Section III(b) by giving the Financial Institution considerable flexibility on how best to present the information subject to the following principle: The Web site must ''fairly disclose the scope, magnitude, and nature of the compensation arrangements and Material Conflicts of Interest in sufficient detail to permit visitors to the Web site to make an informed judgment about the significance of the compensation practices and Material Conflicts of Interest with respect to transactions recommended by the Financial Institution and its Advisers.''

The approach in the final exemption addresses many of the commenters' concerns about the burdens of the proposed web disclosure. To that end, the Department made the changes described above and also eliminated the proposed requirement that the information on the web be made available in machine readable format. However, the Department did not accept comments that suggested only general information be required on the web, or that no information on Adviser compensation arrangements should be provided. Certainly, the Financial Institution need not itemize or otherwise disclose the specific compensation it pays to an individual Adviser on its public Web site. However, the information on the Financial Institution's arrangements, including its compensation arrangements with Advisers, should be provided with enough specificity to inform users of the significance of these arrangements with respect to the transactions recommended by the Financial Institution and its Advisers. Consistent with the Department's initial goals, the web disclosure in the final exemption will create a mechanism for Retirement Investors and financial information companies to evaluate and compare compensation practices and Material Conflicts of Interests among different Financial Institutions and Advisers.

The final disclosure requirement responds to other comments as well. Permitting Financial Institutions to rely on other public disclosures, as set forth in Section III(b)(2), responds to several requests that the Department incorporate existing disclosures to ease the burden on the Financial Institutions. These commenters argued that the information required to be disclosed as part of the exemption may already be part of other existing disclosures, such as those provided pursuant to ERISA sections 404(a)(5) and 408(b)(2) and the SEC's required mutual fund summary prospectuses and Form ADV. The Department has accepted these comments insofar as the information required disclosed pursuant to other requirements also satisfies the conditions of the exemption, and so long as the Financial Institution provides an explanation that the information can be found in the disclosures and a link to where it can be found.

Other commenters were concerned that these Web sites would be considered advertising, and therefore become subject to additional requirements under other federal and state laws, or that disclosure of certain arrangements would violate antitrust laws. Section III(b)(3) of the exemption provides that the Financial Institution is not required to disclose information on the web if such disclosure is otherwise prohibited by law. However, this provision does not excuse a Financial Institution from seeking approval from a regulator under established procedures for such approval, such as for review of advertising material, if such procedures exist.

Commenters also raised antitrust concerns, specifically with regard to the information that the proposed exemptions required Financial Institutions to post on their Web site. The Department believes that the Web site disclosure requirements of the final exemption avoids these concerns by providing Financial Institutions considerable flexibility as to how the information is published on the Web site as long as the Financial Institutions compensation arrangements are described in sufficient detail to allow visitors to the Web site to make an informed judgment about the significance of compensation practice and Material Conflicts of Interest. Additionally, this exemption permits the Financial Institution to group disclosures based on reasonable-defined categories and to disclose reasonable range of values rather than specific numbers. The purpose of the information on the Web site is to allow investors to make informed decisions about their advisers, not to promote anticompetitive arrangements. Moreover, the exemption makes clear that Financial Institutions are not required to disclose information if such disclosure is otherwise prohibited by law.

A commenter also asked for clarification on the requirement that the Web site be ''freely accessible to the public,'' and whether a Web site that requires a visitor to create a user name and password to gain access would comply. The Department clarifies that such requirements are permissible assuming that they impose no additional constraints or conditions on free public access to the Web site, so that the site can serve its purpose of providing transparency in the marketplace, promoting competition, and facilitating the work of financial information companies to review and analyze such information. Another commenter cautioned that many small financial advisers do not maintain a Web site and this disclosure requirement would impose a significant burden on them. In the Department's view, however, the modest cost of maintaining a Web site is more than offset by the need to ensure that the information is freely and easily accessible to the general public, so that the disclosure can serve its competitive and protective purposes. Accordingly, the Department has decided to retain the requirement to provide disclosures through a Web site.

Finally, the correction procedure in Section III(c) addresses the risk to the Financial Institution, raised by commenters, that minor mistakes in the published disclosures could cause large numbers of transactions to become non-exempt prohibited transactions subject to excise tax and rescission.

8. Proprietary Products and Third Party Payments (Section IV)

Section IV of the exemption applies to Financial Institutions that restrict their Advisers' investment recommendations, in whole or in part, to investments that are Proprietary Products or that generate Third Party Payments. Section IV is intended to clarify that such Financial Institutions and Advisers may rely on the exemption. This responds to a number of comments asking the Department to provide certainty as to the treatment of Proprietary Products and limited menus.

Specifically, Section IV(a) of the final exemption provides that a Financial Institution that at the time of the transaction restricts its Advisers' investment recommendations, in whole or in part, to Proprietary Products or to investments that generate Third Party Payments, may rely on the exemption provided all of the applicable conditions are satisfied. Proprietary Products are defined in the exemption as products that are managed, issued or sponsored by the Financial Institution or any of its Affiliates. Third Party Payments are defined to include sales charges that are 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.

Section IV(b) describes how a Financial Institution that limits its Advisers' investment recommendations, in whole or part, based on whether the investments are Proprietary Products or generate Third Party Payments, and an Adviser making recommendations subject to such limitations, will be deemed to satisfy the Best Interest standard. Some, but not all, of the conditions are already applicable to Financial Institutions and Advisers under other provisions of the exemption. Nevertheless, the text sets out each condition in detail rather than by reference so that the section provides a clear statement in one place of the components of the Best Interest standard for such Financial Institutions and Advisers.

Section IV does contain additional conditions for such Financial Institutions, however. In particular, as described in greater detail below, under Section IV(b)(3), Financial Institutions must document the limitations they place on their Advisers' investment recommendations, the Material Conflicts of Interest associated with proprietary or third party arrangements, and the services that will be provided both to Retirement Investors as well as third parties in exchange for payments. Such Financial Institutions must then reasonably conclude that the limitations will not cause the Financial Institution or its Advisers to receive compensation in excess of reasonable compensation, and, after consideration of their policies and procedures, reasonably determine that the limitations and associated conflicts of interest will not cause the Financial Institution or its Advisers to recommend imprudent investments. Financial Institutions must document the bases for their conclusions in these respects and retain the documentation pursuant to the recordkeeping requirements in Section V of the exemption, for examination upon request by the Department and other parties set forth in that section.

The condition in Section IV(b)(3) reflects the Departments' deep and continuing concern regarding the Financial Institutions' own conflicts of interest in limiting products available for investment recommendations. The purpose of Section IV(b)(3) is to require Financial Institutions to carefully consider their business models and form a reasonable conclusion about the impact of conflicts of interest associated with these particular limitations on Advisers' advice. The exemption will be available only if the Financial Institution reasonably concludes that these limitations, in conjunction with the anti-conflict policies and procedures, will not result in advice that violates the standards set forth in the exemption. Of course, the Adviser and the Financial Institution must also comply with the other conditions of the exemption as well.

Specifically, under Section IV(b) such Financial Institutions and Advisers shall be deemed to satisfy the Best Interest standard of Section VIII(d) if:

(1) Prior to or at the same time as the execution of a transaction based on the advice, the Retirement Investor is clearly and prominently informed in writing that the Financial Institution offers Proprietary Products or receives Third Party Payments with respect to the purchase, sale, exchange, or holding of recommended investments; and the Retirement Investor is informed in writing of the limitations placed on the universe of investments that the Adviser may recommend to the Retirement Investor. The notice is insufficient if it merely states that the Financial Institution or Adviser "may" limit investment recommendations based on whether the investments are Proprietary Products or generate Third Party Payments, without specific disclosure of the extent to which recommendations are, in fact, limited on that basis;

(2) Prior to or at the same time as the execution of a recommended transaction, the Retirement Investor is fully and fairly informed in writing of any Material Conflicts of Interest that the Financial Institution or Adviser have with respect to the recommended transaction, and the Adviser and Financial Institution comply with the disclosure requirements set forth in Section III (providing for web and transaction-based disclosure of costs, fees, compensation, and Material Conflicts of Interest);

(3) The Financial Institution documents in writing its limitations on the universe of recommended investments; documents in writing 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; documents any services it will provide to Retirement Investors in exchange for the Third Party Payments, as well as any services or consideration it will furnish to any other party, including the payor, in exchange for Third Party Payments; reasonably concludes that the limitations on the universe of recommended investments and Material Conflicts of Interest will not cause the Financial Institution or its Advisers to receive compensation in excess of reasonable compensation for Retirement Investors as set forth in Section II(c)(2); reasonably determines, after consideration of the policies and procedures established pursuant to Section II(d), that these limitations and Material Conflicts of Interest will not cause the Financial Institution or its Advisers to recommend imprudent investments; and documents the bases for its conclusions;

(4) The Financial Institution adopts, monitors, implements, and adheres to policies and procedures and incentive practices that meet the terms of Section II(d)(1) and (2); and, in accordance with Section II(d)(3), neither the Financial Institution nor (to the best of its knowledge) any Affiliate or Related Entity uses or relies 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 Adviser to make imprudent investment recommendations, to subordinate the interests of the Retirement Investor to the Adviser's own interests, or to make recommendations based on the Adviser's considerations of factors or interests other than the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor;

(5) At the time of the recommendation, the amount of compensation and other consideration reasonably anticipated to be paid, directly or indirectly, to the Adviser, Financial Institution, or their Affiliates or Related Entities for their services in connection with the recommended transaction is not in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2); and

(6) The Adviser's recommendation with respect to the transaction 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; and the Adviser's recommendation is not based on the financial or other interests of the Adviser or on the Adviser's consideration of any factors or interests other than the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor.

The purpose of Section IV, as proposed, was to establish conditions that help ensure that the particular conflicts of interest associated with proprietary business models or the receipt of Third Party Payments did not undermine Advisers' ability to provide advice in Retirement Investors' Best Interest.

Some commenters on Section IV of the proposed exemption focused in large part on the structure of the section. In the proposal, Section IV(a) provided a general requirement that the Financial Institution offer a "range of Assets that is broad enough to enable the Adviser to make recommendations with respect to all of the asset classes reasonably necessary to serve the Best Interests of the Retirement Investor in light of its investment objectives, risk tolerance, and specific financial circumstances." Section IV(b) then provided specific conditions for Financial Institutions that could not satisfy Section IV(a).

Commenters expressed uncertainty as to the meaning of proposed Section IV(a). They requested clarity on the terms "asset classes" and "range of Assets." Some pointed out that all Financial Institutions limit their products in some ways, and so it may be that no Financial Institution would be able to satisfy Section IV(a). A few commenters described this requirement as a penalty for certain investment specialists who offer only a limited set of investments. Particular concerns were raised by insurance companies, many of which sell Proprietary Products.

Several commenters were concerned that Section IV would prohibit advice relating to Proprietary Products. Some commenters requested that Section IV be replaced with a disclosure requirement, so that any Financial Institution which disclosed its Proprietary Products could provide advice relating to those products without satisfying the other conditions of the exemption. Some commenters raised specific concerns about insurance products and fraternal organizations, and whether they would be able to continue to sell their Proprietary Products.

In response to all of these comments, the Department has revised Section IV(a) to clarify that Financial Institutions may limit the products their Advisers offer to Proprietary Products and those that generate Third Party Payments. The Department has revised Section IV(b) to clarify *how* a Financial Institution that limits its products in this way, in whole or in part, can be deemed to satisfy the Best Interest standard, in light of concerns that the Financial Institutions and their Advisers would otherwise be held to violate the Best Interest standard's requirement that recommendations be made "without regard to the financial or other interests of the Adviser, Financial Institution, or any Affiliate, Related Entity, or other party." The standard provides that such Financial Institutions and Advisers are deemed to meet the Best Interest standard if they satisfy the particular requirements set forth in Section IV(b), which require, *inter alia,* full disclosure of the restrictions on investment recommendations and associated conflicts of interest, the adoption of specified measures to protect investors from conflicts of interest, prudent investment recommendations, and insulation of the Adviser from conflicts of interest when making recommendations from the restricted menu.

In response to a commenter that indicated that the proprietary status of products can change over time, the Department notes that the conditions of Section IV must be satisfied at the time of the transaction with the Retirement

Investor. Subsequent changes in the status of products to non-proprietary, or vice versa, will not cause the exemption to fail to apply.

The sections below discuss the conditions of Section IV and the comments that the Department received on the proposal, including (a) the general conditions, (b) the written findings, (c) the reasonable compensation condition, and (d) the notification condition.

a. Best Interest Conditions Common to All Financial Institutions and Advisers

Section IV responds to concerns expressed by Financial Institutions that limit Advisers' recommendations to Proprietary Products or to products that generate Third Party Payments, as to whether they could ever be said to act "without regard to" their own interests, as required by the general definition of "Best Interest." This section makes clear that such Financial Institutions can satisfy the standard, provided that the recommendation is prudent, the fees reasonable, the conflicts disclosed (so that the customer can fairly be said to have knowingly assented to them) and the conflicts managed through stringent policies and procedures that keep the Adviser's focus on the customer's Best Interest.

Commenters on this issue expressed significant concern about their ability to recommend Proprietary Products under the exemption. They asked for assurance that the "without regard to" language would not effectively prohibit advice regarding Proprietary Products because of an implication that the Financial Institution could not have any interest in the transaction. As a result, the commenters feared that the exemption effectively foreclosed proprietary investment providers from receiving compensation under the exemption.

As noted above, Section IV has been crafted to provide a specific definition of Best Interest applicable to Financial Institutions and Advisers that recommend investments from a restricted menu that includes Proprietary Products or investments that generate Third Party Payments, while protecting Retirement Investors from the harmful impact of conflicts of interest. A number of the conditions of this specific definition are already required elsewhere in the exemption, and should not impose any special or additional burden beyond what is required of all Advisers and Financial Institutions subject to the exemption. Thus, Section IV(b)(1) requires that, prior to or at the same time as the execution of a recommended transaction, the Financial Institution provide notice to the Retirement Investor that it offers Proprietary Products or receives Third Party Payments, and inform the Retirement Investor of the limitations placed on the universe of investments available for Advisers to recommend, in accordance with the required contractual disclosure in Section II(e)(5). The notice to the Retirement Investor regarding Proprietary Products must inform the Retirement Investor that a Proprietary Product is a product managed, issued or sponsored by the Financial Institution and that the Adviser or Financial Institution may have a greater conflict of interest when recommending Proprietary Products due to the benefit to the Financial Institution.

Section IV(b)(2) requires that, prior to or at the same time as the execution of the recommended transaction, the Retirement Investor be informed of Material Conflicts of Interest with respect to the recommended transaction, in accordance with the requirements of Section III. Section IV(b)(4) generally requires that the Financial Institution adopt, implements and adhere to policies and procedures that meet the terms of Section II(d). When Advisers make recommendations from a restricted menu, the Financial Institution may not incentivize Advisers to preferentially recommend those products on the menu that are most lucrative to the Financial Institution.

Section IV(b)(6) places a requirement on the Adviser to recommend investments that are prudent. In addition, when making recommendations from the universe of investments offered by the Financial Institution, the Adviser's recommendations may not be based on the financial or other interests of the Adviser or on the Adviser's consideration of any factors or interests other than the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor. This is an articulation of the Adviser's Best Interest obligation in the context of Proprietary Products or investments that generate Third Party Payments.

b. Written Finding and Documentation

In addition to the sections described above, Section IV(b)(3) retains a requirement of a written finding regarding the effect of these arrangements on advice to Retirement Investors. Some commenters on the proposal objected to a similar provision in proposed Section IV(b)(1) that a Financial Institution which offered a limited range of investment options make a specific written finding that the limitations it has placed would not prevent the Adviser from providing advice that is the Best Interest of the Retirement Investor or otherwise adhering to the Impartial Conduct Standards. A few commenters questioned whether the written finding, as proposed, had to be made with respect to each Retirement Investor individually. A number of commenters more generally objected to the requirement as overly burdensome and of questionable protective value to Retirement Investors.

After consideration of the comments, the Department has restated the condition in Section IV(b)(3) and included specific documentation requirements. The written documentation required in this condition is not individualized and does not have to be provided to Retirement Investors, addressing commenters' concerns that the written finding might have to be made on an individual Retirement Investor basis. But the Department remains convinced of the importance of ensuring that the Financial Institution safeguard against conflicts in the manner proposed. While other provisions of the definition and the exemption create strong limitations on conflicted conduct by individual Advisers, this condition focuses specifically on firm-level conflicts, and for that reason is important to protecting Retirement Investors from harm. As revised, the exemption now imposes the following condition:

> (3) The Financial Institution documents in writing its limitations on the universe of recommended investments; documents in writing 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; documents 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, including the payor, in exchange for Third Party Payments; reasonably concludes that the limitations on the universe of recommended investments and Material Conflicts of Interest will not cause the Financial Institution or its Advisers to receive compensation in excess of reasonable compensation for Retirement Investors as set forth in Section II(c)(2); reasonably determines, after consideration of the policies and procedures established pursuant to Section II(d), that these limitations and Material Conflicts of Interest will not cause the Financial Institution or its Advisers to recommend imprudent investments; and documents the bases for its conclusions;

The purpose of this requirement is to ensure that the Financial Institution reasonably safeguards Retirement Investors from dangerous conflicts of interest, notwithstanding its decision to provide a restricted menu of investment options. Accordingly, the Financial Institution must carefully evaluate and document the conflicts of interest associated with the limited menu; reasonably conclude that the practices will not cause the payment of excess compensation to the Advisers or the Financial Institution; reasonably determine, in light of the Financial Institution's policies and procedures, that the limitations will not cause Advisers to make imprudent recommendations; and document the reasoning for all its conclusions. These documents must be retained under the recordkeeping provisions of the exemption discussed below, and would be available to the Department and Retirement Investors.

These requirements of Section IV(b)(3), together with the disclosure and other requirements of Section IV(b) and the rest of the exemption, were carefully crafted to protect the interests of Retirement Investors. The Department has made the requirements more specific in response to comments, but it declines requests to provide greater exemptive relief to Financial Institutions that make conflicted recommendations of Proprietary Products or investments that generate Third Party Payments. In such cases, it is particularly important that conflicts of interest be carefully addressed at the level of the Financial Institution, not just at the level of the Adviser. Section IV(b)(3) adds clarity and substance to the Financial Institutions' important obligations to their Retirement Investor customers.

c. Reasonable Compensation

Section IV(b)(5) retains a reasonable compensation requirement for Financial Institutions that fall within the parameters of Section IV. The proposal had departed, in some respects, from the formulation of the reasonable compensation standard under ERISA section 408(b)(2) and in Section II(c)(2) of the exemption. In particular, rather than looking at the reasonableness of the aggregate compensation for all of the services to the Retirement Investor, the test required that each instance of compensation be reasonable in relation to the fair market value of the specific service that generated the compensation. The Department's intent in this regard was to ensure that any additional payments, such as Third Party Payments, received in connection with advice, where advice is limited to certain products, were tied to specific services of equivalent value.

Some commenters questioned the need for a special reasonable compensation standard in this context. In particular, they complained that it would be difficult to comply with the test, or to match up particular payments with particular investors. A commenter explained that some investors may pay slightly more due to the funds they select while others may pay slightly less even though the services are basically the same. In addition, higher net-worth clients with larger account balances subsidize those with more modest lower account balances, according to the commenter. Another commenter described the requirement as a departure from prior Department guidance, which focused on the reasonableness of compensation in the aggregate, and did not require that each stream of compensation be determined to be reasonable in relation to the specific services provided.

After considering the comments, the Department has decided to use the same reasonable compensation standard throughout the exemption as set forth in Section II(c)(2), rather than a special standard for Financial Institutions making recommendations from a limited menu. Accordingly, Section IV(b)(5) now states the following condition:

> At the time of the recommendation, the amount of compensation and other consideration reasonably anticipated to be paid, directly or indirectly, to the Adviser, Financial Institution, or their Affiliates or Related Entities for their services in connection with the recommended transaction is not in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2);

This condition, used throughout the exemption, applies the familiar reasonable compensation standard applicable to service providers (fiduciary or non-fiduciary) under ERISA and the Code. Although the standard is a fair market standard, there is no requirement to allocate specific compensation to specific services.

The Department stresses the importance of Financial Institutions' obligations in this regard, particularly when limiting their recommendations to Proprietary Products or products that generate Third Party Payments. In such cases, the Financial Institution's conflicts of interest are acute, and the additional compensation generated by their recommendations often are not transparent to the Retirement Investor. Accordingly, Financial Institutions should give special care to meeting their obligations under Section IV(b)(3) to reasonably conclude that the limitations and conflicts of interest associated with Proprietary Products and Third Party Payments will not cause the Financial Institution or its Advisers to receive compensation in excess of reasonable compensation, and to document the bases for their findings.

d. Notification

Section IV(b)(4) of the proposal contained a provision requiring the Adviser to notify the Retirement Investor if the Adviser does not recommend a sufficiently broad range of Assets to meet the Retirement Investor's needs. Some commenters requested that the Department clarify the purpose of the notice, in part to confirm that it is not punitive. Others asked about the specifics of the wording of the notice and whether it could be phrased to emphasize what is offered instead of what is not. A commenter also suggested it was unnecessary in light of some of the initial disclosures regarding the limitations placed on recommendations.

As explained above, Section IV was re-worked in the final exemption to clarify that Financial Institutions and Advisers may limit the products they offer to Proprietary Products and those that generate Third Party Payments and to specify *how* a Financial Institution that limits its products in this way, in whole or in part, can satisfy the Best Interest standard. After consideration of the comments, the Department has deleted the specific disclosure provision from the text of the exemption condition. It should be emphasized, however, that an Adviser must take special care to comply with the exemption's conditions when making recommendations from a very limited menu. The fact that the menu does not offer an investment that meets the prudence and loyalty standards with respect to the particular customer, and in light of that customer's needs, is not a basis for ignoring those standards. Moreover, Advisers that recommend a limited set of products must consider the share of the portfolio that such products account for, when recommending them to a Retirement Investor. If another type of investment would be in the Retirement Investor's Best Interest, the Adviser may not, consistent with the Best Interest obligation, recommend a product from its limited menu.

9. Disclosure to the Department and Recordkeeping (Section V)

Section V of the exemption establishes record retention and disclosure conditions that a Financial Institution must satisfy for the exemption to be available for compensation received in connection with recommended transactions.

a. EBSA Notice

Before receiving compensation in reliance on the exemption, the Financial Institution must notify the Employee Benefits Security Administration (EBSA) of the Department of Labor of its intention to rely on the exemption. The notice will remain in effect until revoked in writing by the Financial Institution. The notice need not identify any plan or IRA.

The Department received several requests to delete the EBSA notice requirement. One commenter complained this would be a "foot fault" for Financial Institutions trying to comply, placing a burden on the Financial Institutions without adding significant protections for the Retirement Investors. According to the comment, the EBSA notice would not be useful for Retirement Investors or the Department because almost all Financial Institutions would make the one-time filing. The commenter also raised questions about the logistics of the notice; whether each separate legal entity would be required to file the notice and if Financial Institutions would be required to amend their notices when restructuring operations.

The Department has retained the notice requirement in the final exemption. The EBSA notice, while imposing a minimal obligation on the Financial Institution, serves a valuable function by enabling the Department to determine which and which type of Financial Institutions intend to rely on the exemption, and by facilitating the Department's audit and compliance assistance programs. These efforts promote compliance with the exemption's terms and redound to the benefit of Retirement Investors. The Department has kept the notice requirement simple to avoid placing an undue burden on Financial Institutions, but it confirms that each Financial Institution relying on the exemption must file the notice, and, if operations are restructured and a new legal entity becomes the Financial Institution, the new entity must file prior to reliance on the exemption.

The Department has clarified the manner of service in response to comments. The notice must be provided by email to the Department of Labor, Employee Benefits Security Administration, Office of Exemption Determinations at *e-BICE@dol.gov.* One commenter suggested that the Department should create an online submission form with mandatory identification fields and a web address for submitting the form. The Department has not accepted this comment, but notes that the notification need not contain much detailed information. It must simply identify the Financial Institution and its intent to rely on the exemption.

The same commenter also suggested that the notices be provided to the Employee Benefits Security Administration, Office of Enforcement, to allow the Department's investigators to target those Financial Institutions for compliance evaluations. The Department has rejected this comment, however, because the notice serves broader purposes than just enforcement, and the information will be readily available to EBSA's Office of Enforcement regardless of the initial recipient of the information within EBSA.

Other commenters suggested the Department share the information more broadly. One commenter requested that the Department create a mechanism to share the notices with other regulators, including the states, the SEC and FINRA to promote investor protection. Another suggested a publicly accessible registry where filings could be electronically verified and viewed. In addition to providing increased transparency, this would also provide a way for Financial Institutions to confirm that their notification has been received. The Department has declined to accept these comments. This is a notice provision only and the Department does not intend to require any approval or finding by the Department that the Financial Institution is eligible for the exemption. As in the proposal, once a Financial Institution has sent the notice, it can immediately begin to rely on the exemption, provided the conditions are satisfied. However, the Department notes that Financial Institutions should retain documentation of having provided the notification in accordance with Section V(b) discussed below.

One commenter requested a change in the timing of the notification, so that it would be required at the time an investment advice program is implemented, rather than before implementation. The Department has not made this change in the text, but notes that the notification need not be provided significantly in advance of any recommendations and that it is effective upon sending. Therefore, a Financial Institution could send the Department its notice immediately prior to receiving compensation in reliance on the Best Interest Contract Exemption and this condition would be satisfied.

b. Data Request

Section V(b) of the proposal would have required the Financial Institution to collect and maintain data relating to inflows, outflows, holdings, and returns for retirement investments for six years from the date of the applicable transactions and to provide that data to the Department upon request within six months. The Department reserved the right to publicly disclose the information provided on an aggregated basis, although it made clear it would not disclose any individually identifiable financial information regarding Retirement Investor accounts.

The Department eliminated the data request in its entirety in response to comments. While the Department received some comments supporting the requirement, a large number of commenters requested elimination of the requirement. Commenters expressed concerned about the burden and costs of maintaining the necessary materials and responding to the Department within the timeframe. They also raised concerns about coordinating with other regulatory requirements, as well as privacy and security, including trade secrets, especially in light of the provision that would potentially have allowed the Department to make portfolio returns and other information public. One commenter asserted that the provision may violate federal banking law. Still other commenters raised questions regarding the purpose and necessity of the requirement, and the consequences of failure to comply.

While the proposed data collection requirement was not adopted as part of the final exemption, the separate proposed general recordkeeping requirement was adopted, with some modifications, as Section V(b) and (c). The requirement to maintain the records necessary to determine compliance with the exemption both encourages thoughtful compliance and provides an important means for the Department and Retirement Investors to assess whether Financial Institutions and their Advisers are, in fact, complying with the exemption's conditions and fiduciary standards. Although the requirement does not lend itself to the same sorts of statistical and quantitative analyses that would have been promoted by the data collection requirement, it too assists the Department and Retirement Investors in evaluating compliance with the exemption, but at substantially less cost.

c. General Recordkeeping

Under Section V(b) and (c) of the exemption, the Financial Institution must maintain for six years records necessary for the Department and certain other entities, including plan fiduciaries, participants, beneficiaries and IRA owners, to determine whether the conditions of the exemption have been satisfied. These records would include, for example, records concerning the Financial Institution's incentive and compensation practices for its Advisers, the Financial Institution's policies and procedures, any documentation governing the application of the policies and procedures, the documents prepared under Section IV (Proprietary Products and Third Party Payments), contracts entered into with Retirement Investors, and disclosure documentation.

Some commenters objected that these proposed recordkeeping requirements were too burdensome, and expressed concern about required disclosure of trade secrets. One commenter indicated that the exemption should not allow parties such as plan fiduciaries, participants, beneficiaries and IRA owners, to obtain information about a transaction involving another plan or IRA. Another raised concerns that the Department's right to review a bank's records could conflict with federal banking laws that prohibit agencies other than the Office of the Comptroller of the Currency (OCC) from exercising "visitorial" powers over national banks and federal savings associations. The commenter asserted that such visitorial powers, governed by 12 U.S.C. 484, include the power of a regulator to inspect, examine, supervise, and regulate the affairs of an entity.

After consideration of the comments, the Department has modified the recordkeeping provision in the following ways. The Department has clarified which parties may view the records that are maintained by the Financial Institution. Plan fiduciaries, participants, beneficiaries, contributing employers, employee organizations with members covered by the plan, and IRA owners are not authorized to examine records regarding a recommended transaction involving another Retirement Investor. Financial Institutions are not required to disclose privileged trade secrets or privileged commercial or financial information to any of the parties other than the Department, as was also true of the proposal. Financial Institutions are also not required to disclose records if such disclosure would be precluded by 12 U.S.C. 484. As revised, the exemption requires the records be "reasonably" available, rather than "unconditionally" available.

The recordkeeping provision in the exemption is necessary to demonstrate compliance with the terms of the exemption and therefore should represent prudent business practices in any event. The Department notes that similar language is used in many other exemptions and has been the Department's standard recordkeeping requirement for exemptions for some time.

C. Exclusions (Section I(c))

Although Section I(b) broadly permits the receipt of compensation resulting from investment advice within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) to a Retirement Investor, the exemption is subject to some specific exclusions, as discussed below.

1. In-House Plans

Section I(c)(1) provides that the exemption does not apply to the receipt of compensation from a transaction involving an ERISA plan if the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the plan. Industry commenters requested elimination of this exclusion. In particular, they said that Financial Institutions in the business of providing investment advice should not be compelled to hire a competitor to provide services to the Financial Institution's own plan. They warned that the exclusion could effectively prevent these Financial Institutions from providing any investment advice to their employees. Some commenters additionally stated that for compliance reasons, employees of a Financial Institution are often required to maintain their financial assets with that firm. As a result, they argued employees of Financial Institutions could be denied access to investment advice on their retirement savings.

In general, the Department has not scaled back the exclusion. The Department continues to be concerned that the danger of abuse is compounded when the advice recipient receives recommendations from the employer, upon whom he or she depends for a job, to make investments in which the employer has a financial interest. To protect employees from abuse, employers generally should not be in a position to use their employees' retirement benefits as potential revenue or profit sources, without stringent safeguards. See, *e.g.,* ERISA section 403(c)(1) (generally providing that "the assets of a plan shall never inure to the benefit of any employer"). Employers can always render advice and recover their direct expenses in transactions involving their employees without need of an exemption. In addition, ERISA section 408(b)(5) provides a statutory exemption for the purchase of life, health insurance, or annuities provided that the plan pays no more than adequate consideration.

In accordance with this condition, the exemption is not available for compensation received in a rollover from such a plan to an IRA, where the compensation is derived from transactions involving the plan, not the IRA. Additionally, the exclusion in Section I(c) does not apply in the case of an IRA or other similar plan that is not covered by Title I of ERISA. The decision to open an IRA account or obtain IRA services from the employer is much more likely to be entirely voluntary on the employees' part than would be true of their interactions with the retirement plan sponsored and designed by their employer for its employee benefit program. Accordingly, an Adviser or Financial Institution may provide advice to the beneficial owner of an IRA who is employed by the Adviser, its Financial Institution or an Affiliate, and receive prohibited compensation as a result, provided the IRA is not covered by Title I of ERISA, and the conditions of this exemption are satisfied.

Section I(c)(1) further provides that the exemption is unavailable if the Adviser or Financial Institution is a named fiduciary or plan administrator, as defined in ERISA section 3(16)(A)) with respect to an ERISA plan, or an affiliate thereof, that was selected to provide advice to the plan by a fiduciary who is not independent of them. This provision is intended to disallow the selection of Advisers and Financial Institutions by named fiduciaries or plan administrators that have a significant financial stake in the selection and was adopted in the final exemption unchanged from the proposal.[86]

2. Principal Transactions

Section I(c)(2) excludes compensation earned in "principal transactions" from the scope of the exemption. In a "principal transaction," the Financial Institution engages in a purchase or sale transaction with a Retirement Investor for the Financial Institution's own account (or for the account of a person directly or indirectly, through one or more intermediaries, controlling,

[86] The definition of "independent" was adjusted in response to comments, as discussed below, to permit circumstances in which the person selecting the Adviser and Financial Institution could receive no more than 2% of its compensation from the Financial Institution.

controlled by, or under common control with the Financial Institution). As discussed above, this restriction does not include riskless principal transactions. In addition, the exemption does not treat sales of insurance or annuity contracts, or mutual fund shares, as principal transactions.

In the proposal for this Best Interest Contract Exemption, the Department stated that principal transactions would be excluded from the relief provided, but did not define the term ''principal transaction.'' The Department received several requests for clarification of the term, particularly with respect to recommendations of proprietary insurance products. After considering the comments, the Department defined ''principal transaction'' to clarify that purchases and sales of insurance and annuity contracts will not be treated as principal transactions.

Other commenters asked about the treatment of unit investment trusts (UITs). UITs are generally traded on a principal basis, according to commenters, but are sold in ways that are similar to mutual funds sales. Commenters noted that in the proposal, the Department specifically indicated that mutual fund transactions were not treated as excluded principal transactions because they are traded on a riskless principal basis. Commenters asked for confirmation that UITs would receive the same treatment. The Department concurs that to the extent UITs are sold in riskless principal transactions, they can be recommended under this exemption. They are also included within the types of investments that can be recommended under the Principal Transactions Exemption.

3. ''Robo-Advice''

Section I(c)(3) generally provides that the exemption does not cover compensation that is received as a result of investment advice generated solely by an interactive Web site in which computer software-based models or applications provide investment advice to Retirement Investors based on personal information the investor supplies through the Web site without any personal interaction or advice from an individual Adviser. Such computer derived advice is often referred to as ''robo-advice.'' A statutory prohibited transaction exemption at ERISA section 408(b)(14) covers computer-generated investment advice and is available for robo-advice involving prohibited transactions if its conditions are satisfied. *See* 29 CFR 2550.408g–1.

The exclusion does not apply, however, to robo-advice providers that are Level Fee Fiduciaries. Such providers may rely on the exemption with respect to investment advice to engage the robo-advice provider for advisory or investment management services with respect to the Plan or IRA assets, provided they comply with the conditions applicable to Level Fee Fiduciaries.

The Department received several requests to include robo-advice in this exemption or provide a separate streamlined exemption for robo-advice. Commenters argued that all advice should be treated the same, regardless of whether it is provided through a computer or through a human Adviser. Some commenters thought that by excluding robo-advice from the exemption, the Department was limiting options for Retirement Investors. In addition, some commenters stated that robo-advice can be difficult to define, and many Financial Institutions and Advisers may use hybrid programs that rely on both computer software-based models and personal advice. One commenter was concerned that excluding robo-advice from the exemption could leave Retirement Investors who rely on robo-advice without any legal remedy, and may force more Retirement Investors to rely on an untested alternative.

The Department is of the view that the marketplace for robo-advice is still evolving in ways that both appear to avoid conflicts of interest that would violate the prohibited transaction rules and minimize cost. Therefore, the Department included robo-advice in the exemption only if the advice is provided by a Level Fee Fiduciary to enter into the arrangement for robo-advice, including by means of a rollover from an ERISA plan to an IRA, and if the conditions applicable to Level Fee Fiduciaries are satisfied. Accordingly, the fiduciary and its Affiliates must receive only a Level Fee, as defined in the exemption. In addition, the Department notes that hybrid programs in which the Adviser relies upon or works in tandem with such interactive materials are not excluded under the language of Section I(c)(3), regardless if they utilize a level fee arrangement. However, the Department determined against providing relief for robo-advice providers acting purely through the web to receive non-level compensation after being retained by the Retirement Investor. Including such relief in this exemption could adversely affect the incentives currently shaping the market for robo-advice.

The Department further notes that to the extent robo-advice is not covered under exemption, it does not mean that Retirement Investors have no protections with respect to their interactions with such advice providers; to the contrary, it means that the robo-advice providers that are fiduciaries under the Regulation must provide advice under circumstances that do not constitute a prohibited transaction, or rely on another exemption, including ERISA section 408(g).

4. Discretion

Finally, Section I(c)(4) provides that the exemption is not available if the Adviser has or exercises any discretionary authority or discretionary control with respect to the recommended transaction. This has been revised from the proposal in response to comments. Under the proposal, relief would not have been available if an Adviser exercised discretionary authority or control respecting management of the plan or IRA assets involved in the transaction, exercised any authority or control respecting management or disposition of the assets, or had any discretionary authority or responsibility in the administration of the Plan or IRA. Commenters expressed concern that the exclusion was too broad. For example, some commenters asserted that it could be read to exclude an Adviser who had no discretionary or authority with respect to the assets at the time of the transaction, but subsequently acquired such control (*e.g.,* an Adviser who recommended that the investor roll the money out of an IRA into an account to be managed by the Adviser). This was not the Department's intent, and the Department has revised the provision to make clear that the Adviser must have had or exercised discretionary authority to engage in the recommended transaction.

Commenters additionally requested that the exemption apply to discretionary asset management, as well as advice, so that Financial Institutions offering both discretionary and non-discretionary services could comply with the same set of rules. The commenters stated that, as part of this regulatory package, there were proposed amendments that would change some prohibited transaction class exemptions previously relied on by discretionary managers.

The Department has considered these comments but has determined not to broaden the exemption to include relief for fiduciaries with investment discretion over the recommended transactions. These fiduciaries are currently subject to a robust regulatory regime, developed over decades, which specifically addresses the issues raised when a fiduciary is given the discretionary authority to manage assets. Including discretionary fiduciaries in the relief provided by the exemption would expose discretionary fiduciaries—and the Retirement Investors they serve as fiduciaries—to conflicts that they are currently not exposed to. The conditions of this exemption are tailored to the conflicts that arise in the context of the provision of investment advice, not the conflicts that could arise with respect to discretionary money managers. Moreover, the Department's decision to amend other exemptions that are applicable to discretionary managers does not alter the Department's view of the proper scope of this Best Interest Contract Exemption. The amendments to other exemptions applicable to discretionary fiduciaries, also published in this issue of the **Federal Register**, are limited; they primarily incorporate the Impartial Conduct Standards as conditions of those exemptions and clarify issues of scope. The purpose of those amendments too is to reduce the harmful impact of conflicts of interest, not expand the scope of their operation.

D. Good Faith Compliance

Commenters requested that the exemption continue to apply in the event of a Financial Institution's or Adviser's good faith failure to comply with one or more of the conditions. In the commenters' views, the exemption was sufficiently complex and the implementation timeline sufficiently short to justify such a provision. For example, FINRA suggested that the Department include a provision for continued application of the exemption despite a failure to comply with "any term, condition or requirement of this exemption . . . if the failure to comply was insignificant and a good faith and reasonable attempt was made to comply with all applicable terms, conditions and requirements." Several commenters specifically supported FINRA's suggestion.

There were other specific suggestions regarding good faith compliance. For example, one commenter suggested that there be a provision to bar litigation concerning "de minimis" claims, including accounts of $5,000 or less, if the Adviser and Financial Institution acted in good faith. Another suggested the Department adopt a "Compliance Program Safe Harbor," which would provide a safe harbor from litigation if the Financial Institution adopted and implemented a compliance program. The suggested compliance program included, among other features, diligence, training, oversight, annual certification of the compliance program by the Chief Compliance Officer of the Financial Institution or a Related Entity, and an annual audit (by internal or external auditors) of the operation of the compliance program. Other commenters were less specific. One suggested a "principles-based approach" to the penalties and corrections to match the principles-based approach to the conditions. Several other commenters pointed to other good faith compliance provisions in the Department's regulations under ERISA sections 404 and 408(b)(2).

The Department has reviewed the exemption's requirements with these comments in mind and has included a good faith correction mechanism for the disclosure requirements in Section II(e) and Section III. These provisions take a similar approach to the provisions in the Department's regulations under ERISA sections 404 and 408(b)(2). In addition, as discussed above, the Department has eliminated a condition requiring compliance with other federal and state laws, which many commenters had argued could expose them to loss of the exemption based on small or technical violations. The Department has also facilitated compliance by streamlining the contracting process (and eliminating the contract requirement for ERISA plans), reducing the disclosure burden, expanding the scope of the grandfather provision, and extending the time for compliance with many of the exemption's conditions. These and other changes should reduce the need for a self-correction process for excusing violations.

The Department declines to permanently adopt a broader unilateral good faith provision for Financial Institutions and their Advisers because it could undermine fiduciaries' long-run incentive to comply with the fundamental standards imposed by the exemption. The exemption's primary purpose is to combat harmful conflict of interest. If the exemption is too forgiving of abusive conduct, however, it runs the risk of permitting those same conflicts of interest to play a role in the design of policies and procedures, the use and oversight of adviser-incentives, the supervision of Adviser conduct, and the substance of investment recommendations. At the very least, it could encourage Financial Institutions and Advisers to resolve doubts on such questions in favor of their own financial interests rather than the interests of the Retirement Investor. Given the dangers posed by conflicts, the Department has deliberately structured this exemption to provide a strong counter-incentive to such conduct.

Additionally, many of the exemption's standards, such as the Best Interest standard and the reasonable compensation standard, already have a built-in reasonableness or prudence standard governing compliance. It would be inappropriate, in the Department's view, to create a self-correction mechanism for conduct that was imprudent or unreasonable. For example, the Best Interest standard requires that the Adviser 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. Similarly, the policies and procedures requirement under Section II(d) turns to a significant degree on adherence to standards of prudence and reasonableness. Thus, under Section II(d)(1), the Financial Institution is required to adopt and comply with written policies and procedures *reasonably and prudently designed* to ensure that its individual Advisers adhere to the Impartial Conduct Standards set forth in Section II(c).

The considerations above apply to large and small investor accounts alike. The Department does not intend for Financial Institutions be less sensitive or careful about adherence to fiduciary norms with respect to small investors, and declines the suggestion that it adopt a special provision to bar litigation for "de minimis" claims. Additionally, the provision allowing mandatory arbitration of individual claims is also responsive to the practicalities of resolving disputes over small claims. The Department also stresses that violations of the exemption's conditions with respect to a particular Retirement Investor or transaction, eliminates the availability of the exemption for that investor or transaction. Such violations do not render the exemption unavailable with respect to other Retirement Investors or other transactions.

E. Jurisdiction

The Department received a number of comments questioning the Department's jurisdiction and legal authority to proceed with the proposal. A number of commenters focused on the Department's authority to impose certain conditions as part of this exemption, specifically including the contract requirement and the Impartial Conduct Standards.

Some commenters asserted that by requiring a contract for all Retirement Investors, and thereby facilitating contract claims by such parties, the proposal would expand upon the remedies established by Congress under ERISA and the Code. Commenters stated that ERISA preempts state law actions, including breach-of-contract actions. With respect to IRAs and non-ERISA plans, commenters stated that Congress provided that the enforcement of the prohibited transaction rules should be carried out by the Internal Revenue Service, not private plaintiffs. These commenters argued that the Department's proposal would impermissibly create a private right of action in violation of Congressional intent.

Commenters' arguments regarding the Impartial Conduct Standards were based generally on the fact that the standards, as noted above, are consistent with longstanding principles of prudence and loyalty set forth in ERISA section 404, but which have no counterpart in the Code. Commenters took the position that because Congress did not choose to impose the standards of prudence and loyalty on fiduciaries with respect to IRAs and non-ERISA plans, the Department exceeded its authority in proposing similar standards as a condition of relief in a prohibited transaction exemption.

With respect to ERISA plans, commenters stated that Congress' separation of the duties of prudence and loyalty (in ERISA section 404) from the prohibited transaction provisions (in ERISA section 406), showed an intent that the two should remain separate. Commenters additionally questioned why the conduct standards were necessary for ERISA plans, when such plans already have an enforceable right to fiduciary conduct that is both prudent and loyal. Commenters asserted that imposing the Impartial Conduct Standards as conditions of the exemption improperly created strict liability for prudence violations.

Some commenters additionally took the position that Congress, in the Dodd-Frank Act, gave the SEC the authority to establish standards for broker-dealers and investment advisers and therefore, the Department did not have the authority to act in that area.

The Department disagrees that the exemption exceeds its authority. The Department has clear authority under ERISA section 408(a) and the Reorganization Plan [87] to grant administrative exemptions from the prohibited transaction provisions of both ERISA and the Code. Congress gave the Department broad discretion to grant or deny exemptions and to craft conditions for those exemptions, subject only to the overarching requirement that the exemption be administratively feasible, in the interests of plans, plan participants and beneficiaries and IRA owners, and protective of their rights.[88] Nothing in ERISA or the Code suggests that, in exercising its express discretion to fashion appropriate conditions, the Department cannot condition exemptions on contractual terms or commitments, or that, in crafting exemptions applicable to fiduciaries, the Department is forbidden to borrow from time-honored trust-law standards and principles developed by the courts to ensure proper fiduciary conduct.

In addition, this exemption does not create a cause of action for plan fiduciaries, participants or IRA owners to directly enforce the prohibited transaction provisions of ERISA and the Code in a federal or state-law contract action. Instead, with respect to ERISA plans and participants and beneficiaries, the exemption facilitates the existing statutory enforcement framework by requiring Financial Institutions to acknowledge in writing their fiduciary status and the fiduciary status of their Advisers. With respect to IRAs and non-ERISA plans, the exemption requires Advisers and Financial Institutions to make certain enforceable commitments to the advice recipient. Violation of the commitments can result in contractual liability to the Adviser and Financial Institution separate and apart from the legal consequences of a non-exempt prohibited transaction (*e.g.,* an excise tax).

There is nothing new about a prohibited transaction exemption requiring certain written documentation between the parties. The Department's widely-used exemption for Qualified Professional Asset Managers (QPAM), requires that an entity acting as a QPAM acknowledge in a written management agreement that it is a fiduciary with respect to each plan that has retained it.[89] Likewise, PTE 2006–16, an exemption applicable to compensation received by fiduciaries in securities lending transactions, requires the compensation to be paid in accordance with the terms of a written instrument.[90] Surely, the terms of these documents can be enforced by the parties. In this regard, the statutory authority permits, and in fact requires, that the Department incorporate conditions in administrative exemptions designed to protect the interests of plans, participants and beneficiaries, and IRA owners. The Department has determined that the contract requirement in the final exemption serves a critical protective function.

Likewise, the Impartial Conduct Standards represent, in the Department's view, baseline standards of fundamental fair dealing that must be present when fiduciaries make conflicted investment recommendations to Retirement Investors. After careful consideration, the Department determined that broad relief should be provided to investment advice fiduciaries receiving conflicted compensation only if such fiduciaries provided advice in accordance with the Impartial Conduct Standards—*i.e.,* if they provided prudent advice without regard to the interests of such fiduciaries and their Affiliates and Related Entities, in exchange for reasonable compensation and without misleading investors. These Impartial Conduct Standards are necessary to ensure that Advisers' recommendations reflect the best interest of their Retirement Investor customers, rather than the conflicting financial interests of the Advisers and their Financial Institutions. As a result, Advisers and Financial Institutions bear the burden of showing compliance with the exemption and face liability for engaging in a non-exempt prohibited transaction if they fail to provide advice that is prudent or otherwise in violation of the standards. The Department does not view this as a flaw in the exemption, as commenters suggested, but rather as a significant deterrent to violations of important conditions under an exemption that accommodates a wide variety of potentially dangerous compensation practices.

The Department similarly disagrees that Congress' directive to the SEC in the Dodd-Frank Act limits its authority to establish appropriate and protective conditions in the context of a prohibited transaction exemption. Section 913 of that Act directs the SEC to conduct a study on the standards of care applicable to brokers-dealers and investment advisers, and issue a report containing, among other things:

[87] *See* fn. 1, *supra,* discussing of Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)).

[88] *See* ERISA section 408(a) and Code section 4975(c)(2).

[89] *See* Section VI(a) of PTE 84–14, 49 FR 9494, March 13, 1984, as amended at 70 FR 49305 (August 23, 2005) and as amended at 75 FR 38837 (July 6, 2010).

[90] *See* Section IV(c) of PTE 2006–16, 71 FR 63786 (Oct. 31, 2006).

an analysis of whether [sic] any identified legal or regulatory gaps, shortcomings, or overlap in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers.[91]

Section 913 authorizes, but does not require, the SEC to issue rules addressing standards of care for broker-dealers and investment advisers for providing personalized investment advice about securities to retail customers.[92] Nothing in the Dodd-Frank Act indicates that Congress meant to preclude the Department's regulation of fiduciary investment advice under ERISA or its application of such a regulation to securities brokers or dealers. To the contrary, Dodd-Frank in directing the SEC study specifically directed the SEC to consider the effectiveness of existing legal and regulatory standards of care under other federal and state authorities.[93] The Dodd-Frank Act did not take away the Department's responsibility with respect to the definition of fiduciary under ERISA and in the Code; nor did it qualify the Department's authority to issue exemptions that are administratively feasible, in the interests of plans, participants and beneficiaries, and IRA owners, and protective of the rights of participants and beneficiaries of the plans and IRA owners. If the Department were unable to rely on contract conditions and trust-law principles, it would be unable to grant broad relief under this exemption from the rigid application of the prohibited transaction rules. This enforceable standards-based approach enabled the Department to grant relief to a much broader range of practices and compensation structures than would otherwise have been possible.

Additionally, the Department notes that nothing in ERISA or the Code requires any Adviser or Financial Institution to use this exemption. Exemptions, including this class exemption, simply provide a means to engage in a transaction otherwise prohibited by the statutes. The conditions to an exemption are not equivalent to a regulatory mandate that conflicts with or changes the statutory remedial scheme. If Advisers or Financial Institutions do not want to be subject to contract claims, they can (1) change their compensation structure and avoid committing a prohibited transaction, (2) use the statutory exemptions in ERISA section 408(b)(14) and section 408(g), or Code section 4975(d)(17) and (f)(8), or (3) apply to the Department for individual exemptions tailored to their particular situations.

[91] Dodd-Frank Act section 913(d)(2)(B).

[92] 15 U.S.C. 80b–11(g)(1).

[93] Dodd-Frank Act section 913(b)(1) and (c)(1).

F. Alternatives

A number of commenters suggested complete alternatives to the approach taken in the proposed exemption. As an initial matter, some suggestions were aimed at streamlining and simplifying the exemption to reduce compliance burdens. The Department reviewed the exemption with these comments in mind and has made changes to reduce complexity and compliance burden without sacrificing significant protections. For example, the Department eliminated the proposed contract requirement for advice to Retirement Investors regarding investments in ERISA plans, adopted a less burdensome approach to disclosure, and eliminated the proposed annual disclosure and the proposed data collection requirement.

For all the reasons set forth in the preceding sections, however, the Department remains convinced of the critical importance of the core requirements of the exemption, including an up-front commitment to act as a fiduciary; enforceable adherence to the Impartial Conduct Standards; the adoption of policies and procedures to reasonably assure compliance with the Impartial Conduct Standards; a prohibition on incentives to violate the Best Interest Standard; and fair disclosure of fees, conflicts of interest, and Material Conflicts of Interest. The Impartial Conduct Standards simply require adherence to basic fiduciary norms and standards of fair dealing—rendering prudent and loyal advice that is in the best interest of the customer, receiving no more than reasonable compensation, and refraining from making misleading statements. These fundamental standards enable the Department to grant an exemption that flexibly covers a broad range of compensation structures and business models, while safeguarding the interest of Retirement Investors against dangerous conflicts of interest. The conditions were critical to the Secretary of Labor's ability to make the required findings under ERISA section 408(a) and Code section 4975(c)(2) that the exemption is in the interests of plans, their participants and beneficiaries, and IRAs, that the exemption is protective of their interests, and that the exemption is administratively feasible.

Alternative Best Interest Formulations

Some commenters suggested alternative approaches that included a standard characterized as a ''best interest'' standard of conduct, combined with certain of the other safeguards that the Department had proposed, including reasonable compensation, disclosures, or anti-conflict policies and procedures. As a general matter, however, none of the suggested alternative approaches incorporated all the components of the proposal that the Department viewed as essential to making the required findings for granting an exemption, or provided alternatives that included conditions that would appropriately safeguard the interests of Retirement Investors in light of the exemption's broad relief from the conflicts of interest and self-dealing prohibitions under ERISA and the Code.

In some instances, commenters indicated that a different best interest standard would be appropriate but failed to provide an alternative to the Department's definition. Others suggested a definition of ''best interest'' that did not include a duty of loyalty constraining Advisers from making recommendations based on their own financial interests. Some of these definitions focused exclusively on the fiduciary obligation of prudence, while excluding the equally fundamental fiduciary duty of loyalty. A number of commenters expressed particular concern about the application of the Department's Best Interest requirement that the recommendation be made ''without regard to the financial or other interests of the Adviser, Financial Institution'' or other parties. Some of these commenters suggested that the Department use different formulations that were similar to the Department's, but might be construed to less stringently forbid the consideration of the financial interests of persons other than the Retirement Investor. For example, commenters suggested a standard providing that the Adviser and Financial Institution ''not subordinate'' their customers' interests to their own interests, or that the Adviser and Financial Institution put their customers' interests ahead of their own interests, or similar constructs.

In response to commenter concerns, the Department created a specific ''Best Interest'' test for Advisers and Financial Institutions that make recommendations from a restricted range of investments, including Proprietary Products or investments that generate Third Party Payments. In that circumstance, the test ensures that the Retirement Investor receives full and fair disclosure of the restricted menu and Material Conflicts of Interest: The Financial Institution takes specified steps to ensure advice is prudent, the compensation is reasonable, and the Adviser is appropriately insulated from conflicts of interest; and the Adviser makes recommendations that are prudent and that are not based upon factors other than the needs of the Retirement Investor. Outside of this context, the Department has retained the ''without regard to'' language as best capturing the exemption's intent that the Adviser's recommendations be based on the Investor's interest. This approach also accords with ERISA section 404(a)(1)'s requirement that plan fiduciaries act ''solely in the interest'' of plan participants and beneficiaries.

In addition, in many of the alternatives suggested by commenters, the Best Interest standard appeared to lack a clear means of enforcement. A number of commenters suggested they could abide by a Best Interest standard but at the same time objected to the enforcement mechanisms that the Department proposed, particularly in the IRA market. As discussed above, the Department does not believe that the exemption can serve its participant protective purposes, or that Financial Institutions and their Advisers will be properly incentivized to comply with its terms, if Retirement Investors do not have an enforceable entitlement to compliance.

Disclosure

Other alternative approaches stressed disclosure as a means of protecting Retirement Investors. Some commenters indicated that additional disclosures, alone, would address many of the Department's concerns. Full and fair disclosure of material conflicts and informed consent are, in the Department's view, important elements of exemptive relief but are not sufficient on their own to form the basis of an exemption that is this broad and flexible.

Disclosure alone has proven ineffective to mitigate conflicts in advice. Extensive research has demonstrated that most investors have little understanding of their advisers' conflicts of interest, and little awareness of what they are paying via indirect channels for the conflicted advice. Even if they understand the scope of the advisers' conflicts, many consumers are not financial experts and therefore, cannot distinguish good advice or investments from bad. The same gap in expertise that makes investment advice necessary and important frequently also prevents investors from recognizing bad advice or understanding advisers' disclosures. Indeed, some research suggests that even if disclosure about conflicts could be made simple and clear, it could be ineffective—or even harmful.[94]

Defer to the Securities and Exchange Commission

Many commenters suggested that a uniform standard applicable to all retail accounts would be preferable to the Department's proposal, and that the Department should work with other regulators, such as the SEC and FINRA, to fashion such an approach. Others suggested that the Department should wait and defer to the SEC's determination of an appropriate standard for broker-dealers under the Dodd-Frank Act. Still others suggested that the Department should provide exemptions based on fiduciary status under securities laws, or based on compliance with other applicable laws or regulations. FINRA indicated that the proposal should be based on existing principles in federal securities laws and FINRA rules but acknowledged that additional rulemaking would be required.

The Department disagrees with the commenters, and believes it is important to move forward with this proposal to remedy the ongoing injury to Retirement Investors as a result of conflicted advice arrangements. ERISA and the Code create special protections applicable to investors in tax qualified plans. The fiduciary duties established under ERISA and the Code are different from those applicable under securities laws, and would continue to differ even if both regimes were interpreted to attach fiduciary status to exactly the same parties and activities. Reflecting the special importance of plan and IRA investments to retirement and health security, this statutory regime flatly prohibits fiduciaries from engaging in transactions involving self-dealing and conflicts of interest unless an exemption applies. Under ERISA and the Code, the Department of Labor has the authority to craft exemptions from these stringent statutory prohibitions, and the Department is specifically charged with ensuring that any exemptions it grants are in the interests of Retirement Investors and protective of these interests. Moreover, the fiduciary provisions of ERISA and the Code broadly protect all investments by Retirement Investors, not just those regulated by the SEC. As a consequence, the Department uniquely has the ability to assure that these fiduciary rules work in harmony for all Retirement Investors, regardless of whether they are investing in securities, insurance products that are not securities, or others type of investment.

The Department has taken very seriously its obligation to harmonize its regulation with other applicable laws, including the securities laws. In pursuing its consultations with other regulators, the Department aimed to coordinate and minimize conflicting or duplicative provisions between ERISA, the Code and federal securities laws. The Department has coordinated—and will continue to coordinate—its efforts with other federal agencies to ensure that the various legal regimes are harmonized to the fullest extent possible. The resulting exemption provides Advisers and Financial Institutions with a choice to provide advice that does not involve prohibited conflicted transactions or comply with this exemption or another exemption, which now all require advice to be provided in accordance with basic fiduciary norms. Likewise, the exemption preserves Retirement Investors' ability to choose the method of payment that works best for them. Far from confusing investors, the standards set forth in the exemption ensure that Retirement Investors can uniformly expect to receive advice that is in their best interest with respect to their retirement investments. Moreover, the best interest standard reflects what many investors have believed they were entitled to all along, even though it was not legally required.

In this regard, waiting for the SEC to act, as some commenters suggested, would delay the implementation of these important, updated safeguards to plan and IRA investors investing in a wide variety of products, and impose substantial costs on them as current harms from conflicted advice would continue.

Provide No Additional Exemptions

A few commenters opposed the grant of any exemption at all. One commenter suggested that the exemption sunset after 5 years, to permit a transition to investment advice that does not raise prohibited transaction issues at all. The Department did not accept these comments. The Department shares these commenters' concerns about conflicted advice, but nevertheless believes that simply banning all commissions, transaction-based payments, and other forms of conflicted payments could have serious adverse unintended consequences. These forms of compensation are commonplace in today's marketplace for retirement

[94] *See* Regulatory Impact Analysis.

advice, and often support beneficial advice arrangements. Accordingly, the Department is concerned about the disruptive impact of simply barring all conflicts after 5 years, assuming that were even possible, and about the potential impact that such dramatic action would have on the availability of advice. Instead, the Department has worked to fashion exemptions that mitigate conflicts of interest, and that ensure that Financial Institutions and Advisers adhere to fundamental fiduciary standards, while permitting a wide range of compensation practices and business models.

Special Exemptions

Finally, the Department acknowledges requests for special, streamlined exemptions for certain circumstances or certain products. For example, some commenters requested special treatment for certain parties based on mission or tax-exempt status; certain products such as target date funds, employer securities, or products that qualify as default investment alternatives under 29 CFR 2550.404c–5; and circumstances in which investment advice to Retirement Investors is ''ancillary'' to advice on non-investment insurance products. The Department has fashioned this exemption to apply broadly to advice arrangements in the retail market by taking a standards-based approach, rather than by focusing on particular highly-specific investments, advisory arrangements, or business models subject to highly-proscriptive conditions. Additionally, as described in detail in preceding sections, the Department has carefully considered comments on how to make the exemption more workable and less burdensome. The Department's goal was to create an exemption that could broadly apply to a wide universe of investments and practices, rather than to write special rules for particular subcategories or special circumstances, such as those requested by these commenters in this class exemption. The fiduciary norms, standards, and conditions set forth in the exemption serve an important protective purpose, which should benefit investors across the board including the arrangements identified by the commenters. If, however, the commenters still believe additional relief is necessary for special categories of investments or practices, the Department invites the commenters to apply for an individual or additional class exemption.

G. Consideration of a Low-Fee Streamlined Exemption

In the proposal, the Department indicated that it was considering a separate streamlined exemption that would allow compensation to be received in connection with recommendations of certain high-quality low-fee investments. The Department sought comments on how to operationalize such an exemption, which might minimize the compliance burdens for Advisers offering high-quality low-fee investment products with minimal potential for Material Conflicts of Interest. Products that met the conditions of the streamlined exemption could be recommended to plans, participants and beneficiaries, and IRA owners, and the Adviser could receive variable and third-party compensation as a result of those recommendations, without satisfying some or all of the conditions of this exemption. The streamlined exemption could reward and encourage best practices with respect to optimizing the quality, amount, and combined, all-in cost of recommended financial products, financial advice, and other related services. In particular, a streamlined exemption could be useful in enhancing access to quality, affordable financial products and advice by savers with smaller account balances. Additionally, because it would be premised on a fee comparison, it would apply only to investments with relatively simple and transparent fee structures.

In the proposal, the Department noted that it had been unable to operationalize such an exemption in a way that would achieve the Department's Retirement Investor-protective objectives and therefore did not propose text for such an exemption. Instead, the Department sought public input to assist in the consideration of the merits and possible design of such an exemption. The Department asked a number of specific questions, including which products should be included, how the fee calculations should be established, performed, communicated and updated, what, if any additional conditions should apply, and how a streamlined exemption would affect the marketplace for investment products.

The vast majority of commenters were opposed to creating a streamlined exemption for low-fee products. Commenters expressed the view that the approach over-emphasized the importance of fees, despite prior Department guidance noting that fees were not the sole factor for investors to consider. Commenters also raised many of the same operational concerns the Department had raised in the preamble, such as identifying the appropriate fee cut off, as well as the potential for undermining suitability and fiduciary obligations under securities laws, with a sole focus on products with low fees.

The Department did receive a few comments in support of a low-fee streamlined exemption. These commenters generally recommended that the exemption be limited to certain investments, most commonly mutual funds, and perhaps just those with fees in the bottom five or ten percent. One commenter requested a carve-out from the Regulation's definition of ''fiduciary,'' or a streamlined exemption, for retirement investments in high-quality, low-cost financial institutions savings products, like CDs, when a direct fee is not charged and a commission is not earned by the bank employee. Other commenters were willing to consider a low fee streamlined exemption, but argued that more information was necessary and any such exemption would need to be proposed separately.

The commenters' concerns as described above echoed the Department's concerns regarding the low-fee streamlined exemption. Despite some limited support, the Department has determined not to proceed with a low fee streamlined exemption. The Department did not receive enough information in the comments to address the significant conceptual and operational concerns associated with the approach. For example, after consideration of the comments, the Department was unable to conclude that the streamlined exemption would result in meaningful cost savings. Most Financial Institutions and Advisers would likely only be able to rely on such a streamlined exemption in part. They would still need to comply with this exemption for many of the investments recommended outside of the streamlined exemption. Many of the costs associated with this exemption are upfront costs (*e.g.,* policies and procedures, contracts) that the Financial Institution would have to incur whether or not it used the streamlined exemption. As a result, the streamlined exemption may not have resulted in significant cost savings. In addition, the Department was unable to overcome the challenges it saw in using a low-fee threshold as a mechanism to jointly optimize quality, quantity, and cost. Fundamentally, it is unclear how to set a ''low-fee'' threshold that achieves these all of aims. A single threshold could be too low for some investors' needs and too high for others'. Further, any threshold might encourage the lowest existing prices to rise to the threshold, potentially harming investors.

H. Exemption for Purchases and Sales, Including Insurance and Annuity Contracts (Section VI)

Section VI provides an exemption, which is supplemental to Section I, for certain prohibited transactions commonly associated with investment advice. Section I permits Advisers and Financial Institutions to receive compensation that would otherwise be prohibited by the self-dealing and conflicts of interest provisions of ERISA section 406(a)(1)(D) and 406(b), and Code section 4975(c)(1)(D)–(F). However, Section I does not extend to any other prohibited transaction sections of ERISA and the Code. ERISA section 406(a) and Code section 4975(c)(1)(A)–(D) contain additional prohibitions on certain specific transactions between plans and IRAs and ''parties in interest'' and ''disqualified persons,'' including service providers. These additional prohibited transactions include: (i) The purchase or sale of an asset between a plan/IRA and a party in interest/disqualified person, and (ii) the transfer of plan/IRA assets to a party in interest/disqualified person. These prohibited transactions are subject to excise tax and personal liability for the fiduciary.

A number of transactions that may occur as a result of an Adviser's or Financial Institution's advice involve a prohibited transaction under ERISA section 406(a)(1)(A) and Code section 4975(c)(1)(A). The entity that causes a plan or IRA to enter into the transaction would not be the Adviser or Financial Institution, but would instead be a plan fiduciary or IRA owner acting on the Adviser's or Financial Institution's advice. Because the party requiring relief for this prohibited transaction is separate from the Adviser and Financial Institution, the Department is granting this exemption subject to discrete conditions. As a result, the Adviser's or Financial Institution's failure to comply with any of the conditions of Section I would not result in the authorizing plan fiduciary or IRA owner having engaged in a non-exempt prohibited transaction.

In this regard, a plan's or IRA's purchase of an insurance or annuity product would be a prohibited transaction if the insurance company is a service provider to the plan or IRA, or is otherwise a party in interest or disqualified person. A plan's or IRA's purchase of a security from a Financial Institution in a Riskless Principal Transaction would involve a prohibited transaction if the Financial Institution also provides advice to the plan or IRA. A plan's or IRA's purchase of a proprietary investment product from a Financial Institution also may involve this type of prohibited transaction. These prohibited transactions are not included in the exemption provided under Section I, which contains conditions that an Adviser and Financial Institution must follow. However, in the Department's view, these circumstances are common enough in connection with recommendations by Advisers and Financial Institutions to warrant a supplemental exemption for these types of transactions in conjunction with the relief provided in Section I. This Section VI establishes the conditions applicable to the entity that causes the plan or IRA to enter into the transaction.

Therefore, relief is provided in Section VI for the purchase of an investment product by a plan, or a participant or beneficiary account, or IRA, from a Financial Institution that is a party in interest or disqualified person. Relief is provided solely from the prohibitions of ERISA section 406(a)(1)(A) and (D), and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A) and (D).

This relief is particularly necessary as part of this exemption because of the amendment to and partial revocation of an existing exemption, PTE 84–24, elsewhere in this issue of the **Federal Register**. Pursuant to the final amendment and revocation, PTE 84–24 no longer provides relief for transactions involving the purchase of variable annuity contracts, or indexed annuity contracts or similar contracts. Therefore, to the extent relief is required from ERISA section 406(a)(1)(A) and Code section 4975(c)(1)(A) for transactions involving such annuities, the relief is provided in Section VI.

The conditions for the exemptions in this Section VI are that the transaction must be effected by the Financial Institution in its ordinary course of its business; the transaction may not result in compensation, direct or indirect, to the Financial Institution and its Affiliates that exceeds reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2); and the terms of the transaction are at least as favorable to the Plan, participant or beneficiary account, or IRA as the terms generally available in an arm's length transaction with an unrelated party.

The scope of the exemption in Section VI is broader than the proposal. The proposed exemption was limited to transactions involving insurance or annuity contracts. However, in connection with certain other changes made in the final exemption, the Department determined that broader relief in this area is necessary. In particular, the expansion beyond insurance or annuity contracts was necessary to provide relief for transactions involving investments not within the original definition of ''Asset'' that may be Proprietary Products purchased and sold with a Financial Institution, and to include investments purchased or sold in Riskless Principal Transactions with Financial Institutions. Of course, the exemption remains available for insurance and annuity products as well.

One commenter requested broader supplemental relief for extensions of credit for bank deposits, certificates of deposit and debt instruments that may be recommended pursuant to Section I. The final exemption does not include such relief. The Department believes that the requested relief is generally available in existing statutory exemptions. For example, relief for extensions of credit in connection with bank deposits and CDs is available under ERISA section 408(b)(4) and Code section 4975(d)(4). Relief for extensions of credit in connection with a plan's or IRA's purchase of a debt security is available in ERISA section 408(b)(17) and Code section 4975(d)(20), provided that extension of credit is not from a fiduciary with respect to the plan or IRA. This would cover the circumstance in which a plan or IRA purchases a debt security, through the Financial Institution, if the issuer of the debt security is a party in interest or disqualified person with respect to the plan or IRA, but not a fiduciary. If relief is sought for the circumstance in which the issuer of the debt security is a fiduciary with respect to the plan or IRA, the Department believes that such transactions should be considered on an individual basis and invites Financial Institutions that wish to recommend their own debt securities to apply for an individual exemption.

The Department made certain changes to the conditions proposed for this exemption, in response to comments. As proposed, the exemption in Section VI was limited to transactions for cash. A few commenters ask that the Department reconsider, and permit in-kind purchases, on the basis that these purchases can result in advantageous pricing to the investor. Other commenters expressed concern that the proposed restriction to cash transactions would exclude a purchase via rollover. The Department concurs with these commenters, and the final exemption does not contain the limitation to cash transactions. The Department also confirms that the exemption covers transactions that occur through a rollover.

In addition, the Department eliminated the approach in the proposed exemption that would have limited relief to small plans (in addition to IRAs, plan participants and beneficiaries). As explained above, under the companion amendment to and partial revocation of PTE 84–24, that exemption no longer provides relief from ERISA section 406(a)(1)(A) and Code section 4975(c)(1)(A) for transactions involving variable annuity contracts and indexed annuity contracts and similar contracts. In light of this restriction of PTE 84–24, there was a broader need for relief from ERISA section 406(a)(1)(A) and Code section 4975(c)(1)(A) for transactions involving plans of all sizes. The final exemption in Section VI provides such relief.

A few commenters requested that Section VI be expanded to provide a broad exemption similar to Section I, that would be specifically tailored to insurance and annuity purchases but would provide relief for Advisers and Financial Institutions from the self-dealing and conflict of interests restrictions in ERISA section 406(b) and Code section 4975(c)(1)(E) and (F). The Department has declined to accept this suggestion, opting instead to make changes regarding insurance products to the various provisions of Section I. The Department is concerned about creating a special less-protective set of conditions available just for insurers with respect to transactions prohibited by ERISA section 406(b) and Code section 4975(c)(1)(E) and (F). Such an approach could encourage Advisers and Financial Institutions, for example, to potentially recommend variable or indexed annuities based on their preference for a less protective regulatory regime rather than on the basis of the Retirement Investor's Best Interest. However, in response to commenters, the Department has revised the reasonable compensation standard in accordance with Section II(c)(2) to avoid unnecessary complexity.

I. Exemption for Pre-Existing Transactions (Section VII)

Section VII provides a supplemental exemption for pre-existing transactions. The exemption permits continued receipt of compensation based on investment transactions that occurred prior to the Applicability Date as well as receipt of compensation for recommendations to continue to adhere to a systematic purchase program established before the Applicability Date. The exemption also explicitly covers compensation received as a result of a recommendation to hold an investment that was entered into prior to the Applicability Date. In this regard, some Advisers and Financial Institutions did not consider themselves fiduciaries before the Applicability Date. Other Advisers and Financial Institutions entered into transactions involving plans, participant or beneficiary accounts, or IRAs before the Applicability Date, in accordance with the terms of a prohibited transaction exemption that has since been amended. The exemption provides relief from the restrictions of ERISA section 406(a)(1)(A), (D) and 406(b) and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A), (D), (E) and (F).

This exemption is conditioned on the following:

(1) The compensation is received pursuant to an agreement, arrangement or understanding that was entered into prior to the Applicability Date and that has not expired or come up for renewal post-Applicability Date;

(2) The purchase, exchange, holding or sale of the securities or other investment property was not otherwise a non-exempt prohibited transaction pursuant to ERISA section 406 and Code section 4975 on the date it occurred;

(3) The compensation is not received in connection with the plan's, participant or beneficiary account's or IRA's investment of additional amounts in the previously acquired investment vehicle; except that for avoidance of doubt, the exemption does apply to a recommendation to exchange investments within a mutual fund family or variable annuity contract pursuant to an exchange privilege or rebalancing program that was established before the Applicability Date, provided that the recommendation does not result in the Adviser and Financial Institution, or their Affiliates or Related Entities receiving more compensation (either as a fixed dollar amount or a percentage of assets) than they were entitled to receive prior to the Applicability Date;

(4) The amount of the compensation paid, directly or indirectly, to the Adviser, Financial Institution, or their Affiliates or Related Entities in connection with the transaction is not in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2); and

(5) Any investment recommendations made after the Applicability Date by the Financial Institution or Adviser with respect to the securities or other investment property reflect 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, and are made without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.

The Department's intent in proposing the exemption for pre-existing investments was to provide certainty that Advisers and Financial Institutions could continue to receive revenue streams based on transactions that occurred prior to the Applicability Date. Under the proposal, the relief for pre-existing transactions was limited, so that any additional advice would have had to occur under the conditions of Section I of the exemption. The Department also proposed that the pre-existing transaction relief should be limited only to limited categories of Assets as defined in the proposed exemption.

Commenters identified the need for broader grandfathering relief in these respects. They stated that limiting the relief to investments within the proposed definition of "Asset" and disallowing additional advice would cut off the ability of plans, participants and beneficiaries, and IRAs to receive advice on a broader range of investments that may already be held in their accounts. They reasoned that in many cases, an investor that has already purchased an investment may already be entitled to continued advice or services based on existing compensation arrangements.

Commenters also indicated that the proposal's approach of restricting any additional advice for investments that were not on the list of Assets could, in some circumstances, create an especially difficult situation for Financial Institutions and Advisers regulated by FINRA. According to commenters, FINRA has been clear that ongoing advice may be a requirement of suitability. Thus, commenters asserted, Financial Institutions and Advisers could be faced with the decision to risk either a prohibited transaction or a suitability violation. Similarly, commenters expressed concern that Financial Institutions would require all Retirement Investors to invest through fee-based accounts—raising concerns about "reverse churning"—if no differential payments with respect to existing investments could be received after the Applicability Date.

The Department concurs with commenters that it is appropriate to provide broader grandfathering relief as a means of affording the industry time to transition to the new regulatory structure, and to minimize disruption of existing arrangements. Consistent with the broadening of the scope of Section I to cover all investment products, not just those within the proposed definition of Asset, the final exemption also includes a grandfathering provision that it is not limited to Assets, and the provision permits additional advice on pre-existing investments to be provided after the Applicability Date. The exemption specifically applies to a hold recommendation.

The exemption does provide, however, that the compensation received must satisfy the reasonable compensations standard, and additional advice must reflect 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, and must be made without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.

The exemption is limited to compensation received as a result of investment advice on securities or other property purchased prior to the Applicability Date and as a result of investment advice to continue to adhere to a systematic purchase program established before the Applicability Date. Section VII(b)(3) provides that the compensation covered under the exemption may not be in connection with the Retirement Investor's investment of additional assets in the previously acquired investment vehicle. This is intended to preclude, for example, advice on additional contributions to a variable annuity product purchased prior to the Applicability Date, or recommending additional investments in a particular mutual fund or asset pool. Although commenters requested broader relief in this area, the Department has declined to permit advice on additional contributions to existing investments without compliance with the protective conditions applicable to Section I. The primary purpose of the exemption for pre-existing investments is to preserve compensation for services already rendered and to permit orderly transition from past arrangements, not to exempt future advice and investments from the important protections of the Regulation and this Best Interest Contract Exemption. Permitting Advisers to recommend additional investments in an existing investment vehicle, without the safeguards provided by the fiduciary norms and other conditions of the exemption, would permit conflicts to flourish unchecked.

Section VII(b)(3) makes clear that the exemption extends to exchanges of investments within a mutual fund family or variable annuity pursuant to exchange privileges or rebalancing programs established prior the Applicability Date.

Several commenters requested even broader relief, asking that the Department grandfather all existing Retirement Investors or Retirement Investor accounts or all IRAs. Some argued that it would not be fair for Retirement Investors who entered into agreements with their Financial Institutions and Advisers that were compliant at the time to have the terms of those agreements change over the course of the investment. The Department declines to provide broader relief. When Advisers make recommendations to make new investments after the Applicability Date, Retirement Investors should be able to expect that the recommendations will adhere to the basic fiduciary standards and conditions set out in this exemption. The Retirement Investor who had a pre-existing relationship is no less in need of protection from conflicts of interest—and no less deserving of adherence to a best interest standard—than the investor who has no such pre-existing relationship. The failure to implement safeguards against conflicts of interest would result in the continued injury of these Retirement Investors, as they invested still more money based on recommendations subject to dangerous conflicts of interest.

A few commenters requested clarification of the circumstances under which the relief in Section VII would be necessary. The fact that the Department proposed an exemption for compensation received in connection with pre-existing investments caused concern among some commenters that the Regulation might apply retroactively to circumstances that occurred prior to the Applicability Date. Therefore, the commenters sought confirmation that compliance with the exemption would not be necessary unless fiduciary investment advice is provided after the Applicability Date with respect to the pre-existing investments.

In response, the Department confirms that the Regulation does not apply retroactively to circumstances that occurred before the Applicability Date. The exemption is only necessary for non-exempt prohibited transactions occurring after the Applicability Date. By providing an exemption for compensation received for investments made prior to the Applicability Date, the Department is not suggesting otherwise; the exemption merely provides transitional relief to avoid uncertainty relating to compensation received after the Applicability Date.

J. Definitions (Section VIII)

Section VIII of the exemption provides definitions of the terms used in the exemption. The Department received comments on certain definitions and has addressed them as described below. Additional comments on definitions, such as "Retirement Investor," "Best Interest," and "Material Conflict of Interest," are discussed above in their respective sections.

1. Adviser

Section VIII(a) defines the term "Adviser" as an individual who:

(1) is a fiduciary of the Plan or IRA solely by reason of the provision of investment advice described in ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B), or both, and the applicable regulations, with respect to the assets of the Plan or IRA involved in the recommended transaction;

(2) is an employee, independent contractor, agent, or registered representative of a Financial Institution; and

(3) satisfies the federal and state regulatory and licensing requirements of insurance, banking, and securities laws with respect to the covered transaction, as applicable.

The Department received some comments on this definition, but has maintained the definition unchanged from the proposal. One commenter asked the Department to treat branch managers in the same manner as Advisers. The Department has declined to expand the definition of Adviser to cover branch managers, but notes that, as discussed above in Section II, the incentives of branch managers should generally be considered as part of the Financial Institution's policies and procedures. Another commenter expressed concern that, because of the requirement to satisfy applicable federal and state laws, call center employees might be required to register with the SEC as "advisers" under the Investment Advisers Act of 1940. The Department notes that the requirement in Section VIII(a)(3) is limited to *applicable* regulatory and licensing requirements. Nothing in this exemption would require call center employees to register under the Investment Advisers Act of 1940 unless they would otherwise be required to do so.

2. Affiliate

Section VIII(b) defines "Affiliate" of an Adviser or Financial Institution as:

(1) any person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution. For this purpose, ''control'' means the power to exercise a controlling influence over the management or policies of a person other than an individual;

(2) any officer, director, partner, employee, or relative (as defined in ERISA section 3(15)), of the Adviser or Financial Institution; and

(3) any corporation or partnership of which the Adviser or Financial Institution is an officer, director, or partner.

The Department received a comment requesting that this definition adopt a securities law definition. The commenter expressed the view that use of a separate definition would make compliance more difficult for broker-dealers. The Department did not accept this comment. Instead, the Department made minor adjustments so that the definition is identical to the affiliate definition incorporated in prior exemptions under ERISA and the Code, that are applicable to broker dealers,[95] as well as the definition that is used in the Regulation. Therefore, the definition should not be new to the broker-dealer community, and is consistent with other applicable laws. In addition, the Department notes that not all entities relying on this exemption are subject to securities laws.

3. Financial Institution

Section VIII(e) defines ''Financial Institution'' as the entity that employs the Adviser or otherwise retains such individual as an independent contractor, agent or registered representative, and that is one of the following:

(1) registered as an investment adviser under the Investment Advisers Act of 1940 or under the laws of the state in which the adviser maintains its principal office and place of business;

(2) a bank or similar financial institution supervised by the United States or state, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act);

(3) an insurance company qualified to do business under the laws of a state, provided that such insurance company: (i) Has obtained a Certificate of Authority from the insurance commissioner of its domiciliary state which has neither been revoked nor suspended, (ii) has undergone and shall continue to undergo an examination by an Independent certified public accountant for its last completed taxable year or has undergone a financial examination (within the meaning of the law of its domiciliary state) by the state's insurance commissioner within the preceding 5 years, and (iii) is domiciled in a state whose law requires that actuarial review of reserves be conducted annually by an Independent firm of actuaries and reported to the appropriate regulatory authority; or (4) a broker or dealer registered under the Securities Exchange Act of 1934.

Congress identified these entities as advice providers in the statutory exemption for investment advice under ERISA section 408(g) and Code section 4975(f)(8).

The Department received several comments on this definition and has made certain modifications. One commenter said that the proposed definition did not reflect the variety of channels in which financial products and services are marketed. The commenter, and a few other commenters, recommended that the Department delete the requirement in the proposed Section VIII(e)(2) that required that advice from banks and similar institutions be provided through a trust department. The Department has accepted this change in the final exemption.

The Department also received several questions about the applicability of the exemption when more than one ''Financial Institution'' is involved in the sale of a financial product. This may occur, for example, if there is a product manufacturer that is an insurance company, and a broker-dealer or registered investment adviser recommending the product to clients. Commenters asked for assurances that the product manufacturer in that example would not have to satisfy the conditions of the exemption applicable to Financial Institutions. As explained earlier, under the exemption, *a* Financial Institution must acknowledge fiduciary status, and the Adviser's recommendations must be subject to oversight by a Financial Institution that meets the definition set forth in the exemption. The exemption does not condition relief on acknowledgment of fiduciary status or execution of the contract or oversight by more than one Financial Institution. However, the Financial Institution exercising supervisory authority must adhere to the conditions of the exemption, including the policies and procedures requirement and the obligation to insulate the Adviser from incentives to violate the Best Interest Standard, including incentives created by any other Financial Institution. The Department notes that if the product manufacturer is the only entity that satisfies the ''Financial Institution'' definition with respect to a particular transaction, the product manufacturer must acknowledge fiduciary status and exercise the required supervisory authority with respect to the exemption, including entering into the contract in the case of IRAs and non-ERISA plans.

In a related example, commenters asked about marketing or distribution affiliates and intermediaries that would not meet the definition of Financial Institution, as proposed. One commenter specifically requested that the definition of Financial Institution be revised to include all entities within an insurance group that arrange for the marketing of financial products. The commenter stated that an insurance company, with its representatives and agents, may market the products of a second financial institution and the contractual arrangements that allow for this marketing frequently are with an entity that is affiliated with the insurance company, but which does not itself meet the proposed definition of a ''Financial Institution.''

The Department declines to expand the categories of Financial Institutions to such intermediaries, but rather limits the definition of Financial Institution to the regulated entities included in the proposed definition which are subject to well-established regulatory conditions and oversight. However, the Department has made provision to add entities to the definition of Financial Institution through the grant of an individual exemption. Accordingly, the definition of Financial Institution includes ''[a]n entity that is described in the definition of Financial Institution in an individual exemption granted by the Department under section 408(a) of ERISA and section 4975(c) of the Code, after the date of this exemption, that provides relief for the receipt of compensation in connection with investment advice provided by an investment advice fiduciary, under the same conditions as this class exemption.'' If parties wish to expand the definition of Financial Institution to include marketing intermediaries or other entities, they can submit an application to the Department for an individual exemption, with information regarding their role in the distribution of financial products, the regulatory oversight of such entities, and their ability to effectively supervise individual Advisers' compliance with the terms of this exemption. If a marketing intermediary or other entity which does not meet the definition of Financial Institution, wishes to obtain the relief provided in this class exemption, the Department will consider such a request in an application for an individual exemption.

4. Independent

Section VIII(f) defines ''Independent'' as a person that:

[95] *See e.g.,* PTE 75–1, Part II, 40 FR 50845 (Oct. 31, 1975), as amended at 71 FR 5883 (Feb. 3, 2006).

(1) Is not the Adviser, the Financial Institution or any Affiliate relying on the exemption;

(2) Does not have a relationship to or an interest in the Adviser, the Financial Institution or Affiliate that might affect the exercise of the person's best judgment in connection with transactions described in this exemption; and

(3) Does not receive or is not projected to receive within the current federal income tax year, compensation or other consideration for his or her own account from the Adviser, Financial Institution or Affiliate in excess of 2% of the person's annual revenues based upon its prior income tax year.

The term Independent is used in Section I(c)(1)(ii), which precludes Financial Institutions and Advisers from relying on the exemption if they are the named fiduciary or plan administrator, as defined in ERISA section 3(16)(A), with respect to an ERISA-covered plan, unless such Financial Institutions or Advisers are selected to provide advice to the plan by a plan fiduciary that is Independent of the Financial Institutions or Advisers. The term Independent is also used in the definitions section, in describing the types of entities that may be Financial Institutions. Insurance companies that are Financial Institutions must have been examined by Independent certified public accountants and be domiciled in a state whose law requires that actuarial review of reserves be conducted annually by an Independent firm of actuaries.

In the proposed exemption, the definition of Independent provided that the person (*e.g.,* the independent fiduciary appointing the Adviser or Financial Institution under Section I(c)(1)(ii), or the certified public accountant or firm of actuaries acting with respect to an insurance company) could not receive any compensation or other consideration for his or her own account from the Adviser, the Financial Institution or an Affiliate. A commenter indicated that as a result, a number of parties providing services to the Financial Institution, and receiving compensation in return, could not satisfy the Independence requirement. The commenter suggested defining entities that receive less than 5% of their gross income from the fiduciary as Independent.

In response, the Department revised the definition of Independent so that it provides that the person's compensation in the current tax year from the Financial Institution may not be in excess of 2% of the person's annual revenues based on the prior year. This approach is consistent with the Department's general approach to fiduciary independence. For example, the Department's prohibited transaction exemption procedures regulation provide a presumption of independence for appraisers and fiduciaries if the revenue they receive from a party is not more than 2% of their total annual revenue.[96] The Department has revised the definition accordingly.[97]

5. Individual Retirement Account

Section VIII(g) defines "Individual Retirement Account" or "IRA" as any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code. This definition is unchanged from the proposal.

The Department received comments on both the application of the proposed Regulation and the exemption proposals to other non-ERISA plans covered by Code section 4975, such as Health Savings Accounts (HSAs), Archer Medical Savings Accounts and Coverdell Education Savings Accounts. The Department notes that these accounts are given tax preferences as are IRAs. Further, some of the accounts, such as HSAs, can be used as long term savings accounts for retiree health care expenses. These types of accounts also are expressly defined by Code section 4975(e)(1) as plans that are subject to the Code's prohibited transaction rules. Thus, although they generally may hold fewer assets and may exist for shorter durations than IRAs, there is no statutory reason to treat them differently than other conflicted transactions and no basis for suspecting that the conflicts are any less influential with respect to advice on these arrangements. Accordingly, the Department does not agree with the commenters that the owners of these accounts are entitled to less protection than IRA investors. The Regulation continues to include advisers to these "plans," and this exemption provides relief to them in the same manner it does for individual retirement accounts described in section 408(a) of the Code.

6. Proprietary Product

Section VIII(l) defines "Proprietary Product" as a product that is managed, issued or sponsored by the Financial Institution or any of its Affiliates. This is revised from the proposal, which defined a Proprietary Product as one that is "managed" by the Financial Institution or an Affiliate. One commenter specifically addressed the proposed definition, and recommended that the definition use the terms "issued" or "sponsored" instead of managed, in order to better match how the industry determines whether a product is proprietary. It is the Department's understanding that a variety of terms can be used to describe a proprietary relationship, particularly depending on the nature of the investment product. Therefore, in the final exemption, the Department has retained the word "managed," but has also added the words "issued" and "sponsored" as suggested by the commenter.

7. Related Entity

Section VIII(m) defines "Related Entity" as any entity other than an Affiliate in which the Adviser or Financial Institution has an interest which may affect the exercise of its best judgment as a fiduciary. This definition is unchanged from the proposal.

The Department received one comment requesting that this be made more specific with respect to the types of relationships the Department envisions. In response the Department explains that the intent behind the Related Entity concept is to provide relief for fiduciary investment advisers that is co-extensive with the scope of the prohibited transactions provisions under ERISA and the Code. As stated in the Department's regulation under ERISA section 408(b)(2):

> The prohibitions [of Section 406(b)] are imposed upon fiduciaries to deter them from exercising the authority, control, or responsibility which makes such persons fiduciaries when they have interests which may conflict with the interests of the plans for which they act. In such cases, the fiduciaries have interests in the transactions which may affect the exercise of their best judgment as fiduciaries. Thus, a fiduciary may not use the authority, control, or responsibility which makes such a person a fiduciary to cause a plan to pay an additional fee to such fiduciary (*or to a person in which the fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary*) to provide a service.

Therefore, the exemption's definition of Related Entity is not intended to identify specific relationships but rather to extend coverage to any entity that has a relationship with the Adviser or Financial Institution that could cause a prohibited transaction. The provisions of the exemption that address Related Entities are generally permissive, and do not require any action on the part of the Related Entity. The purpose is to allow

[96] 29 CFR 2570.31(j).

[97] The same commenter also requested clarification that an IRA owner will not be deemed to fail the Independence requirement simply because he or she is an employee of the Financial Institution. However, the Independence requirement is not applicable to IRA owners.

these entities to receive compensation that would otherwise be prohibited, as long as the conditions of the exemption are satisfied by the Financial Institution and Adviser.

K. Applicability Date and Transition Rules

The Regulation will become effective June 7, 2016 and this Best Interest Contract Exemption is issued on that same date. The Regulation is effective at the earliest possible date under the Congressional Review Act. For the exemption, the issuance date serves as the date on which the exemption is intended to take effect for purposes of the Congressional Review Act. This date was selected to provide certainty to plans, plan fiduciaries, plan participants and beneficiaries, IRAs, and IRA owners that the new protections afforded by the final rule are now officially part of the law and regulations governing their investment advice providers, and to inform financial services providers and other affected service providers that the rule and exemption are final and not subject to further amendment or modification without additional public notice and comment. The Department expects that this effective date will remove uncertainty as an obstacle to regulated firms allocating capital and other resources toward transition and longer term compliance adjustments to systems and business practices.

The Department has also determined that, in light of the importance of the Regulation's consumer protections and the significance of the continuing monetary harm to retirement investors without the rule's changes, an Applicability Date of April 10, 2017, is appropriate for plans and their affected service providers to adjust to the basic change from non-fiduciary to fiduciary status. This exemption has the same Applicability Date; parties may rely on it as of the Applicability Date.

Section IX provides a transition period under which relief from the prohibited transaction provisions of ERISA and the Code is available for Financial Institutions and Advisers during the period between the Applicability Date and January 1, 2018 (the "Transition Period"). For the Transition Period, full relief under the exemption will be available for Financial Institutions and Advisers subject to more limited conditions than the full set of conditions described above. This period is intended to give Financial Institutions and Advisers time to prepare for compliance with the conditions of Section II–V set forth above, while safeguarding the interests of Retirement Investors. The Transition Period conditions set forth in Section IX are subject to the same exclusions in Section I(c), for advice rendered in connection with Principal Transactions, advice from fiduciaries with discretionary authority over the customer's investments, robo-advice, and specified advice concerning in-house plans.

The transitional conditions of Section IX require the Financial Institution and its Advisers to comply with the Impartial Conduct Standards when making recommendations to Retirement Investors. The Impartial Conduct Standards required in Section IX are the same as required in Section II(c) but are repeated for ease of use.

During the Transition Period, the Financial Institution must additionally provide a written notice to the Retirement Investor prior to or at the same time as the execution of the recommended transaction, which may cover multiple transactions or all transactions taking place within the Transition Period, acknowledging its and its Adviser(s) fiduciary status under ERISA or the Code or both with respect to the recommended transaction. The Financial Institution also must state in writing that it and its Advisers will comply with the Impartial Conduct Standards and disclose its Material Conflicts of Interest.

Further, the Financial Institution's notice must disclose whether it recommends Proprietary Products or investments that generate Third Party Payments; and, to the extent the Financial Institution or Adviser limits investment recommendations, in whole or part, to Proprietary Products or investments that generate Third Party Payments, the Financial Institution must notify the Retirement Investor of the limitations placed on the universe of investment recommendations. The notice is insufficient if it merely states that the Financial Institution or Adviser "may" limit investment recommendations based on whether the investments are Proprietary Products or generate Third Party Payments, without specific disclosure of the extent to which recommendations are, in fact, limited on that basis. The disclosure may be provided in person, electronically or by mail. It does not have to be repeated for any subsequent recommendations during the Transition Period.

Similar to the disclosure provisions of Section II(e) and III, the transition exemption in Section IX provides for exemptive relief to continue despite errors and omissions with respect to the disclosures, if the Financial Institution acts in good faith and with reasonable diligence.

In addition, the Financial Institution must designate a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards.

Finally, the Financial Institution must comply with the recordkeeping provision of Section V(b) and (c) of the exemption regarding the transactions entered into during the Transition Period.

After the Transition Period, however, the limited conditions provided in Section IX for the exemption will no longer be available. After that date, Financial Institutions and Advisers must satisfy all of the applicable conditions described in Sections II–V for the relief in Section I(b) to be available for any prohibited transactions occurring after that date. This includes the requirement to enter into a contract with a Retirement Investor, where required. Financial Institutions relying on the negative consent procedure set forth in Section II(a)(1)(ii) must provide the contractual provisions to Retirement Investors with existing contracts prior to January 1, 2018, and allow those Retirement Investors 30 days to terminate the contract. If the Retirement Investor does terminate the contract within that 30-day period, this exemption will provide relief for 14 days after the date on which the termination is received by the Financial Institution. In that event, the Retirement Investor's account generally should be able to fall within the provisions of Section VII for pre-existing transactions. The provisions in Sections VI and VII of this Best Interest Contract Exemption, providing exemptions for certain purchase and sale transactions, including insurance and annuity contracts, and pre-existing transactions, respectively, are also available on the Applicability Date. The transition relief does not extend to the transactions described in Section VI which provides an exemption for purchase and sales of investments including insurance and annuity contracts, and Section VII, which provides an additional exemption for pre-existing transactions. Compliance with these exemptions does not require an extended transition period because they have relatively few conditions, which are largely based on meeting well-known standards such as reasonable compensation, arm's length terms, and prudence.

The proposed Best Interest Contract Exemption, with the proposed Regulation and other exemption proposals, generally set forth an Applicability Date of eight months, although the proposal sought comment on a phase in of conditions. Some commenters, concerned about the ongoing harm to Retirement Investors, urged the Department to implement the Regulation and related exemptions quickly. However, the majority of industry commenters requested a two- to three-year transition period. These commenters requested time to enter into contracts with Retirement Investors (including developing and implementing the policies and procedures and incentive practices that meet the terms of Section II(d)(1) and (2); and, in accordance with Section II(d)(3)), create systems needed to provide the required disclosures, and receive any required state approvals for insurance products. Some commenters requested the Department allow good faith compliance during the transition period. Others requested the Department phase in the requirements over time. One commenter requested the best interest standard become effective immediately, with the other conditions becoming effective within one year. Another comment expressed concern about phasing in the conditions over time, referring to this as ''piecemeal'' approach, which would not be helpful to implementing a system to protect Retirement Investors. Other commenters wrote that the Department should re-propose the exemption or adopt it as an interim final exemption and seek additional comments.

The transition provisions in Section IX of the final exemption respond to commenters' concerns about ongoing economic harm to Retirement Investors during the period in which Financial Institutions develop systems to comply with the exemption. The provisions require prompt implementation of certain core protections of the exemption in the form of the acknowledgment of fiduciary status, compliance with the Impartial Conduct Standards, and certain important disclosures, to safeguard Retirement Investors' interests. The provisions recognize, however, that the Financial Institutions will need time to develop policies and procedures and supervisory structures that fully comport with the requirements of the final exemption. Accordingly, during the Transition Period, Financial Institutions are not required to execute the contract or give Retirement Investors warranties or disclosures on their anti-conflict policies and procedures. While the Department expects that Advisers and Financial Institutions will, in fact, adopt prudent supervisory mechanisms to prevent violations of the Impartial Conduct Standards (and potential liability for such violations), the exemption will not require the Financial Institutions to make specific representations on the nature or quality of the policies and procedures during this Transition Period. The Department will be available to respond to Financial Institutions' request for guidance during this period, as they develop the systems necessary to comply with the exemption's conditions.

The transition provisions also accommodate Financial Institutions' need for time to prepare for full compliance with the exemption, and therefore full compliance with all the final exemption's applicable conditions is delayed until January 1, 2018. The Department selected that period, rather than two to three years, as requested by some commenters, in light of the adjustments in the final exemption that significantly eased compliance burdens. Although the Department believes that the conditions of the exemption set forth in Section II–V are required to support the Department's findings required under ERISA section 408(a), and Code section 4975(c)(2) over the long term, the Department recognizes that Financial Institutions may need time to achieve full compliance with these conditions. The Department therefore finds that the provisions set forth in Section IX satisfy the criteria of ERISA section 408(a) and Code section 4975(c)(2) for the Transition Period because they provide the significant protections to Retirement Investors while providing Financial Institutions with time necessary to achieve full compliance. A similar transition period is provided for the companion Principal Transactions Exemption due to the corresponding provisions in that exemption that may require time for Financial Institutions to begin compliance.

The Department considered but declined delaying the application of the rule defining fiduciary investment advice until such time as Financial Institutions could make the changes to their practices and compensation structures necessary to comply with Sections II through V of this exemption. The Department believed that delaying the application of the new fiduciary rule would inordinately delay the basic protections of loyalty and prudence that the rule provides. Moreover, a long period of delay could incentivize Financial Institutions to increase efforts to provide conflicted advice to Retirement Investors before it becomes subject to the new rule. The Department understands that many of the concerns regarding the applicability date of the rule are related to the prohibited transaction provisions of ERISA and the Code rather than the basic fiduciary standards. This transition period exemption addresses these concerns by giving Financial Institutions and Advisers necessary time to fully comply with Sections II–V of the exemption.

The Department also considered the views of commenters that requested re-proposal of the regulation and exemptions, or issuing the rule and exemptions as interim final rules with requests for additional comment. After reviewing all the comments on the 2015 proposal, which was itself a re-proposal, the Department has concluded that it is in a position to publish a final rule and exemptions. It has carefully considered and responded to the significant issues raised in the comments in drafting the final rule and exemptions. Moreover, the Department has concluded that the difference between the final documents and the proposals are also responsive to the commenters' concerns and could be reasonably foreseen by affected parties.

The amendments to and partial revocations of existing exemptions finalized elsewhere in this issue of the **Federal Register** will be issued June 7, 2016 and will become applicable on the Applicability Date. Specifically, this includes amendments to and partial revocations PTEs 86–128, 84–24, 75–1, 77–4, 80–83 and 83–1. The conditions of these amended exemptions are largely standards-based, or contain only minimal additional disclosure requirements, and therefore Financial Institutions should not require a transition period longer than through the Applicability Date, to comply. For the avoidance of doubt, no revocation will be applicable prior to the Applicability Date.

No Relief From ERISA Section 406(a)(1)(C) or Code Section 4975(c)(1)(C) for the Provision of Services

This exemption does not provide relief from a transaction prohibited by ERISA section 406(a)(1)(C), or from the taxes imposed by Code section 4975(a) and (b) by reason of Code section 4975(c)(1)(C), regarding the furnishing of goods, services or facilities between a plan and a party in interest. The provision of investment advice to a plan under a contract with a plan fiduciary is a service to the plan and compliance with this exemption will not relieve an Adviser or Financial Institution of the need to comply with ERISA section 408(b)(2), Code section 4975(d)(2), and applicable regulations thereunder.

Paperwork Reduction Act Statement

In accordance with the requirements of the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506(c)(2)), the Department solicited comments on the information collections included in the proposed Best Interest Contract Exemption. 80 FR 21960, 21980–83 (Apr. 20, 2015). The Department also submitted an information collection request (ICR) to OMB in accordance with 44 U.S.C. 3507(d), contemporaneously with the publication of the proposal, for OMB's review. The Department received two comments from one commenter that specifically addressed the paperwork burden analysis of the information collections. Additionally many comments were submitted, described elsewhere in the preamble to the accompanying final rule, which contained information relevant to the costs and administrative burdens attendant to the proposals. The Department took into account such public comments in connection with making changes to the prohibited transaction exemption, analyzing the economic impact of the proposals, and developing the revised paperwork burden analysis summarized below.

In connection with publication of this final prohibited transaction exemption, the Department is submitting an ICR to OMB requesting approval of a new collection of information under OMB Control Number 1210–0156. The Department will notify the public when OMB approves the ICR.

A copy of the ICR may be obtained by contacting the PRA addressee shown below or at *http://www.RegInfo.gov.* PRA ADDRESSEE: G. Christopher Cosby, Office of Policy and Research, U.S. Department of Labor, Employee Benefits Security Administration, 200 Constitution Avenue NW., Room N–5718, Washington, DC 20210. Telephone: (202) 693–8410; Fax: (202) 219–4745. These are not toll-free numbers.

As discussed in detail below, the final class exemption will require Financial Institutions to enter into a contractual arrangement with Retirement Investors regarding investments in IRAs and plans not subject to Title I of ERISA (non-ERISA plans), adopt written policies and procedures and make disclosures to Retirement Investors (including with respect to ERISA plans), the Department, and on a publicly accessible Web site, in order to receive relief from ERISA's and the Code's prohibited transaction rules for the receipt of compensation as a result of a Financial Institution's and its Adviser's advice (*i.e.,* prohibited compensation). Financial Institutions that limit recommendations in whole or in part to Proprietary Products or investments that generate Third Party Payments will have to prepare a written documentation regarding these limitations. Financial Institutions will be required to maintain records necessary to prove that the conditions of the exemption have been met. Financial Institutions that are Level Fee Fiduciaries will be required to make disclosures to Retirement Investors acknowledging fiduciary status and, if recommending a rollover from an ERISA plan to an IRA, from an IRA to another IRA, or a switch from a commission-based account to a fee-based account, document the reasons for the recommendation, but will not be subject to any of the other paperwork conditions of the exemption. In addition, the exemption provides a transition period from the Applicability Date, to January 1, 2018. As a condition of relief during the transition period, Financial Institutions must make a disclosure (transition disclosure) to all Retirement Investors (in ERISA plans, IRAs, and non-ERISA plans) prior to or at the same time as the execution of recommended transactions. These requirements are ICRs subject to the Paperwork Reduction Act.

The Department has made the following assumptions in order to establish a reasonable estimate of the paperwork burden associated with these ICRs:

• 51.8 percent of disclosures to ERISA plans and plan participants [98] and 44.1 percent of contracts with and disclosures to IRAs and non-ERISA plans [99] will be distributed electronically via means already used by respondents in the normal course of business and the costs arising from electronic distribution will be negligible, while the remaining contracts and disclosures will be distributed on paper and mailed at a cost of $0.05 per page for materials and $0.49 for first class postage;

• Financial Institutions will use existing in-house resources to distribute required disclosures and to create documentations for transactions recommended by Level Fee Fiduciaries.

• Tasks associated with the ICRs performed by in-house personnel will be performed by clerical personnel at an hourly wage rate of $55.21 and financial advisers at an hourly wage rate of $198.58.[100]

• Financial Institutions will hire outside service providers to assist with nearly all other compliance costs;

• Outsourced legal assistance will be billed at an hourly rate of $335.00.[101]

• Approximately 7,000 broker-dealers, RIAs that are ineligible to be Level Fee Fiduciaries, and insurance companies will use this exemption. Additionally, approximately 13,000 Level Fee Fiduciary RIAs will use of this exemption under level fee conditions.[102] All of these Financial

[98] According to data from the National Telecommunications and Information Agency (NTIA), 33.4 percent of individuals age 25 and over have access to the internet at work. According to a Greenwald & Associates survey, 84 percent of plan participants find it acceptable to make electronic delivery the default option, which is used as the proxy for the number of participants who will not opt out that are automatically enrolled (for a total of 28.1 percent receiving electronic disclosure at work). Additionally, the NTIA reports that 38.9 percent of individuals age 25 and over have access to the internet outside of work. According to a Pew Research Center survey, 61 percent of internet users use online banking, which is used as the proxy for the number of internet users who will opt in for electronic disclosure (for a total of 23.7 percent receiving electronic disclosure outside of work). Combining the 28.1 percent who receive electronic disclosure at work with the 23.7 percent who receive electronic disclosure outside of work produces a total of 51.8 percent who will receive electronic disclosure overall.

[99] According to data from the NTIA, 72.4 percent of individuals age 25 and older have access to the internet. According to a Pew Research Center survey, 61 percent of internet users use online banking, which is used as the proxy for the number of internet users who will opt in for electronic disclosure. Combining these data produces an estimate of 44.1 percent of individuals who will receive electronic disclosures.

[100] For a description of the Department's methodology for calculating wage rates, see *http://www.dol.gov/ebsa/pdf/labor-cost-inputs-used-in-ebsa-opr-ria-and-pra-burden-calculations-march-2016.pdf.* The Department's methodology for calculating the overhead cost input of its wage rates was adjusted from the proposed PTE to the final PTE. In the proposed PTE, the Department based its overhead cost estimates on longstanding internal EBSA calculations for the cost of overhead. In response to a public comment stating that the overhead cost estimates were too low and without any supporting evidence, the Department incorporated published US Census Bureau survey data on overhead costs into its wage rate estimates.

[101] This rate is the average of the hourly rate of an attorney with 4–7 years of experience and an attorney with 8–10 years of experience, taken from the Laffey Matrix. See *http://www.justice.gov/sites/default/files/usao-dc/legacy/2014/07/14/Laffey%20Matrix_2014-2015.pdf.*

[102] One commenter questioned the basis for the Department's assumption regarding the number of Financial Institutions likely to use the exemption. According to the "2015 Investment Management Compliance Testing Survey," Investment Adviser Association, cited in the regulatory impact analysis for the accompanying rule, 63 percent of Registered Investment Advisers service ERISA-covered plans and IRAs. The Department conservatively interprets this to mean that all of the 113 large Registered Investment Advisers (RIAs), 63 percent of the 3,021 medium RIAs (1,903), and 63 percent of the 24,475 small RIAs (15,419) work with ERISA-covered plans and IRAs. The Department assumes that all of the 42 large broker-dealers, and similar shares of the 233 medium broker-dealers (147) and the 3,682 small broker-dealers (2,320) work with ERISA-covered plans and IRAs. According to SEC and

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Institutions will use this exemption in conjunction with transactions involving nearly all of their clients in the retirement market.

Compliance Costs for Financial Institutions That Are Not Level Fee Fiduciaries

The Department believes that nearly all Financial Institutions that are not Level Fee Fiduciaries will contract with outside service providers to implement the various compliance requirements of this exemption. As described in the regulatory impact analysis, per-firm costs for BDs were calculated by allocating the total cost reductions in the medium assumptions scenario across the firm size categories, and then subtracting the cost reductions from the per-firm average costs derived from the Oxford Economics study. The methodology for calculating the per-firm costs for RIAs and Insurance Companies is described in detail in the regulatory impact analysis. The Department is attributing 50 percent of the compliance costs for BDs and RIAs to this exemption and 50 percent of the compliance costs for BDs and RIAs to the Class Exemption for Principal Transactions in Certain Assets between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Principal Transactions Exemption) published elsewhere in today's **Federal Register**. The Department is attributing all of the compliance costs for insurance companies to this exemption.[103] With the above assumptions, the per-firm costs are as follows:

- Start-Up Costs for Large BDs: $3.7 million
- Start-Up Costs for Large RIAs: $3.2 million
- Start-Up Costs for Large Insurance Companies: $6.6 million
- Start-Up Costs for Medium BDs: $889,000
- Start-Up Costs for Medium RIAs: $662,000
- Start-Up costs for Medium Insurance Companies: $1.4 million
- Start-Up Costs for Small BDs: $278,000
- Start-Up Costs for Small RIAs: $219,000
- Start-Up Costs for Small Insurance Companies: $464,000
- Ongoing Costs for Large BDs: $918,000
- Ongoing Costs for Large RIAs: $803,000
- Ongoing Costs for Large Insurance Companies: $1.7 million
- Ongoing Costs for Medium BDs: $192,000
- Ongoing Costs for Medium RIAs: $143,000
- Ongoing Costs for Medium Insurance Companies: $306,000
- Ongoing Costs for Small BDs: $60,000
- Ongoing Costs for Small RIAs: $47,000
- Ongoing Costs for Small Insurance Companies: $100,000

In order to receive compensation covered under this exemption (other than under level fee conditions, which is discussed separately below), Section II requires Financial Institutions to acknowledge, in writing, their fiduciary status and adopt written policies and procedures designed to ensure compliance with the Impartial Conduct Standards. Financial Institutions and Advisers must make certain disclosures to Retirement Investors. Financial Institutions must generally enter into a written contract with Retirement Investors with respect to investments in IRAs and non-ERISA plans with certain required provisions, including affirmative agreement to adhere to the Impartial Conduct Standards.

Sections III and V require Financial Institutions and Advisers to make certain disclosures. These disclosures include: (1) A pre-transaction disclosure, stating the best interest standard of care, describing any Material Conflicts of Interest with respect to the transaction, disclosing the recommendation of proprietary products and products that generate third party payments (where applicable), and informing the Retirement Investor of disclosures available on the Financial Institution's Web site and informing the Retirement Investor that the investor may receive specific disclosure of the costs, fees, and other compensation associated with the transaction; (2) a disclosure, on request, describing in detail the costs, fees, and other compensation associated with the transaction; (3) a web-based disclosure; and (4) a one-time disclosure to the Department.

Under Section IV, Financial Institutions that limit recommendations in whole or in part to Proprietary Products or investments that generate Third Party Payments will have to prepare a written documentation regarding these limitations.

Section IX requires Financial Institutions to make a transition disclosure, acknowledging their fiduciary status and that of their Advisers with respect to the advice, stating the Best Interest standard of care, and describing the Financial Institution's Material Conflicts of Interest and any limitations on product offerings, prior to or at the same time as the execution of any transactions during the transition period from the Applicability Date to January 1, 2018. The transition disclosure can cover multiple transactions, or all transactions occurring in the transition period.

Financial Institutions will also be required to maintain records necessary to prove that the conditions of the exemption have been met.

The Department is able to disaggregate an estimate of many of the legal costs from the costs above; however, it is unable to disaggregate any of the other costs. The Department received a comment on the proposed PTE stating that the estimates for legal professional time to draft disclosures were not supported by any empirical evidence. The Department also received multiple comments on the proposed PTE stating that its estimate of 60 hours of legal professional time during the first year a financial institution used the exemption and then no legal professional time in subsequent years was too low.

In response to a recommendation made during the Department's August 2015, public hearing on the proposed

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FINRA data, cited in the regulatory impact analysis, 18 percent of broker-dealers are also registered as RIAs. Removing these firms from the RIA counts produces counts of 105 large RIAs, 1,877 medium RIAs, and 15,001 small RIAs that work with ERISA-covered plans and IRAs and are not also registered as broker-dealers. SNL Financial data show that 398 life insurance companies reported receiving either individual or group annuity considerations in 2014, of which 22 companies are large, 175 companies are medium, and 201 companies are small. The Department has used these data as the count of insurance companies working in the ERISA-covered plan and IRA markets. Further, according to Hung et al. (2008) (see Regulatory Impact Analysis for complete citation), approximately 13 percent of RIAs report receiving commissions. Additionally, 20 percent of RIAs report receiving performance based fees; however, at least 60 percent of these RIAs are likely to be hedge funds. Thus, as much as 8 percent of RIAs providing investment advice receive performance based fees. Combining the 8 percent of RIAs receiving performance based fees with the 13 percent of RIAs receiving commissions creates an estimate of the number of RIAs that could be ineligible to be Level Fee Fiduciaries (21 percent). The remaining RIAs could be Level Fee Fiduciaries. In total, the Department estimates that 2,509 broker-dealers, 3,566 RIAs ineligible to be Level Fee Fiduciaries, 13,417 Level Fee Fiduciary RIAs, and 398 insurance companies will use this exemption. As described in detail in the regulatory impact analysis, the Department believes a *de minimis* number of banks may also use the exemption.

[103] The Department changed its methodology for estimating costs in an attempt to be responsive to public comments. Many of the comments received on the costs of the rule and exemptions suggested that much of the compliance burden for the rule results from the information collections in the accompanying exemptions. Therefore, the Department believes that a more accurate depiction of the costs of the rule and exemptions can be created by integrating the cost estimates.

rule and exemptions, and in an attempt to create estimates with a clearer empirical evidentiary basis, the Department drafted certain portions of the required disclosures, including a sample contract, the one-time disclosure to the Department, and the transition disclosure. The Department believes that the time spent updating existing contracts and disclosures in future years would be no longer than the time necessary to create the original disclosure. The Department did not attempt to draft the complete set of required disclosures because it expects that the amount of time necessary to draft such disclosures will vary greatly among firms. For example the Department did not attempt to draft sample policies and procedures, disclosures describing in detail the costs, fees, and other compensation associated with the transaction, documentation of the limitations regarding proprietary products or investments that generate third party payments, or a sample web disclosure. The Department expects the amount of time necessary to complete these disclosures will vary significantly based on a variety of factors including the nature of a firm's compensation structure, and the extent to which a firm's policies and procedures require review and signatures by different individuals.

Considered in conjunction with the estimates provided in the proposal, the Department estimates that outsourced legal assistance to draft standard contracts, contract disclosures, pre-transaction disclosures, the one-time disclosure to the Department, and the transition disclosures will cost an average of $3,857 per firm for a total of $25.0 million during the first year. In subsequent years, it will cost an average of $3,076 per firm for a total of $19.9 million annually to update the contracts, contract disclosures, and pre-transaction disclosures.

The legal costs of these disclosures were disaggregated from the total compliance costs because these disclosures are expected to be relatively uniform. Although the tested disclosures generally took less time than many of the commenters said they would, the Department acknowledges that the disclosures that were not tested are those that are expected to be the most time consuming. Importantly, as explained in greater detail in section 5.3 of the regulatory impact analysis, the Department is primarily relying on cost data provided by the Securities Industry and Financial Markets Association (SIFMA) and the Financial Services Institute (FSI) to calculate the total cost of the legal disclosures, rather than its own internal drafting of disclosures. Accordingly, in the event that any of the Department's estimates understate the time necessary to create and update the disclosures, it does not impact the total burden estimates. The total burden estimates were derived from SIFMA and FSI's all-inclusive costs. Therefore, in the event that legal costs are understated, other cost estimates in this analysis would be overstated in an equal manner.

In addition to legal costs for creating the contracts and disclosures, the start-up cost estimates include the costs of implementing and updating the IT infrastructure, creating the web disclosures, gathering and maintaining the records necessary to produce the various disclosures and to prove that the conditions of the exemption have been met, developing policies and procedures, documenting any limitations regarding proprietary products or investments that generate third party payments, addressing material conflicts of interest, monitoring Advisers' adherence to the Impartial Conduct Standards, and any other steps necessary to ensure compliance with the conditions of the exemption not described elsewhere. In addition to legal costs for updating the contracts and disclosures, the ongoing cost estimates include the costs of updating the IT infrastructure, updating the web disclosures, reviewing processes for gathering and maintaining the records necessary to produce the various disclosures and to prove that the conditions of the exemption have been met, reviewing the policies and procedures, producing the detailed transaction disclosures on request, documenting any limitations regarding proprietary products or investments that generate third party payments, monitoring investments as agreed upon with the Retirement Investor, addressing material conflicts of interest, monitoring Advisers' adherence to the Impartial Conduct Standards, and any other steps necessary to ensure compliance with the conditions of the exemption not described elsewhere. These costs total $2.4 billion during the first year and $520.4 million in subsequent years. These costs do not include the costs of distributing disclosures and contracts or the costs of operating under level fee conditions, all of which are discussed below.

Distribution of Disclosures and Contracts

The Department estimates that 1.1 million Retirement Investors with respect to ERISA plans and 29.9 million Retirement Investors with respect to IRAs and non-ERISA plans will receive a three-page transition disclosure during the first year. Additionally, 1.1 million Retirement Investors with respect to ERISA plans will receive a fifteen-page contract disclosure, and 29.9 million Retirement Investors with respect to IRAs and non-ERISA plans will receive a fifteen-page contract during the first year. In subsequent years, 320,000 million Retirement Investors with respect to ERISA plans will receive a fifteen-page contract disclosure and 6.0 million Retirement Investors with respect to IRAs and non-ERISA plans will receive a fifteen-page contract. To the extent that Financial Institutions use both the Best Interest Contract Exemption and the Principal Transactions Exemption, these estimates may represent overestimates because significant overlap exists between the requirements of the transition disclosure and the contract for both exemptions. If Financial Institutions choose to use both exemptions with the same clients, they will probably combine the documents.

The transition disclosure will be distributed electronically to 51.8 percent of ERISA plan investors and 44.1 percent of IRAs and non-ERISA plan investors during the first year. Paper disclosures will be mailed to the remaining 48.2 percent of ERISA plan investors and 55.9 percent of IRAs and non-ERISA plan investors. The contract disclosure will be distributed electronically to 51.8 percent of ERISA plan investors during the first year or during any subsequent year in which the plan begins a new advisory relationship. Paper contract disclosures will be mailed to the remaining 48.2 percent of ERISA plan investors. The contract will be distributed electronically to 44.1 percent of IRAs and non-ERISA plan investors during the first year or during any subsequent year in which the investor enters into a new advisory relationship. Paper contracts will be mailed to the remaining 55.9 percent of IRAs and non-ERISA plan investors. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution will cost approximately $32.5 million during the first year and $4.3 million during subsequent years. Paper distribution will also require two minutes of clerical time to print and mail the disclosure or contract,[104] resulting in 1.2 million

[104] One commenter questioned the basis for this estimate. The Department worked with clerical staff to determine that most notices and disclosures can be printed and prepared for mailing in less than one

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hours at an equivalent cost of $63.6 million during the first year and 117,000 hours at an equivalent cost of $6.4 million during subsequent years.

The Department assumes that ERISA plans that do not allow participants to direct investments will engage in two transactions per month that require pre-transaction disclosures. The Department assumes that ERISA plan participants and IRA holders will engage in two transactions per year that require pre-transaction disclosures. Therefore, the Department estimates that plans and IRAs will receive 62.9 million three page pre-transaction disclosures during the second year and all subsequent years. The pre-transaction disclosures will be distributed electronically for 51.8 percent of the ERISA plan investors and 44.1 percent of the IRA holders and non-ERISA plan participants. The remaining 34.9 million disclosures will be mailed. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution will cost approximately $22.4 million. Paper distribution will also require two minutes of clerical time to print and mail the statement, resulting in 1.2 million hours at an equivalent cost of $64.3 million annually.

The Department estimates that Financial Institutions will receive ten requests per year for more detailed information on the fees, costs, and compensation associated with the transaction during the second year and all subsequent years. The detailed disclosures will be distributed electronically for 51.8 percent of the ERISA plan investors and 44.1 percent of the IRA holders and non-ERISA plan participants. The Department believes that requests for additional information will be proportionally likely with each Retirement Investor type. Therefore, approximately 36,000 detailed disclosures will be distributed on paper. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution will cost approximately $27,000. Paper distribution will also require two minutes of clerical time to print and mail the statement, resulting in 1,000 hours at an equivalent cost of $66,000 annually.

Finally, the Department estimates that all of the 7,000 Financial Institutions that are not Level Fee Fiduciaries will submit the required one-page disclosure to the Department electronically at de minimis cost during the first year.

minute per disclosure. Therefore, an estimate of two minutes per disclosure is a conservative estimate.

Option for Level Fee Fiduciaries Operating Under Level Fee Conditions

The Department estimates that 13,000 Level Fee Fiduciaries will make recommendations to 3.0 million Retirement Investors with respect to ERISA plans, IRAs, and non-ERISA plans annually under level fee conditions.

Based on consultation with its legal staff, the Department estimates that the standard fiduciary acknowledgements required by Level Fee Fiduciaries will take 1 hour and 25 minutes to draft.[105] The Department believes that the time spent updating existing fiduciary acknowledgements in future years would be no longer than the time necessary to create the original acknowledgement. The Department estimates that outsourced legal assistance to draft and/or update fiduciary acknowledgements will cost $6.4 million annually.

The fiduciary acknowledgements will be distributed electronically for 51.8 percent of ERISA plan investors and 44.1 percent of the IRA holders and non-ERISA plan investors. The remaining 1.6 million acknowledgements will be mailed. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution will cost approximately $888,000. Paper distribution will also require two minutes of clerical time to print and mail the acknowledgement, resulting in 55,000 hours at an equivalent cost of $3.0 million annually.

The Department estimates that it will take financial advisers thirty minutes to record the documentation for each recommendation. This results in 1.5 million hours annually at an equivalent cost of $296.9 million.

Overall Summary

Overall, the Department estimates that in order to meet the conditions of this class exemption, Financial Institutions and Advisers will distribute approximately 74.6 million disclosures and contracts during the first year and 73.3 million disclosures and contracts during subsequent years. Distributing these disclosures and contracts, and maintaining records that the conditions of the exemption have been fulfilled will result in a total of 2.5 million hours of burden during the first year and 2.5 million hours of burden in subsequent years. The equivalent cost of this burden is $201.5 million during the first year and $201.2 million in subsequent years. This exemption will result in an outsourced labor, materials, and postage cost burden of $1.6 billion during the first year and $380.7 million during subsequent years.

[105] This estimate does not include the time the Level Fee Fiduciaries will spend documenting the reason or reasons the recommendation was consistent with this exemption.

These paperwork burden estimates are summarized as follows:

Type of Review: New collection.

Agency: Employee Benefits Security Administration, Department of Labor.

Titles: (1) Best Interest Contract Exemption and (2) Final Investment Advice Regulation.

OMB Control Number: 1210–0156.

Affected Public: Businesses or other for-profits; not for profit institutions.

Estimated Number of Respondents: 19,890.

Estimated Number of Annual Responses: 65,095,501 during the first year and 72,282,441 during subsequent years.

Frequency of Response: When engaging in exempted transaction.

Estimated Total Annual Burden Hours: 2,701,270 during the first year and 2,832,369 in subsequent years.

Estimated Total Annual Burden Cost: $2,479,541,143 during the first year and $574,302,408 during subsequent years.

Regulatory Flexibility Act

This exemption, which is issued pursuant to section 408(a) of ERISA and section 4975(c)(2) of the IRC, is part of a broader rulemaking that includes other exemptions and a final regulation published in today's **Federal Register**. The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) imposes certain requirements with respect to Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act (5 U.S.C. 551 *et seq.*), or any other laws. Unless the head of an agency certifies that a final rule is not likely to have a significant economic impact on a substantial number of small entities, section 604 of the RFA requires that the agency present a final regulatory flexibility analysis (FRFA) describing the rule's impact on small entities and explaining how the agency made its decisions with respect to the application of the rule to small entities.

The Secretary has determined that this rulemaking, including this exemption, will have a significant economic impact on a substantial number of small entities. The Secretary has separately published a Regulatory Impact Analysis (RIA) which contains the complete economic analysis for this rulemaking including the Department's FRFA for the rule and the related prohibited transaction exemptions. This section of this preamble sets forth a summary of the FRFA. The RIA is available at *www.dol.gov/ebsa.*

As noted in section 6.1 of the RIA, the Department has determined that regulatory action is needed to mitigate conflicts of interest in connection with investment advice to retirement investors. The regulation is intended to improve plan and IRA investing to the benefit of retirement security. In response to the proposed rulemaking, organizations representing small businesses submitted comments expressing particular concern with three issues: The carve-out for investment education, the best interest contract exemption, and the carve-out for persons acting in the capacity of counterparties to plan fiduciaries with financial expertise. Section 2 of the RIA contains an extensive discussion of these concerns and the Department's response.

As discussed in section 6.2 of the RIA, the Small Business Administration (SBA) defines a small business in the Financial Investments and Related Activities Sector as a business with up to $38.5 million in annual receipts. In response to a comment received from the SBA's Office of Advocacy on our Initial Regulatory Flexibility Analysis, the Department contacted the SBA, and received from them a dataset containing data on the number of firms by NAICS codes, including the number of firms in given revenue categories. This dataset would allow the estimation of the number of firms with a given NAICS code that fall below the $38.5 million threshold and therefore be considered small entities by the SBA. However, this dataset alone does not provide a sufficient basis for the Department to estimate the number of small entities affected by the rule. Not all firms within a given NAICS code would be affected by this rule, because being an ERISA fiduciary relies on a functional test and is not based on industry status as defined by a NAICS code. Further, not all firms within a given NAICS code work with ERISA-covered plans and IRAs.

Over 90 percent of broker-dealers, registered investment advisers, insurance companies, agents, and consultants are small businesses according to the SBA size standards (13 CFR 121.201). Applying the ratio of entities that meet the SBA size standards to the number of affected entities, based on the methodology described at greater length in the RIA, the Department estimates that the number of small entities affected by this rule is 2,438 BDs, 16,521 RIAs, 496 Insurers, and 3,358 other ERISA service providers.

For purposes of the RFA, the Department continues to consider an employee benefit plan with fewer than 100 participants to be a small entity. Further, while some large employers may have small plans, in general small employers maintain most small plans. The definition of small entity considered appropriate for this purpose differs, however, from a definition of small business that is based on size standards promulgated by the SBA. These small pension plans will benefit from the rule, because as a result of the rule, they will receive non-conflicted advice from their fiduciary service providers. The 2013 Form 5500 filings show nearly 595,000 ERISA covered retirement plans with less than 100 participants.

Section 6.5 of the RIA summarizes the projected reporting, recordkeeping, and other compliance costs of the rule and exemptions, which are discussed in detail in section 5 of the RIA. Among other things, the Department concludes that it is likely that some small service providers may find that the increased costs associated with ERISA fiduciary status outweigh the benefits of continuing to service the ERISA plan market or the IRA market. The Department does not believe that this outcome will be widespread or that it will result in a diminution of the amount or quality of advice available to small or other retirement savers, because some firms will fill the void and provide services to the ERISA plan and IRA market. It is also possible that the economic impact of the rule and exemptions on small entities would not be as significant as it would be for large entities, because anecdotal evidence indicates that small entities do not have as many business arrangements that give rise to conflicts of interest. Therefore, they would not be confronted with the same costs to restructure transactions that would be faced by large entities.

Section 5.3.1 of the RIA includes a discussion of the changes to the proposed rule and exemptions that are intended to reduce the costs affecting both small and large business. These include elimination of data collection and annual disclosure requirements in the Best Interest Contract Exemption, and changes to the implementation of the contract requirement in the exemption. Section 7 of the RIA discusses significant regulatory alternatives considered by the Department and the reasons why they were rejected.

Congressional Review Act

This exemption, along with related exemptions and a final rule published elsewhere in this issue of the **Federal Register**, is part of a rulemaking that is subject to the Congressional Review Act provisions of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801, *et seq.*) and, will be transmitted to Congress and the Comptroller General for review. This rulemaking, including this exemption is treated as a "major rule" as that term is defined in 5 U.S.C. 804, because it is likely to result in an annual effect on the economy of $100 million or more.

General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under section 408(a) of ERISA and section 4975(c)(2) of the Code does not relieve a fiduciary, or other party in interest or disqualified person with respect to a plan, from certain other provisions of ERISA and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404 of ERISA which require, among other things, that a fiduciary act prudently and discharge his or her duties respecting the plan solely in the interests of the participants and beneficiaries of the plan. Additionally, the fact that a transaction is the subject of an exemption does not affect the requirement of section 401(a) of the Code that the plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries;

(2) The Department finds 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 the plan;

(3) The exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the exemption; and

(4) The exemption is supplemental to, and not in derogation of, any other provisions of ERISA and the Code, including statutory or administrative exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

Exemption

Section I—Best Interest Contract Exemption

(a) In general. ERISA and the Internal Revenue Code prohibit fiduciary advisers to employee benefit plans

(Plans) and individual retirement plans (IRAs) from receiving compensation that varies based on their investment advice. Similarly, fiduciary advisers are prohibited from receiving compensation from third parties in connection with their advice. This exemption permits certain persons who provide investment advice to Retirement Investors, and associated Financial Institutions, Affiliates and other Related Entities, to receive such otherwise prohibited compensation as described below.

(b) Covered transactions. This exemption permits Advisers, Financial Institutions, and their Affiliates and Related Entities, to receive compensation as a result of their provision of investment advice within the meaning of ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B) to a Retirement Investor.

As defined in Section VIII(o) of the exemption, a Retirement Investor is: (1) A participant or beneficiary of a Plan with authority to direct the investment of assets in his or her Plan account or to take a distribution; (2) the beneficial owner of an IRA acting on behalf of the IRA; or (3) a Retail Fiduciary with respect to a Plan or IRA.

As detailed below, Financial Institutions and Advisers seeking to rely on the exemption must adhere to Impartial Conduct Standards in rendering advice regarding retirement investments. In addition, Financial Institutions must adopt policies and procedures designed to ensure that their individual Advisers adhere to the Impartial Conduct Standards; disclose important information relating to fees, compensation, and Material Conflicts of Interest; and retain records demonstrating compliance with the exemption. Level Fee Fiduciaries that will receive only a Level Fee in connection with advisory or investment management services must comply with more streamlined conditions designed to target the conflicts of interest associated with such services. The exemption provides relief from the restrictions of ERISA section 406(a)(1)(D) and 406(b) and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(D), (E) and (F). The Adviser and Financial Institution must comply with the applicable conditions of Sections II–V to rely on this exemption. This document also contains separate exemptions in Section VI (Exemption for Purchases and Sales, including Insurance and Annuity Contracts) and Section VII (Exemption for Pre-Existing Transactions).

(c) Exclusions. This exemption does not apply if:

(1) The Plan is covered by Title I of ERISA, and (i) the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the Plan, or (ii) the Adviser 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;

(2) The compensation is received as a result of a Principal Transaction;

(3) 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'') unless the robo-advice provider is a Level Fee Fiduciary that complies with the conditions applicable to Level Fee Fiduciaries; or

(4) The Adviser has or exercises any discretionary authority or discretionary control with respect to the recommended transaction.

Section II—Contract, Impartial Conduct, and Other Requirements

The conditions set forth in this section include certain Impartial Conduct Standards, such as a Best Interest Standard, that Advisers and Financial Institutions must satisfy to rely on the exemption. In addition, Section II(d) and (e) requires Financial Institutions to adopt anti-conflict policies and procedures that are reasonably designed to ensure that Advisers adhere to the Impartial Conduct Standards, and requires disclosure of important information about the Financial Institutions' services, applicable fees and compensation. With respect to IRAs and other Plans not covered by Title I of ERISA, the Financial Institutions must agree that they and their Advisers will adhere to the exemption's standards in a written contract that is enforceable by the Retirement Investors. To minimize compliance burdens, the exemption provides that the contract terms may be incorporated into account opening documents and similar commonly-used agreements with new customers, permits reliance on a negative consent process with respect to existing contract holders, and provides a method of meeting the exemption requirement in the event that the Retirement Investor does not open an account with the Adviser but nevertheless acts on the advice through other channels. Advisers and Financial Institutions need not execute the contract before they make a recommendation to the Retirement Investor. However, the contract must cover any advice given prior to the contract date in order for the exemption to apply to such advice. There is no contract requirement for recommendations to Retirement Investors about investments in Plans covered by Title I of ERISA, but the Impartial Conduct Standards and other requirements of Section II(b)–(e), including a written acknowledgment of fiduciary status, must be satisfied in order for relief to be available under the exemption, as set forth in Section II(g). Section II(h) provides conditions for recommendations by Level Fee Fiduciaries, which, with their Affiliates, will receive only a Level Fee in connection with advisory or investment management services with respect to the Plan or IRA assets. Section II(i) provides conditions for referral fees received by banks and bank employees pursuant to Bank Networking Arrangements. Section II imposes the following conditions on Financial Institutions and Advisers:

(a) Contracts with Respect to Investments in IRAs and Other Plans Not Covered by Title I of ERISA. If the investment advice concerns an IRA or a Plan that is not covered by Title I of ERISA, the advice is subject to an enforceable written contract on the part of the Financial Institution, which may be a master contract covering multiple recommendations, that is entered into in accordance with this Section II(a) and incorporates the terms set forth in Section II(b)–(d). The Financial Institution additionally must provide the disclosures required by Section II(e). The contract must cover advice rendered prior to the execution of the contract in order for the exemption to apply to such advice and related compensation.

(1) *Contract Execution and Assent*—(i) *New Contracts.* Prior to or at the same time as the execution of the recommended transaction, the Financial Institution enters into a written contract with the Retirement Investor acting on behalf of the Plan, participant or beneficiary account, or IRA, incorporating the terms required by Section II(b)–(d). The terms of the contract may appear in a standalone document or they may be incorporated into an investment advisory agreement, investment program agreement, account opening agreement, insurance or annuity contract or application, or similar document, or amendment thereto. The contract must be enforceable against the Financial

Institution. The Retirement Investor's assent to the contract may be evidenced by handwritten or electronic signatures.

(ii) Amendment of Existing Contracts by Negative Consent. As an alternative to executing a contract in the manner set forth in the preceding paragraph, the Financial Institution may amend Existing Contracts to include the terms required in Section II(b)–(d) by delivering the proposed amendment and the disclosure required by Section II(e) to the Retirement Investor prior to January 1, 2018, and considering the failure to terminate the amended contract within 30 days as assent. An Existing Contract is an investment advisory agreement, investment program agreement, account opening agreement, insurance contract, annuity contract, or similar agreement or contract that was executed before January 1, 2018, and remains in effect. If the Financial Institution elects to use the negative consent procedure, it may deliver the proposed amendment by mail or electronically, but it may not impose any new contractual obligations, restrictions, or liabilities on the Retirement Investor by negative consent.

(iii) Failure to enter into contract. Notwithstanding a Financial Institution's failure to enter into a contract as required by subsection (i) above with a Retirement Investor who does not have an Existing Contract, this exemption will apply to the receipt of compensation by the Financial Institution, or any Adviser, Affiliate or Related Entity thereof, as a result of the Adviser's or Financial Institution's investment advice to such Retirement Investor regarding an IRA or non-ERISA Plan, provided:

(A) The Adviser making the recommendation does not receive compensation, directly or indirectly, that is reasonably attributable to the Retirement Investor's purchase, holding, exchange or sale of the investment;

(B) The Financial Institution's policies and procedures prohibit the Financial Institution and its Affiliates and Related Entities from providing compensation to their Advisers in lieu of compensation described in subsection (iii)(A), including, but not limited to bonuses or prizes or other incentives, and the Financial Institution reasonably monitors such policies and procedures;

(C) The Adviser and Financial Institution comply with the Impartial Conduct Standards set forth in Section II(c), the policies and procedures requirements of Section II(d) (except for the requirement of a warranty with respect to those policies and procedures), the web disclosure requirements of Section III(b) and, as applicable, the conditions of Sections IV(b)(3)–(6) (Conditions for Advisers and Financial Institution that restrict recommendations, in whole or part, to Proprietary Products or to investments that generate Third Party Payments) with respect to the recommendation; and

(D) The Financial Institution's failure to enter into the contract is not part of an effort, attempt, agreement, arrangement or understanding by the Adviser or the Financial Institution designed to avoid compliance with the exemption or enforcement of its conditions, including the contractual conditions set forth in subsections (i) and (ii).

(2) *Notice.* The Financial Institution maintains an electronic copy of the Retirement Investor's contract on its Web site that is accessible by the Retirement Investor.

(b) *Fiduciary.* The Financial Institution affirmatively states in writing that it and the Adviser(s) act as fiduciaries under ERISA or the Code, or both, with respect to any investment advice provided by the Financial Institution or the Adviser subject to the contract or, in the case of an ERISA plan, with respect to any investment recommendations regarding the Plan or participant or beneficiary account.

(c) *Impartial Conduct Standards.* The Financial Institution affirmatively states that it and its Advisers will adhere to the following standards and, they in fact, comply with the standards:

(1) When providing investment advice to the Retirement Investor, the Financial Institution and the Adviser(s) provide investment advice that is, at the time of the recommendation, in the Best Interest of the Retirement Investor. As further defined in Section VIII(d), 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 Adviser, Financial Institution or any Affiliate, Related Entity, or other party;

(2) The recommended transaction will not cause the Financial Institution, Adviser 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 section 408(b)(2) and Code section 4975(d)(2).

(3) Statements by the Financial Institution and its Advisers 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, will not be materially misleading at the time they are made.

(d) *Warranties.* The Financial Institution affirmatively warrants, and in fact complies with, the following:

(1) The Financial Institution has adopted and will comply with written policies and procedures reasonably and prudently designed to ensure that its Advisers adhere to the Impartial Conduct Standards set forth in Section II(c);

(2) In formulating its policies and procedures, the Financial Institution has specifically identified and documented its Material Conflicts of Interest; adopted measures reasonably and prudently designed to prevent Material Conflicts of Interest from causing violations of the Impartial Conduct Standards set forth in Section II(c); and designated a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring their Advisers' adherence to the Impartial Conduct Standards.

(3) The Financial Institution's policies and procedures require that neither the Financial Institution nor (to the best of its knowledge) any Affiliate or Related Entity 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 Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. Notwithstanding the foregoing, this Section II(d)(3) does not prevent the Financial Institution, its Affiliates or Related Entities from providing Advisers with differential compensation (whether in type or amount, and including, but not limited to, commissions) based on investment decisions by Plans, participant or beneficiary accounts, or IRAs, to the extent that the Financial Institution's policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of Advisers with the interests of the Retirement Investors they serve as fiduciaries (such compensation practices can include differential compensation based on neutral factors tied to the differences in the services delivered to the Retirement Investor

with respect to the different types of investments, as opposed to the differences in the amounts of Third Party Payments the Financial Institution receives in connection with particular investment recommendations).

(e) *Disclosures.* In the Best Interest Contract or in a separate single written disclosure provided to the Retirement Investor with the contract, or, with respect to ERISA plans, in another single written disclosure provided to the Plan prior to or at the same time as the execution of the recommended transaction, the Financial Institution clearly and prominently:

(1) States the Best Interest standard of care owed by the Adviser and Financial Institution to the Retirement Investor; informs the Retirement Investor of the services provided by the Financial Institution and the Adviser; and describes how the Retirement Investor will pay for services, directly or through Third Party Payments. If, for example, the Retirement Investor will pay through commissions or other forms of transaction-based payments, the contract or writing must clearly disclose that fact;

(2) Describes Material Conflicts of Interest; discloses any fees or charges the Financial Institution, its Affiliates, or the Adviser imposes upon the Retirement Investor or the Retirement Investor's account; and states the types of compensation that the Financial Institution, its Affiliates, and the Adviser expect to receive from third parties in connection with investments recommended to Retirement Investors;

(3) Informs the Retirement Investor that the Investor has the right to obtain copies of the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d), as well as the specific disclosure of costs, fees, and compensation, including Third Party Payments, regarding recommended transactions, as set forth in Section III(a), below, described in dollar amounts, percentages, formulas, or other means reasonably designed to present materially accurate disclosure of their scope, magnitude, and nature in sufficient detail to permit the Retirement Investor to make an informed judgment about the costs of the transaction and about the significance and severity of the Material Conflicts of Interest, and describes how the Retirement Investor can get the information, free of charge; provided that if the Retirement Investor's request is made prior to the transaction, the information must be provided prior to the transaction, and if the request is made after the transaction, the information must be provided within 30 business days after the request;

(4) Includes a link to the Financial Institution's Web site as required by Section III(b), and informs the Retirement Investor that: (i) Model contract disclosures updated as necessary on a quarterly basis are maintained on the Web site, and (ii) the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d) are available free of charge on the Web site;

(5) Discloses to the Retirement Investor whether the Financial Institution offers Proprietary Products or receives Third Party Payments with respect to any recommended investments; and to the extent the Financial Institution or Adviser 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 investments that the Adviser may offer for purchase, sale, exchange, or holding by the Retirement Investor. The notice is insufficient if it merely states that the Financial Institution or Adviser "may" limit investment recommendations based on whether the investments are Proprietary Products or generate Third Party Payments, without specific disclosure of the extent to which recommendations are, in fact, limited on that basis;

(6) Provides contact information (telephone and email) for a representative of the Financial Institution that the Retirement Investor can use to contact the Financial Institution with any concerns about the advice or service they have received; and, if applicable, a statement explaining that the Retirement Investor can research the Financial Institution and its Advisers using FINRA's BrokerCheck database or the Investment Adviser Registration Depository (IARD), or other database maintained by a governmental agency or instrumentality, or self-regulatory organization; and

(7) Describes whether or not the Adviser and Financial Institution will monitor the Retirement Investor's investments and alert the Retirement Investor to any recommended change to those investments, and, if so monitoring, the frequency with which the monitoring will occur and the reasons for which the Retirement Investor will be alerted.

(8) The Financial Institution will not fail to satisfy this Section II(e), or violate a contractual provision based thereon, solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, provided the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. To the extent compliance with this Section II(e) requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

(f) *Ineligible Contractual Provisions.* Relief is not available under the exemption if a Financial Institution's contract contains the following:

(1) Exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms;

(2) Except as provided in paragraph (f)(4) of this Section, 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 Adviser or Financial Institution, or in an individual or class claim agrees to an amount representing liquidated damages for breach of the contract; provided that, the parties may 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; or

(3) Agreements 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 this exemption.

(4) In the event that the provision on pre-dispute arbitration agreements for class or representative claims in paragraph (f)(2) of this Section is ruled invalid by a court of competent jurisdiction, this provision shall not be

a condition of this exemption with respect to contracts subject to the court's jurisdiction unless and until the court's decision is reversed, but all other terms of the exemption shall remain in effect.

(g) *ERISA plans.* Section II(a) does not apply to recommendations to Retirement Investors regarding investments in Plans that are covered by Title I of ERISA. For such investment advice, relief under the exemption is conditioned upon the Adviser and Financial Institution complying with certain provisions of Section II, as follows:

(1) 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 Advisers' fiduciary status, in accordance with Section II(b).

(2) The Financial Institution and the Adviser comply with the Impartial Conduct Standards of Section II(c).

(3) The Financial Institution adopts policies and procedures incorporating the requirements and prohibitions set forth in Section II(d)(1)–(3), and the Financial Institution and Adviser comply with those requirements and prohibitions.

(4) The Financial Institution provides the disclosures required by Section II(e).

(5) The Financial Institution and Adviser do not in any contract, instrument, or communication: purport to disclaim any responsibility or liability for any responsibility, obligation, or duty under Title I of ERISA to the extent the disclaimer would be prohibited by ERISA section 410; purport to waive or qualify the right of the Retirement Investor to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution, or require arbitration or mediation of individual claims in locations that are distant or that otherwise unreasonably limit the ability of the Retirement Investors to assert the claims safeguarded by this exemption.

(h) *Level Fee Fiduciaries.* Sections II(a), (d), (e), (f), (g) III and V do not apply to recommendations by Financial Institutions and Advisers that are Level Fee Fiduciaries. For such investment advice, relief under the exemption is conditioned upon the Adviser and Financial Institution complying with certain other provisions of Section II, as follows:

(1) 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 Advisers' fiduciary status, in accordance with Section II(b).

(2) The Financial Institution and Adviser comply with the Impartial Conduct Standards of Section II(c).

(3)(i) In the case of a recommendation to roll over 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. This documentation must include consideration of the Retirement Investor's alternatives to a rollover, including leaving the money in his or her current employer's Plan, if permitted, and must take into account the fees and expenses associated with both the Plan and the IRA; whether the employer pays for some or all of the plan's administrative expenses; and the different levels of services and investments available under each option; and (ii) 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.

(i) *Bank Networking Arrangements.* An Adviser who is a bank employee, and a Financial Institution that is a bank or similar financial institution supervised by the United States or a state, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1)), may receive compensation pursuant to a Bank Networking Arrangement as defined in Section VIII(c), in connection with their provision of investment advice to a Retirement Investor, provided the investment advice adheres to the Impartial Conduct Standards set forth in Section II(c). The remaining conditions of the exemption do not apply.

Section III—Web and Transaction-Based Disclosure

The Financial Institution must satisfy the following conditions with respect to an investment recommendation, to be covered by this exemption:

(a) *Transaction Disclosure.* The Financial Institution provides the Retirement Investor, prior to or at the same time as the execution of the recommended investment in an investment product, the following disclosure, clearly and prominently, in a single written document, that:

(1) States the Best Interest standard of care owed by the Adviser and Financial Institution to the Retirement Investor; and describes any Material Conflicts of Interest;

(2) Informs the Retirement Investor that the Retirement Investor has the right to obtain copies of the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d), as well as specific disclosure of costs, fees and other compensation including Third Party Payments regarding recommended transactions. The costs, fees, and other compensation may be described in dollar amounts, percentages, formulas, or other means reasonably designed to present materially accurate disclosure of their scope, magnitude, and nature in sufficient detail to permit the Retirement Investor to make an informed judgment about the costs of the transaction and about the significance and severity of the Material Conflicts of Interest. The information required under this Section must be provided to the Retirement Investor prior to the transaction, if requested prior to the transaction, and, if the request is made after the transaction, the information must be provided within 30 business days after the request; and

(3) Includes a link to the Financial Institution's Web site as required by Section III(b) and informs the Retirement Investor that: (i) Model contract disclosures or other model notices, updated as necessary on a quarterly basis, are maintained on the Web site, and (ii) the Financial Institution's written description of its policies and procedures as required under Section III(b)(1)(iv) are available free of charge on the Web site.

(4) These disclosures do not have to be repeated for subsequent recommendations by the Adviser and Financial Institution of the same investment product within one year of the provision of the contract disclosure in Section II(e) or a previous disclosure pursuant to this Section III(a), unless there are material changes in the subject of the disclosure.

(b) *Web Disclosure.* For relief to be available under the exemption for any investment recommendation, the conditions of Section III(b) must be satisfied.

(1) The Financial Institution maintains a Web site, freely accessible to the public and updated no less than quarterly, which contains:

(i) A discussion of the Financial Institution's business model and the Material Conflicts of Interest associated with that business model;

(ii) A schedule of typical account or contract fees and service charges;

(iii) A model contract or other model notice of the contractual terms (if applicable) and required disclosures described in Section II(b)–(e), which are reviewed for accuracy no less frequently than quarterly and updated within 30 days if necessary;

(iv) A written description of the Financial Institution's policies and procedures that accurately describes or summarizes key components of the policies and procedures relating to conflict-mitigation and incentive practices in a manner that permits Retirement Investors to make an informed judgment about the stringency of the Financial Institution's protections against conflicts of interest;

(v) To the extent applicable, a list of all product manufacturers and other parties with whom the Financial Institution maintains arrangements that provide Third Party Payments to either the Adviser or the Financial Institution with respect to specific investment products or classes of investments recommended to Retirement Investors; a description of the arrangements, including a statement on whether and how these arrangements impact Adviser compensation, and a statement on any benefits the Financial Institution provides to the product manufacturers or other parties in exchange for the Third Party Payments;

(vi) Disclosure of the Financial Institution's compensation and incentive arrangements with Advisers including, if applicable, any incentives (including both cash and non-cash compensation or awards) to Advisers for recommending particular product manufacturers, investments or categories of investments to Retirement Investors, or for Advisers to move to the Financial Institution from another firm or to stay at the Financial Institution, and a full and fair description of any payout or compensation grids, but not including information that is specific to any individual Adviser's compensation or compensation arrangement.

(vii) The Web site may describe the above arrangements with product manufacturers, Advisers, and others by reference to dollar amounts, percentages, formulas, or other means reasonably calculated to present a materially accurate description of the arrangements. Similarly, the Web site may group disclosures based on reasonably-defined categories of investment products or classes, product manufacturers, Advisers, and arrangements, and it may disclose reasonable ranges of values, rather than specific values, as appropriate. But, however constructed, the Web site must fairly disclose the scope, magnitude, and nature of the compensation arrangements and Material Conflicts of Interest in sufficient detail to permit visitors to the Web site to make an informed judgment about the significance of the compensation practices and Material Conflicts of Interest with respect to transactions recommended by the Financial Institution and its Advisers.

(2) To the extent the information required by this Section is provided in other disclosures which are made public, including those required by the SEC and/or the Department such as a Form ADV, Part II, the Financial Institution may satisfy this Section III(b) by posting such disclosures to its Web site with an explanation that the information can be found in the disclosures and a link to where it can be found.

(3) The Financial Institution is not required to disclose information pursuant to this Section III(b) if such disclosure is otherwise prohibited by law.

(4) In addition to providing the written description of the Financial Institution's policies and procedures on its Web site, as required under Section III(b)(1)(iv), Financial Institutions must provide their complete policies and procedures adopted pursuant to Section II(d) to the Department upon request.

(5) In the event that a Financial Institution determines to group disclosures as described in subsection (1)(vii), it must retain the data and documentation supporting the group disclosure during the time that it is applicable to the disclosure on the Web site, and for six years after that, and make the data and documentation available to the Department within 90 days of the Department's request.

(c)(1) The Financial Institution will not fail to satisfy the conditions in this Section III solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, or if the Web site is temporarily inaccessible, provided that, (i) in the case of an error or omission on the Web site, the Financial Institution discloses the correct information as soon as practicable, but not later than seven (7) days after the date on which it discovers or reasonably should have discovered the error or omission, and (ii) in the case of an error or omission with respect to the transaction disclosure, the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission.

(2) To the extent compliance with the Section III disclosures requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (i) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (ii) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

(3) The good faith provisions of this Section apply to the requirement that the Financial Institution retain the data and documentation supporting the group disclosure during the time that it is applicable to the disclosure on the Web site and provide it to the Department upon request, as set forth in subsection (b)(1)(vii) and (b)(5) above. In addition, if such records are lost or destroyed, due to circumstances beyond the control of the Financial Institution, then no prohibited transaction will be considered to have occurred solely on the basis of the unavailability of those records; and no party, other than the Financial Institution responsible for complying with subsection (b)(1)(vii) and (b)(5) will be subject to the civil penalty that may be assessed under ERISA section 502(i) or the taxes imposed by Code section 4975(a) and (b), if applicable, if the records are not maintained or provided to the Department within the required timeframes.

Section IV—Proprietary Products and Third Party Payments

(a) *General.* A Financial Institution that at the time of the transaction restricts Advisers' investment recommendations, in whole or part, to Proprietary Products or to investments that generate Third Party Payments, may rely on this exemption provided all the applicable conditions of the exemption are satisfied.

(b) *Satisfaction of the Best Interest standard.* A Financial Institution that limits Advisers' investment recommendations, in whole or part, based on whether the investments are Proprietary Products or generate Third Party Payments, and an Adviser making recommendations subject to such limitations, shall be deemed to satisfy the Best Interest standard of Section VIII(d) if:

(1) Prior to or at the same time as the execution of the recommended transaction, the Retirement Investor is clearly and prominently informed in writing that the Financial Institution offers Proprietary Products or receives Third Party Payments with respect to the purchase, sale, exchange, or holding of recommended investments; and the Retirement Investor is informed in writing of the limitations placed on the universe of investments that the Adviser may recommend to the Retirement Investor. The notice is insufficient if it merely states that the Financial Institution or Adviser "may" limit investment recommendations based on whether the investments are Proprietary Products or generate Third Party Payments, without specific disclosure of the extent to which recommendations are, in fact, limited on that basis;

(2) Prior to or at the same time as the execution of the recommended transaction, the Retirement Investor is fully and fairly informed in writing of any Material Conflicts of Interest that the Financial Institution or Adviser have with respect to the recommended transaction, and the Adviser and Financial Institution comply with the disclosure requirements set forth in Section III above (providing for web and transaction-based disclosure of costs, fees, compensation, and Material Conflicts of Interest);

(3) The Financial Institution documents in writing its limitations on the universe of recommended investments; documents in writing 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; documents in writing 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, including the payor, in exchange for the Third Party Payments; reasonably concludes that the limitations on the universe of recommended investments and Material Conflicts of Interest will not cause the Financial Institution or its Advisers to receive compensation in excess of reasonable compensation for Retirement Investors as set forth in Section II(c)(2); reasonably determines, after consideration of the policies and procedures established pursuant to Section II(d), that these limitations and Material Conflicts of Interest will not cause the Financial Institution or its Advisers to recommend imprudent investments; and documents in writing the bases for its conclusions;

(4) The Financial Institution adopts, monitors, implements, and adheres to policies and procedures and incentive practices that meet the terms of Section II(d)(1) and (2); and, in accordance with Section II(d)(3), neither the Financial Institution nor (to the best of its knowledge) any Affiliate or Related Entity uses or relies 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 Adviser to make imprudent investment recommendations, to subordinate the interests of the Retirement Investor to the Adviser's own interests, or to make recommendations based on the Adviser's considerations of factors or interests other than the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor;

(5) At the time of the recommendation, the amount of compensation and other consideration reasonably anticipated to be paid, directly or indirectly, to the Adviser, Financial Institution, or their Affiliates or Related Entities for their services in connection with the recommended transaction is not in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2); and

(6) The Adviser's recommendation 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; and the Adviser's recommendation is not based on the financial or other interests of the Adviser or on the Adviser's consideration of any factors or interests other than the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor.

Section V—Disclosure to the Department and Recordkeeping

This Section establishes record retention and disclosure conditions that a Financial Institution must satisfy for the exemption to be available for compensation received in connection with recommended transactions.

(a) *EBSA Disclosure.* Before receiving compensation in reliance on the exemption in Section I, the Financial Institution notifies the Department of its intention to rely on this exemption. The notice will remain in effect until revoked in writing by the Financial Institution. The notice need not identify any Plan or IRA. The notice must be provided by email to *e-BICE@dol.gov.*

(b) *Recordkeeping.* The Financial Institution maintains for a period of six (6) years, in a manner that is reasonably accessible for examination, the records necessary to enable the persons described in paragraph (c) of this Section to determine whether the conditions of this exemption have been met with respect to a transaction, except that:

(1) If such records are lost or destroyed, due to circumstances beyond the control of the Financial Institution, then no prohibited transaction will be considered to have occurred solely on the basis of the unavailability of those records; and

(2) No party, other than the Financial Institution responsible for complying with this paragraph (c), will be subject to the civil penalty that may be assessed under ERISA section 502(i) or the taxes imposed by Code section 4975(a) and (b), if applicable, if the records are not maintained or are not available for examination as required by paragraph (c), below.

(c)(1) Except as provided in paragraph (c)(2) of this Section or precluded by 12 U.S.C. 484, and notwithstanding any provisions of ERISA section 504(a)(2) and (b), the records referred to in paragraph (b) of this Section are reasonably available at their customary location for examination during normal business hours by:

(i) Any authorized employee or representative of the Department or the Internal Revenue Service;

(ii) Any fiduciary of a Plan that engaged in an investment transaction pursuant to this exemption, or any authorized employee or representative of such fiduciary;

(iii) Any contributing employer and any employee organization whose members are covered by a Plan described in paragraph (c)(1)(ii), or any authorized employee or representative of these entities; or

(iv) Any participant or beneficiary of a Plan described in paragraph (c)(1)(ii), IRA owner, or the authorized representative of such participant, beneficiary or owner; and

(2) None of the persons described in paragraph (c)(1)(ii)–(iv) of this Section are authorized to examine records regarding a recommended transaction involving another Retirement Investor, privileged trade secrets or privileged

commercial or financial information of the Financial Institution, or information identifying other individuals.

(3) Should the Financial Institution refuse to disclose information on the basis that the information is exempt from disclosure, the Financial Institution must, by the close of the thirtieth (30th) day following the request, provide a written notice advising the requestor of the reasons for the refusal and that the Department may request such information.

(4) Failure to maintain the required records necessary to determine whether the conditions of this exemption have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions.

Section VI—Exemption for Purchases and Sales, Including Insurance and Annuity Contracts

(a) *In general.* In addition to prohibiting fiduciaries from receiving compensation from third parties and compensation that varies based on their investment advice, ERISA and the Internal Revenue Code prohibit the purchase by a Plan, participant or beneficiary account, or IRA of an investment product, including insurance or annuity product from an insurance company that is a service provider to the Plan or IRA. This exemption permits a Plan, participant or beneficiary account, or IRA to engage in a purchase or sale with a Financial Institution that is a service provider or other party in interest or disqualified person to the Plan or IRA. This exemption is provided because investment transactions often involve prohibited purchases and sales involving entities that have a pre-existing party in interest relationship to the Plan or IRA.

(b) *Covered transactions.* The restrictions of ERISA section 406(a)(1)(A) and (D), and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A) and (D), shall not apply to the purchase of an investment product by a Plan, participant or beneficiary account, or IRA, from a Financial Institution that is a party in interest or disqualified person.

(c) The following conditions are applicable to this exemption:

(1) The transaction is effected by the Financial Institution in the ordinary course of its business;

(2) The compensation, direct or indirect, for any services rendered by the Financial Institution and its Affiliates and Related Entities is not in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2); and

(3) The terms of the transaction are at least as favorable to the Plan, participant or beneficiary account, or IRA as the terms generally available in an arm's length transaction with an unrelated party.

(d) *Exclusions,* The exemption in this Section VI does not apply if:

(1) The Plan is covered by Title I of ERISA and (i) the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the Plan, or (ii) the Adviser and 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.

(2) The compensation is received as a result of a Principal Transaction;

(3) 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'') unless the robo-advice provider is a Level Fee Fiduciary that complies with the conditions applicable to Level Fee Fiduciaries; or

(4) The Adviser has or exercises any discretionary authority or discretionary control with respect to the recommended transaction.

Section VII—Exemption for Pre-Existing Transactions

(a) *In general.* ERISA and the Internal Revenue Code prohibit Advisers, Financial Institutions and their Affiliates and Related Entities from receiving compensation that varies based on their investment advice. Similarly, fiduciary advisers are prohibited from receiving compensation from third parties in connection with their advice. Some Advisers and Financial Institutions did not consider themselves fiduciaries within the meaning of 29 CFR 2510–3.21 before the applicability date of the amendment to 29 CFR 2510–3.21 (the Applicability Date). Other Advisers and Financial Institutions entered into transactions involving Plans, participant or beneficiary accounts, or IRAs before the Applicability Date, in accordance with the terms of a prohibited transaction exemption that has since been amended. This exemption permits Advisers, Financial Institutions, and their Affiliates and Related Entities, to receive compensation, such as 12b–1 fees, in connection with a Plan's, participant or beneficiary account's or IRA's purchase, sale, exchange, or holding of securities or other investment property that was acquired prior to the Applicability Date, as described and limited below.

(b) *Covered transaction.* Subject to the applicable conditions described below, the restrictions of ERISA section 406(a)(1)(A), 406(a)(1)(D), and 406(b) and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A), (D), (E) and (F), shall not apply to the receipt of compensation by an Adviser, Financial Institution, and any Affiliate and Related Entity, as a result of investment advice (including advice to hold) provided to a Plan, participant or beneficiary or IRA owner in connection with the purchase, holding, sale, or exchange of securities or other investment property (i) that was acquired before the Applicability Date, or (ii) that was acquired pursuant to a recommendation to continue to adhere to a systematic purchase program established before the Applicability Date. This Exemption for Pre-Existing Transactions is conditioned on the following:

(1) The compensation is received pursuant to an agreement, arrangement or understanding that was entered into prior to the Applicability Date and that has not expired or come up for renewal post-Applicability Date;

(2) The purchase, exchange, holding or sale of the securities or other investment property was not otherwise a non-exempt prohibited transaction pursuant to ERISA section 406 and Code section 4975 on the date it occurred;

(3) The compensation is not received in connection with the Plan's, participant or beneficiary account's or IRA's investment of additional amounts in the previously acquired investment vehicle; except that for avoidance of doubt, the exemption does apply to a recommendation to exchange investments within a mutual fund family or variable annuity contract) pursuant to an exchange privilege or rebalancing program that was established before the Applicability Date, provided that the recommendation does not result in the Adviser and Financial Institution, or their Affiliates or Related Entities, receiving more compensation (either as a fixed dollar amount or a percentage of assets) than they were entitled to receive prior to the Applicability Date;

(4) The amount of the compensation paid, directly or indirectly, to the Adviser, Financial Institution, or their Affiliates or Related Entities in connection with the transaction is not in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2); and

(5) Any investment recommendations made after the Applicability Date by the Financial Institution or Adviser with respect to the securities or other investment property reflect 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, and are made without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.

Section VIII—Definitions

For purposes of these exemptions:

(a) ''Adviser'' means an individual who:

(1) Is a fiduciary of the Plan or IRA solely by reason of the provision of investment advice described in ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B), or both, and the applicable regulations, with respect to the assets of the Plan or IRA involved in the recommended transaction;

(2) Is an employee, independent contractor, agent, or registered representative of a Financial Institution; and

(3) Satisfies the federal and state regulatory and licensing requirements of insurance, banking, and securities laws with respect to the covered transaction, as applicable.

(b) ''Affiliate'' of an Adviser or Financial Institution means—

(1) Any person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution. For this purpose, ''control'' means the power to exercise a controlling influence over the management or policies of a person other than an individual;

(2) Any officer, director, partner, employee, or relative (as defined in ERISA section 3(15)), of the Adviser or Financial Institution; and

(3) Any corporation or partnership of which the Adviser or Financial Institution is an officer, director, or partner.

(c) A ''Bank Networking Arrangement'' is an arrangement for the referral of retail non-deposit investment products that satisfies applicable federal banking, securities and insurance regulations, under which employees of a bank refer bank customers to an unaffiliated investment adviser registered under the Investment Advisers Act of 1940 or under the laws of the state in which the adviser maintains its principal office and place of business, insurance company qualified to do business under the laws of a state, or broker or dealer registered under the Securities Exchange Act of 1934, as amended. For purposes of this definition, a ''bank'' is a bank or similar financial institution supervised by the United States or a state, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1)),

(d) Investment advice is in the ''Best Interest'' of the Retirement Investor when the Adviser 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. Financial Institutions that limit investment recommendations, in whole or part, based on whether the investments are Proprietary Products or generate Third Party Payments, and Advisers making recommendations subject to such limitations are deemed to satisfy the Best Interest standard when they comply with the conditions of Section IV(b).

(e) ''Financial Institution'' means an entity that employs the Adviser or otherwise retains such individual as an independent contractor, agent or registered representative and that is:

(1) Registered as an investment adviser under the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 *et seq.*) or under the laws of the state in which the adviser maintains its principal office and place of business;

(2) A bank or similar financial institution supervised by the United States or a state, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1));

(3) An insurance company qualified to do business under the laws of a state, provided that such insurance company:

(i) Has obtained a Certificate of Authority from the insurance commissioner of its domiciliary state which has neither been revoked nor suspended,

(ii) Has undergone and shall continue to undergo an examination by an Independent certified public accountant for its last completed taxable year or has undergone a financial examination (within the meaning of the law of its domiciliary state) by the state's insurance commissioner within the preceding 5 years, and

(iii) Is domiciled in a state whose law requires that actuarial review of reserves be conducted annually by an Independent firm of actuaries and reported to the appropriate regulatory authority;

(4) A broker or dealer registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*); or

(5) An entity that is described in the definition of Financial Institution in an individual exemption granted by the Department under ERISA section 408(a) and Code section 4975(c), after the date of this exemption, that provides relief for the receipt of compensation in connection with investment advice provided by an investment advice fiduciary, under the same conditions as this class exemption.

(f) ''Independent'' means a person that:

(1) Is not the Adviser, the Financial Institution or any Affiliate relying on the exemption;

(2) Does not have a relationship to or an interest in the Adviser, the Financial Institution or Affiliate that might affect the exercise of the person's best judgment in connection with transactions described in this exemption; and

(3) Does not receive or is not projected to receive within the current federal income tax year, compensation or other consideration for his or her own account from the Adviser, Financial Institution or Affiliate in excess of 2% of the person's annual revenues based upon its prior income tax year.

(g) ''Individual Retirement Account'' or ''IRA'' means any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

(h) A Financial Institution and Adviser are ''Level Fee Fiduciaries'' if the only fee received by the Financial Institution, the Adviser 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.

(i) A ''Material Conflict of Interest'' exists when an Adviser or Financial Institution has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor.

(j) ''Plan'' means any employee benefit plan described in section 3(3) of the Act and any plan described in section 4975(e)(1)(A) of the Code.

(k) A ''Principal Transaction'' means a purchase or sale of an investment product if an Adviser or Financial Institution is purchasing from or selling to a Plan, participant or beneficiary account, or IRA on behalf of the Financial Institution's own account or the account of a person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Financial Institution. For purposes of this definition, a Principal Transaction does not include the sale of an insurance or annuity contract, a mutual fund transaction, or a Riskless Principal Transaction as defined in Section VIII(p) below.

(l) ''Proprietary Product'' means a product that is managed, issued or sponsored by the Financial Institution or any of its Affiliates.

(m) ''Related Entity'' means any entity other than an Affiliate in which the Adviser or Financial Institution has an interest which may affect the exercise of its best judgment as a fiduciary.

(n) A ''Retail Fiduciary'' means a fiduciary of a Plan or IRA that is not described in section (c)(1)(i) of the Regulation (29 CFR 2510.3–21(c)(1)(i)).

(o) ''Retirement Investor'' means—

(1) A participant or beneficiary of a Plan subject to Title I of ERISA or described in section 4975(e)(1)(A) of the Code, with authority to direct the investment of assets in his or her Plan account or to take a distribution,

(2) The beneficial owner of an IRA acting on behalf of the IRA, or

(3) A Retail Fiduciary with respect to a Plan subject to Title I of ERISA or described in section 4975(e)(1)(A) of the Code or IRA.

(p) A ''Riskless Principal Transaction'' is a transaction in which a Financial Institution, after having received an order from a Retirement Investor to buy or sell an investment product, purchases or sells the same investment product for the Financial Institution's own account to offset the contemporaneous transaction with the Retirement Investor.

(q) ''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.

Section IX—Transition Period for Exemption

(a) *In general.* ERISA and the Internal Revenue Code prohibit fiduciary advisers to Plans and IRAs from receiving compensation that varies based on their investment advice. Similarly, fiduciary advisers are prohibited from receiving compensation from third parties in connection with their advice. This transition period provides relief from the restrictions of ERISA section 406(a)(1)(D), and 406(b) and the sanctions imposed by Code section 4975(a) and (b) by reason of Code section 4975(c)(1)(D), (E), and (F) for the period from April 10, 2017, to January 1, 2018 (the Transition Period) for Advisers, Financial Institutions, and their Affiliates and Related Entities, to receive such otherwise prohibited compensation subject to the conditions described in Section IX(d).

(b) *Covered transactions.* This provision permits Advisers, Financial Institutions, and their Affiliates and Related Entities to receive compensation as a result of their provision of investment advice within the meaning of ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B) to a Retirement Investor, during the Transition Period.

(c) *Exclusions.* This provision does not apply if:

(1) The Plan is covered by Title I of ERISA, and (i) the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the Plan, or (ii) the Adviser 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;

(2) The compensation is received as a result of a Principal Transaction;

(3) 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

(4) The Adviser has or exercises any discretionary authority or discretionary control with respect to the recommended transaction.

(d) *Conditions.* The provision is subject to the following conditions:

(1) The Financial Institution and Adviser adhere to the following standards:

(i) When providing investment advice to the Retirement Investor, the Financial Institution and the Adviser(s) provide investment advice that is, at the time of the recommendation, in the Best Interest of the Retirement Investor. As further defined in Section VIII(d), 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 Adviser, Financial Institution or any Affiliate, Related Entity, or other party;

(ii) The recommended transaction does not cause the Financial Institution, Adviser 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 section 408(b)(2) and Code section 4975(d)(2).

(iii) Statements by the Financial Institution and its Advisers 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.

(2) *Disclosures.* The Financial Institution provides to the Retirement Investor, prior to or at the same time as, the execution of the recommended transaction, a single written disclosure, which may cover multiple transactions or all transactions occurring within the Transition Period, that clearly and prominently:

(i) Affirmatively states that the Financial Institution and the Adviser(s) act as fiduciaries under ERISA or the Code, or both, with respect to the recommendation;

(ii) Sets forth the standards in paragraph (d)(1) of this Section and affirmatively states that it and the Adviser(s) adhered to such standards in recommending the transaction;

(iii) Describes the Financial Institution's Material Conflicts of Interest; and

(iv) Discloses to the Retirement Investor whether the Financial Institution offers Proprietary Products or receives Third Party Payments with respect to any investment recommendations; and to the extent the Financial Institution or Adviser 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 notice is insufficient if it merely states that the Financial Institution or Adviser "may" limit investment recommendations based on whether the investments are Proprietary Products or generate Third Party Payments, without specific disclosure of the extent to which recommendations are, in fact, limited on that basis.

(v) The disclosure may be provided in person, electronically or by mail. It does not have to be repeated for any subsequent recommendations during the Transition Period.

(vi) The Financial Institution will not fail to satisfy this Section IX(d)(2) solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, provided the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. To the extent compliance with this Section IX(d)(2) requires Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know, or unless they should have known, that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

(3) The Financial Institution designates a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards; and

(4) The Financial Institution complies with the recordkeeping requirements of Section V(b) and (c).

Signed at Washington, DC, this 1st day of April, 2016.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

BILLING CODE 4510–29–P

Appendix I - Comparing Different Types of Deferred Annuities

	Fixed-Rate	Fixed-Indexed	Variable
Overview	• A contract providing a guaranteed, specified rate of interest on premiums paid.	• A contract providing for the crediting of interest based on changes in a market index.	• A contract with an account value that rises or falls based on the performance of investment options, known as "subaccounts," chosen by the contract owner.
		Returns	
Allocation of Investment Risk	• Premiums are guaranteed to earn at least a minimum specified interest rate. The insurance company may in its discretion credit interest at rates higher than the minimum. • Under most current state laws, upon surrender of the contract the buyer is guaranteed to always receive at least 87.5% of premiums paid, credited with a minimum interest rate such as 1%. This is known as the Nonforfeiture Amount.	• Returns are less predictable because the interest credited at the end of each index period depends on changes in a market index. • The surrender value must always equal at least the Nonforfeiture Amount and the interest rate is guaranteed to never be less than zero during each index period. • In general, returns depend on what index is linked and how the index-linked gains are calculated.[3] Many current product designs offer alternatives to traditional indexes such as the S&P 500 and allow owners to allocate premiums among different indexes. These alternative indexes may include precious commodities, international and emerging markets, and proprietary indexes developed by insurance companies. • Changes in the index can be determined by several methods such as annual reset, high water mark, low water mark, point-to-point, and index averaging.[3]	• Returns are variable based on the performance of underlying funds in the subaccounts.[1] • The insurance company does not guarantee investment performance. Investment risk is borne by the contract owner. • A variable annuity contract can offer hundreds of subaccounts and generally allows owners to transfer or reallocate their account values among the various subaccounts.

	Fixed-Rate	Fixed-Indexed	Variable
		Returns	
		• Index-linked gains are not always fully credited. How much of the gain in the index will be credited depends on the particular features of the annuity such as participation rates, interest rate caps, and spread/margin/asset fees.[3] • The insurer generally reserves the right to change participation rates, interest rate caps, and spread/margin/asset fees, subject to minimums and maximums specified in the contract[3]	
		Surrender Charges & Surrender Period	
Fees	• If the owner withdraws all or part of the value out of the annuity within a specified period, surrender charge will be applied.[1]	• same as fixed-rate	• same as fixed-rate
	• The buyer can often receive a partial withdrawal (usually up to 10%) without paying surrender charges[1] and the charge may be waived in certain circumstances, such as confinement in a nursing home.	• same as fixed-rate	• same as fixed-rate
	• State laws generally require “free-look” provisions under which the owner can return the contract free of charge within a stated number of days after purchase.[2]	• same as fixed-rate	• same as fixed-rate
	• Some annuities have a market value adjustment (MVA). If at the time of surrender interest rates are higher than at the time of purchase, the MVA could reduce the amount paid on surrender; conversely, if interest rates have fallen, the MVA could increase the surrender value.[1,2]	• same as fixed-rate	

	Fixed-Rate	Fixed-Indexed	Variable
	Other Fees & Charges		
Fees	• Generally no express fees[6]	• Generally no express fees[6] • Often sold with a guaranteed lifetime withdrawal benefit, which requires a rider fee.	• Contract Fee[2] • Transaction Fee • Mortality and Expense risk fee • Underlying fund fees • Additional fees or charges for certain product features (often contained in "riders" to the base contract) such as stepped-up death benefits, guaranteed minimum income benefits, and principal protection.[4]
Guaranteed Optional Benefits	**Guaranteed Living Benefit Riders[7]**		
	• Seldom offered.	• The most popular benefit, the guaranteed lifetime withdrawal benefit, is offered with 84% of all new fixed indexed annuity sales in 2014.[5]	• Contracts constituting 83% of all new variable annuity sales in 2014 offered guaranteed living benefit riders.[5]
	Death Benefit		
	• Annuities pay a death benefit to the beneficiary upon death of the owner or annuitant during the accumulation phase.[2] Benefit is typically the greater of the accumulated account value or the Nonforfeiture Amount. Different rules govern death benefits during the payout phase.	• same as fixed-rate	• If the owner dies during the accumulation period, the beneficiary generally receives the greater of (a) the accumulated account value or (b) premium payments less prior withdrawals. An enhanced guaranteed minimum death benefit may be available for an additional fee.[8]

Sources: 1: NAIC Buyer's Guide for Deferred Annuities, 2013

2: NAIC Buyers' Guide to Fixed Deferred Annuities with Appendix for Equity-Indexed Annuities, 1999

3: FINRA Investor Alert "Equity-Indexed Annuities: A Complex Choice," 2012

4: FINRA Investor Alert "Variable Annuities: Beyond the Hard Sell," 2012

5: LIMRA "U.S. Individual Annuity Yearbook 2014"

6: The insurer covers its expenses via the margin of premiums received over the cost of the annuity benefits, commonly referred to a "spread."

7: Guaranteed living benefits are available for additional fees and generally protect against investment risks by guaranteeing the level of account values or annuity payments, regardless of market performance. There are three types of guaranteed living benefits—guaranteed minimum income, guaranteed minimum accumulation, and guaranteed minimum withdrawal (including lifetime withdrawal benefits).

8: Some fixed-indexed annuities also offer this benefit for an additional fee.

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DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

[Application Number D–11713]

ZRIN 1210–ZA25

Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs

AGENCY: Employee Benefits Security Administration (EBSA), U.S. Department of Labor.

ACTION: Adoption of Class Exemption.

SUMMARY: This document contains an exemption from certain prohibited transactions provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (the Code). The provisions at issue generally prohibit fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs) from purchasing and selling investments when the fiduciaries are acting on behalf of their own accounts (principal transactions). The exemption permits principal transactions and riskless principal transactions in certain investments between a plan, plan participant or beneficiary account, or an IRA, and a fiduciary that provides investment advice to the plan or IRA, under conditions to safeguard the interests of these investors. The exemption affects participants and beneficiaries of plans, IRA owners, and fiduciaries with respect to such plans and IRAs.

DATES:

Issuance date: This exemption is issued June 7, 2016.

Applicability date: This exemption is applicable to transactions occurring on or after April 10, 2017. See Section F of this preamble, *Applicability Date and Transition Rules* in this preamble, for further information.

FOR FURTHER INFORMATION CONTACT: Brian Shiker, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor (202) 693–8824 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Executive Summary

Purpose of Regulatory Action

The Department grants this exemption in connection with its publication today, elsewhere in this issue of the **Federal Register**, of a final regulation defining who is a ''fiduciary'' of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries (Regulation). The Regulation also applies to the definition of a ''fiduciary'' of a plan (including an IRA) under the Code. The Regulation amends a prior regulation, dating to 1975, specifying when a person is a ''fiduciary'' under ERISA and the Code by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. The Regulation takes into account the advent of 401(k) 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 existing regulation was issued. In light of the extensive changes in retirement investment practices and relationships, the Regulation updates 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.

This exemption allows investment advice fiduciaries to engage in purchases and sales of certain investments out of their inventory (*i.e.,* engage in principal transactions) with plans, participant or beneficiary accounts, and IRAs, under conditions designed to safeguard the interests of these investors. In the absence of an exemption, these transactions would be prohibited under ERISA and the Code. In this regard, ERISA and the Code generally prohibit fiduciaries with respect to plans and IRAs from purchasing or selling any property to plans, participant or beneficiary accounts, or IRAs. Fiduciaries also may not engage in self-dealing or, under ERISA, act in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan or the interests of its participants and beneficiaries. When a fiduciary purchases or sells an investment in a principal transaction or riskless principal transaction, it violates these prohibitions.

ERISA section 408(a) specifically authorizes the Secretary of Labor to grant administrative exemptions from ERISA's prohibited transaction provisions.[1] Regulations at 29 CFR 2570.30 to 2570.52 describe the procedures for applying for an administrative exemption. In granting this exemption, the Department has determined that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners.

Summary of the Major Provisions

The exemption allows an individual investment advice fiduciary (an Adviser)[2] and the firm that employs or otherwise contracts with the Adviser (a Financial Institution) to engage in principal transactions and riskless principal transactions involving certain investments, with plans, participant and beneficiary accounts, and IRAs. The exemption limits the type of investments that may be purchased or sold and contains conditions which the

[1] Code section 4975(c)(2) authorizes the Secretary of the Treasury to grant exemptions from the parallel prohibited transaction provisions of the Code. Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)) (Reorganization Plan) generally transferred the authority of the Secretary of the Treasury to grant administrative exemptions under Code section 4975 to the Secretary of Labor. To rationalize the administration and interpretation of dual provisions under ERISA and the Code, the Reorganization Plan divided the interpretive and rulemaking authority for these provisions between the Secretaries of Labor and of the Treasury, so that, in general, the agency with responsibility for a given provision of Title I of ERISA would also have responsibility for the corresponding provision in the Code. Among the sections transferred to the Department were the prohibited transaction provisions and the definition of a fiduciary in both Title I of ERISA and in the Code. ERISA's prohibited transaction rules, 29 U.S.C. 1106–1108, apply to ERISA-covered plans, and the Code's corresponding prohibited transaction rules, 26 U.S.C. 4975(c), apply both to ERISA-covered pension plans that are tax-qualified pension plans, as well as other tax-advantaged arrangements, such as IRAs, that are not subject to the fiduciary responsibility and prohibited transaction rules in ERISA. Specifically, section 102(a) of the Reorganization Plan provides the Department of Labor with ''all authority'' for ''regulations, rulings, opinions, and exemptions under section 4975 [of the Code]'' subject to certain exceptions not relevant here. Reorganization Plan section 102. In President Carter's message to Congress regarding the Reorganization Plan, he made explicitly clear that as a result of the plan, ''Labor will have statutory authority for fiduciary obligations. . . . Labor will be responsible for overseeing fiduciary conduct under these provisions.'' Reorganization Plan, Message of the President. This exemption provides relief from the indicated prohibited transaction provisions of both ERISA and the Code.

[2] By using the term ''Adviser,'' the Department does not intend to limit the exemption to investment advisers registered under the Investment Advisers Act of 1940 or under state law. As explained herein, an Adviser must be an investment advice fiduciary of a plan or IRA who is an employee, independent contractor, agent, or registered representative of a registered investment adviser, bank, or registered broker-dealer.

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Part V

Department of Labor

Employee Benefits Security Administration

29 CFR Parts 2509, 2510, and 2550

Definition of the Term ‘‘Fiduciary’’; Conflict of Interest Rule—Retirement Investment Advice; Best Interest Contract Exemption; Class Exemption for Principal Transactions in Certain Assets between Investment Advice Fiduciaries and Employee Benefit Plans and IRA; Amendment to Prohibited Transaction Exemption (PTE) 75–1, Part V, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks; Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 84–24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters; Amendments to and Partial Revocation of Prohibited Transaction Exemption (PTE) 86–128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; Amendment to and Partial Revocation of PTE 75–1, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefits Plans and Certain Broker-Dealers, Reporting Dealers and Banks; Amendments to Class Exemptions 75–1, 77–4, 80–83 and 83–1; Final Rule

DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Parts 2509, 2510, and 2550

RIN 1210–AB32

Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice

AGENCY: Employee Benefits Security Administration, Department of Labor

ACTION: Final rule.

SUMMARY: This document contains a final regulation defining who is a "fiduciary" of an employee benefit plan under the Employee Retirement Income Security Act of 1974 (ERISA or the Act) as a result of giving investment advice to a plan or its participants or beneficiaries. The final rule also applies to the definition of a "fiduciary" of a plan (including an individual retirement account (IRA)) under the Internal Revenue Code of 1986 (Code). The final rule treats persons who provide investment advice or recommendations for a fee or other compensation with respect to assets of a plan or IRA as fiduciaries in a wider array of advice relationships.

DATES: *Effective date:* The final rule is effective June 7, 2016.

Applicability date: April 10, 2017. As discussed more fully below, the Department of Labor (Department or DOL) has determined that, in light of the importance of the final rule's consumer protections and the significance of the continuing monetary harm to retirement investors without the rule's changes, an applicability date of April 10, 2017, is adequate time for plans and their affected financial services and other service providers to adjust to the basic change from non-fiduciary to fiduciary status. The Department has also decided to delay the application of certain requirements of certain of the exemptions being finalized with this rule. That action, described in more detail in the final exemptions published elsewhere in this issue of the **Federal Register**, will allow firms and advisers to benefit from the relevant exemptions without having to meet all of the exemptions' requirements for a limited time.

FOR FURTHER INFORMATION CONTACT: For Questions Regarding the Final Rule: Contact Luisa Grillo-Chope, Office of Regulations and Interpretations, Employee Benefits Security Administration (EBSA), (202) 693–8825. (Not a toll-free number). For Questions Regarding the Final Prohibited Transaction Exemptions: Contact Karen Lloyd, Office of Exemption Determinations, EBSA, 202–693–8824. (Not a toll free number). For Questions Regarding the Regulatory Impact Analysis: Contact G. Christopher Cosby, Office of Policy and Research, EBSA, 202–693–8425. (Not a toll-free number).

SUPPLEMENTARY INFORMATION:

I. Executive Summary

A. Purpose of the Regulatory Action

Under ERISA and the Code, a person is a fiduciary to a plan or IRA to the extent that the person engages in specified plan activities, including rendering "investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan . . . [.]" ERISA safeguards plan participants by imposing trust law standards of care and undivided loyalty on plan fiduciaries, and by holding fiduciaries accountable when they breach those obligations. In addition, fiduciaries to plans and IRAs are not permitted to engage in "prohibited transactions," which pose special dangers to the security of retirement, health, and other benefit plans because of fiduciaries' conflicts of interest with respect to the transactions. Under this regulatory structure, fiduciary status and responsibilities are central to protecting the public interest in the integrity of retirement and other important benefits, many of which are tax-favored.

In 1975, the Department issued regulations that significantly narrowed the breadth of the statutory definition of fiduciary investment advice by creating a five-part test that must, in each instance, be satisfied before a person can be treated as a fiduciary adviser. This regulatory definition applies to both ERISA and the Code. The Department created the five-part test in a very different context and investment advice marketplace. The 1975 regulation was adopted prior to the existence of participant-directed 401(k) plans, the widespread use of IRAs, and the now commonplace rollover of plan assets from ERISA-protected plans to IRAs. Today, as a result of the five-part test, many investment professionals, consultants, and advisers [1] have no obligation to adhere to ERISA's fiduciary standards or to the prohibited transaction rules, despite the critical role they play in guiding plan and IRA investments. Under ERISA and the Code, if these advisers are not fiduciaries, they may operate with conflicts of interest that they need not disclose and have limited liability under federal pension law for any harms resulting from the advice they provide. Non-fiduciaries may give imprudent and disloyal advice; steer plans and IRA owners to investments based on their own, rather than their customers' financial interests; and act on conflicts of interest in ways that would be prohibited if the same persons were fiduciaries. In light of the breadth and intent of ERISA and the Code's statutory definition, the growth of participant-directed investment arrangements and IRAs, and the need for plans and IRA owners to seek out and rely on sophisticated financial advisers to make critical investment decisions in an increasingly complex financial marketplace, the Department believes it is appropriate to revisit its 1975 regulatory definition as well as the Code's virtually identical regulation. With this regulatory action, the Department will replace the 1975 regulations with a definition of fiduciary investment advice that better reflects the broad scope of the statutory text and its purposes and better protects plans, participants, beneficiaries, and IRA owners from conflicts of interest, imprudence, and disloyalty.

The Department has also sought to preserve beneficial business models for delivery of investment advice by separately publishing new exemptions from ERISA's prohibited transaction rules that would broadly permit firms to continue to receive many common types of fees, as long as they are willing to adhere to applicable standards aimed at ensuring that their advice is impartial and in the best interest of their customers. Rather than create a highly prescriptive set of transaction-specific exemptions, the Department instead is publishing exemptions that flexibly accommodate a wide range of current types of compensation practices, while minimizing the harmful impact of conflicts of interest on the quality of advice.

In particular, the Department is publishing a new exemption (the "Best Interest Contract Exemption") that would provide conditional relief for common compensation, such as commissions and revenue sharing, that an adviser and the adviser's employing firm might receive in connection with

[1] By using the term "adviser," the Department does not intend to refer only to investment advisers registered under the Investment Advisers Act of 1940 or under state law. For example, as used herein, an adviser can be an individual or entity who is, among other things, a representative of a registered investment adviser, a bank or similar financial institution, an insurance company, or a broker-dealer.

investment advice to retail retirement investors.[2]

In order to protect the interests of the plan participants and beneficiaries, IRA owners, and plan fiduciaries, the exemption requires the Financial Institution to acknowledge fiduciary status for itself and its Advisers. The Financial Institutions and Advisers must adhere to basic standards of impartial conduct. In particular, under this standards-based approach, the Adviser and Financial Institution must give prudent advice that is in the customer's best interest, avoid misleading statements, and receive no more than reasonable compensation. Additionally, Financial Institutions generally must adopt policies and procedures reasonably designed to mitigate any harmful impact of conflicts of interest, and disclose basic information about their conflicts of interest and the cost of their advice. Level Fee Fiduciaries that receive only a level fee in connection with advisory or investment management services are subject to more streamlined conditions, including a written statement of fiduciary status, compliance with the standards of impartial conduct, and, as applicable, documentation of the specific reason or reasons for the recommendation of the Level Fee arrangements.

If advice is provided to an IRA investor or a non-ERISA plan, the Financial Institution must set forth the standards of fiduciary conduct and fair dealing in an enforceable contract with the investor. The contract creates a mechanism for IRA investors to enforce their rights and ensures that they will have a remedy for advice that does not honor their best interest. In this way, the contract gives both the individual adviser and the financial institution a powerful incentive to ensure advice is provided in accordance with fiduciary norms, or risk litigation, including class litigation, and liability and associated reputational risk.

This principles-based approach aligns the adviser's interests with those of the plan participant or IRA owner, while leaving the individual adviser and employing firm with the flexibility and discretion necessary to determine how best to satisfy these basic standards in light of the unique attributes of their business. The Department is similarly publishing amendments to existing exemptions for a wide range of fiduciary advisers to ensure adherence to these basic standards of fiduciary conduct. In addition, the Department is publishing a new exemption for "principal transactions" in which advisers sell certain investments to plans and IRAs out of their own inventory, as well as an amendment to an existing exemption that would permit advisers to receive compensation for extending credit to plans or IRAs to avoid failed securities transactions.

This broad regulatory package aims to require advisers and their firms to give advice that is in the best interest of their customers, without prohibiting common compensation arrangements by allowing such arrangements under conditions designed to ensure the adviser is acting in accordance with fiduciary norms and basic standards of fair dealing. The new exemptions and amendments to existing exemptions are published elsewhere in today's edition of the **Federal Register**.

Some comments urged the Department to publish yet another proposal before moving to publish a final rule. As noted elsewhere, the proposal published in the **Federal Register** on April 20, 2015 (2015 Proposal)[3] benefitted from comments received on an earlier proposal issued in 2010 (2010 Proposal),[4] and this final rule reflects the Department's careful consideration of the extensive comments received on the 2015 Proposal. The Department believes that the changes it has made in response to those comments are consistent with reasonable expectations of the affected parties and, together with the prohibited transaction exemptions being finalized with this rule, strike an appropriate balance in addressing the need to modernize the fiduciary rule with the various stakeholder interests. As a result, the Department does not believe a third proposal and comment period is necessary. To the contrary, after careful consideration of the public comments and in light of the importance of the final rule's consumer protections and the significance of the continuing monetary harm to retirement investors without the rule's changes, the Department has determined that it is important for the final rule to become effective on the earliest possible date. Making the rule effective will provide certainty to plans, plan fiduciaries, plan participants and beneficiaries, IRAs, and IRA owners that the new protections afforded by the final rule are now officially part of the law and regulations governing their investment advice providers. Similarly, the financial services providers and other affected service providers will also have certainty that the rule is final and that will remove uncertainty as an obstacle to allocating capital and resources toward transition and longer term compliance adjustments to systems and business practices.

To the extent the public comments were based on concerns about compliance and interpretive issues arising after publication of the final rule, the Department fully intends to support advisers, plan sponsors and fiduciaries, and other affected parties with extensive compliance assistance activities. The Department routinely provides such assistance following its issuance of highly technical or significant guidance. For example, the Department's compliance assistance Web page, at *http://www.dol.gov/ebsa/compliance_assistance.html,* provides a variety of tools, including compliance guides, tips, and fact sheets, to assist parties in satisfying their ERISA obligations. Recently, the Department added broad assistance for regulated parties on the Affordable Care Act regulations, at *www.dol.gov/ebsa/healthreform/.* The Department also intends to be accessible to affected parties who wish to contact the Department with individual questions about the final rule. For example, this final rule specifically provides directions on contacting the Department for further information about the final rule. See "For Further Information Contact" at the beginning of this Notice. Although the Department expects advisers and firms to make reasonable and good faith efforts to comply with the rule and applicable exemptions, the Department expects to initially emphasize these sorts of compliance assistance activities as opposed to using investigations and enforcement actions as a primary implementation tool as employee benefit plans, plan sponsors, plan fiduciaries, advisers, firms and other affected parties make the transition to the new regulatory regime.

B. Summary of the Major Provisions of the Final Rule

After careful consideration of the issues raised by the written comments and hearing testimony and the extensive public record, the Department is adopting the final rule contained herein.[5] The final rule contains modifications to the 2015 Proposal to address comments seeking clarification

[2] For purposes of the exemption, retail investors generally include individual plan participants and beneficiaries, IRA owners, and plan fiduciaries not described in section 2510.3–21(c)(1)(i) of this rule (banks, insurance carriers, registered investment advisers, broker-dealers, or independent fiduciaries that hold, manage, or control $50 million or more).

[3] 80 FR 21928 (Apr. 20, 2015).

[4] 75 FR 65263 (Oct. 22, 2010).

[5] "Comments" and "commenters" as used in this Notice generally include written comments, petitions and hearing testimony.

of certain provisions in the proposal and delineating the differences between the final rule's operation in the plan and IRA markets. The final rule amends the regulatory definition of fiduciary investment advice in 29 CFR 2510.3–21 (1975) to replace the restrictive five-part test with a new definition that better comports with the statutory language in ERISA and the Code.[6] Similar to the proposal, the final rule first describes the kinds of communications that would constitute investment advice and then describes the types of relationships in which such communications give rise to fiduciary investment advice responsibilities.

Specifically, paragraph (a)(1) of the final rule provides that person(s) render investment advice if they provide for a fee or other compensation, direct or indirect, certain categories or types of advice. The listed types of advice are—

• 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.

• A recommendation as to the management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, selection of other persons to provide investment advice or investment management services, selection of investment account arrangements (*e.g.,* brokerage versus advisory); or recommendations with respect to rollovers, distributions, or transfers 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.

Paragraph (a)(2) establishes the types of relationships that must exist for such recommendations to give rise to fiduciary investment advice responsibilities. The rule covers: Recommendations by person(s) who represent or acknowledge that they are acting as a fiduciary within the meaning of the Act or the Code; advice rendered pursuant to a written or verbal agreement, arrangement, or understanding that the advice is based on the particular investment needs of the advice recipient; and recommendations directed 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.

Paragraph (b)(1) describes when a communication, based on its context, content, and presentation, would be viewed as a "recommendation," a fundamental element in establishing the existence of fiduciary investment advice. Paragraph (b)(1) provides that "recommendation" means 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. The determination of whether a "recommendation" has been made is an objective rather than subjective inquiry. In addition, 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 as appropriate for an advice recipient would be a recommendation as to the advisability of acquiring securities even if no recommendation is made with respect to any one security. Furthermore, a series of actions, directly or indirectly (*e.g.,* through or together with any affiliate), that may not constitute recommendations 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.

Paragraph (b)(2) sets forth non-exhaustive examples of certain types of communications which generally are not "recommendations" under that definition and, therefore, are not fiduciary communications. Although the proposal classified these examples as "carve-outs" from the scope of the fiduciary definition, they are better understood as specific examples of communications that are non-fiduciary because they fall short of constituting "recommendations." The paragraph describes general communications and commentaries on investment products such as financial newsletters, which, with certain modifications, were identified as carve-outs under paragraph (b) of the 2015 Proposal, certain activities and communications in connection with marketing or making available a platform of investment alternatives that a plan fiduciary could choose from, and the provision of information and materials that constitute investment education or retirement education. With respect to investment education in particular, the final rule expressly describes in detail four broad categories of non-fiduciary educational information and materials, including (A) plan information, (B) general financial, investment, and retirement information, (C) asset allocation models, and (D) interactive investment materials. Additionally, in response to comments on the proposal, the final rule allows educational asset allocation models and interactive investment materials provided to participants and beneficiaries in plans to reference specific investment alternatives under conditions designed to ensure the communications are presented as hypothetical examples that help participants and beneficiaries understand the educational information and not as investment recommendations. The rule does not, however, create such a broad safe harbor from fiduciary status for such "hypothetical" examples in the IRA context for reasons described below.

Paragraph (c) describes and clarifies conduct and activities that the Department determined should not be considered investment advice activity, even if the communications meet the regulation's definition of "recommendation" and satisfy the criteria established by paragraph (a). As noted in the proposal, the regulation's general definition of investment advice, like the statute, sweeps broadly, avoiding the weaknesses of the 1975 regulation. At the same time, however, as the Department acknowledged in the proposal, the broad test could sweep in some relationships that are not appropriately regarded as fiduciary in nature and that the Department does not believe Congress intended to cover as fiduciary relationships. Thus, included in paragraph (c) is a revised version of the "counterparty" carve-out from the proposal that excludes from fiduciary investment advice communications in arm's length transactions with certain plan fiduciaries who are licensed financial professionals (broker-dealers, registered investment advisers, banks, insurance companies, etc.) or plan fiduciaries who have at least $50 million under management. Other exclusions in the final rule include a revised version of the swap transaction carve-out in the proposal, and an expanded version of the carve-out in the proposal for plan sponsor employees.

Because the proposal referred to all of the instances of non-fiduciary communications set forth in (b)(2) and

[6] For purposes of readability, this rulemaking republishes 29 CFR 2510.3–21 in its entirety, as revised, rather than only the specific amendments to this section.

(c) as ''carve-outs,'' regardless of whether the communications would have involved covered recommendations even in the absence of a carve-out, a number of commenters found the use of the term confusing. In particular, they worried that the provisions could be read to create an implication that any communication that did not technically meet the conditions of a specific carve-out would automatically meet the definition of investment advice. This was not the Department's intention, however, and the Department no longer uses the term ''carve-out'' in the final regulation. Even if a particular communication does not fall within any of the examples and exclusions set forth in (b)(2) and (c), it will be treated as a fiduciary communication only if it is an investment ''recommendation'' of the sort described in paragraphs (a) and (b)(1). All of the provisions in paragraphs (b) and (c) continue to be subject to conditions designed to draw an appropriate line between fiduciary and non-fiduciary communications and activities, consistent with the statutory text and purpose.

Except for minor clarifying changes, paragraph (d)'s description of the scope of the investment advice fiduciary duty, and paragraph (e) regarding the mere execution of a securities transaction at the direction of a plan or IRA owner, remained mostly unchanged from the 1975 regulation. Paragraph (f) also remains unchanged from the two prior proposals and articulates the application of the final rule to the parallel definitions in the prohibited transaction provisions of Code section 4975. Paragraph (g) includes definitions. Paragraph (h) describes the effective and applicability dates associated with the final rule, and paragraph (i) includes an express provision acknowledging the savings clause in ERISA section 514(b)(2)(A) for state insurance, banking, or securities laws.

In the Department's view, this structure is faithful to the remedial purpose of the statute, but avoids burdening activities that do not implicate relationships of trust.

As noted elsewhere, in addition to the final rule in this Notice, the Department is simultaneously publishing a new Best Interest Contract Exemption and a new Exemption for Principal Transactions, and revising other exemptions from the prohibited transaction rules of ERISA and the Code.

C. Benefit-Cost Assessment

Tax-preferred retirement savings, in the form of private-sector, employer-sponsored retirement plans, such as 401(k) plans, and IRAs, are critical to the retirement security of most U.S. workers. Investment professionals play an important role in guiding their investment decisions. However, these professional advisers often are compensated in ways that create conflicts of interest, which can bias the investment advice that some render and erode plan and IRA investment results.

Since the Department issued its 1975 rule, the retirement savings market has changed profoundly. Individuals, rather than large employers, are increasingly responsible for their investment decisions as IRAs and 401(k)-type defined contribution plans have supplanted defined benefit pensions as the primary means of providing retirement security. Financial products are increasingly varied and complex. Retail investors now confront myriad choices of how and where to invest, many of which did not exist or were uncommon in 1975. These include, for example, market-tracking, passively managed and so-called ''target-date'' mutual funds; exchange traded funds (ETFs) (which may be leveraged to multiply market exposure); hedge funds; private equity funds; real estate investment trusts (both traded and non-traded); various structured debt instruments; insurance products that offer menus of direct or formulaic market exposures and guarantees from which consumers can choose; and an extensive array of derivatives and other alternative investments. These choices vary widely with respect to return potential, risk characteristics, liquidity, degree of diversification, contractual guarantees and/or restrictions, degree of transparency, regulatory oversight, and available consumer protections. Many of these products are marketed directly to retail investors via email, Web site pop-ups, mail, and telephone. All of this creates the opportunity for retail investors to construct and pursue financial strategies closely tailored to their unique circumstances—but also sows confusion and increases the potential for very costly mistakes.

Plan participants and IRA owners often lack investment expertise and must rely on experts—but are unable to assess the quality of the expert's advice or guard against conflicts of interest. Most have no idea how advisers are compensated for selling them products. Many are bewildered by complex choices that require substantial financial expertise and welcome advice that appears to be free, without knowing that the adviser is compensated through indirect third-party payments creating conflicts of interest or that opaque fees over the life of the investment will reduce their returns. The consequences are growing as baby boomers retire and move money from plans, where their employer has both the incentive and the fiduciary duty to facilitate sound investment choices, to IRAs, where both good and bad investment choices are more numerous and much advice is conflicted. These rollovers are expected to approach $2.4 trillion cumulatively from 2016 through 2020.[7] Because advice on rollovers is usually one-time and not ''on a regular basis,'' it is often not covered by the 1975 standard, even though rollovers commonly involve the most important financial decisions that investors make in their lifetime. An ERISA plan investor who rolls her retirement savings into an IRA could lose 6 to 12 and possibly as much as 23 percent of the value of her savings over 30 years of retirement by accepting advice from a conflicted financial adviser.[8] Timely regulatory action to redress advisers' conflicts is warranted to avert such losses.

In the retail IRA marketplace, growing consumer demand for personalized advice, together with competition from online discount brokerage firms, has pushed brokers to offer more comprehensive guidance services rather than just transaction support. Unfortunately, their traditional compensation sources—such as brokerage commissions, revenue shared by mutual funds and funds' asset managers, and mark-ups on bonds sold from their own inventory—can introduce acute conflicts of interest. What is presented to an IRA owner as trusted advice is often paid for by a financial product vendor in the form of a sales commission or shelf-space fee, without adequate counter-balancing consumer protections to ensure that the advice is in the investor's best interest.

[7] Cerulli Associates, ''Retirement Markets 2015.''

[8] For example, an ERISA plan investor who rolls $200,000 into an IRA, earns a 6 percent nominal rate of return with 2.3 percent inflation, and aims to spend down her savings in 30 years, would be able to consume $11,034 per year for the 30-year period. A similar investor whose assets underperform by 0.5, 1, or 2 percentage points per year would only be able to consume $10,359, $9,705, or $8,466, respectively, in each of the 30 years. The 0.5 and 1 percentage point figures represent estimates of the underperformance of retail mutual funds sold by potentially conflicted brokers. These figures are based on a large body of literature cited in the 2015 NPRM Regulatory Impact Analysis, comments on the 2015 NPRM Regulatory Impact Analysis, and testimony at the DOL hearing on conflicts of interest in investment advice in August 2015. The 2 percentage point figure illustrates a scenario for an individual where the impact of conflicts of interest is more severe than average. For details, see U.S. Department of Labor, Fiduciary Investment Advice Regulatory Impact Analysis, (2016), Section 3.2.4 at *www.dol.gov/ebsa.*

Likewise in the plan market, pension consultants and advisers that plan sponsors rely on to guide their decisions often avoid fiduciary status under the five-part test in the 1975 regulation, while receiving conflicted payments. Many advisers do put their customers' best interest first and there are many good practices in the industry. But the balance of research and evidence indicates the aggregate harm from the cases in which consumers receive bad advice based on conflicts of interest is large.

As part of the 2015 Proposal, the Department conducted an in-depth economic assessment of current market conditions and the likely effects of reform and conducted and published a detailed regulatory impact analysis, U.S. Department of Labor, Fiduciary Investment Advice Regulatory Impact Analysis, (Apr. 2015), pursuant to Executive Order 12866 and other applicable authorities. That analysis examined a broad range of evidence, including public comments on the 2010 Proposal; a growing body of empirical, peer-reviewed, academic research into the effect of conflicts of interest in advisory relationships; a recent study conducted by the Council of Economic Advisers, The Effects of Conflicted Investment Advice on Retirement Savings (Feb. 2015), at *www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf;* and some other countries' early experience with related reform efforts, among other sources. Taken together, the evidence demonstrated that advisory conflicts are costly to retail and plan investors.

The Department's regulatory impact analysis of its final rulemaking finds that conflicted advice is widespread, causing serious harm to plan and IRA investors, and that disclosing conflicts alone would fail to adequately mitigate the conflicts or remedy the harm. By extending fiduciary status to more advice and providing flexible and protective PTEs that apply to a broad array of compensation arrangements, the final rule and exemptions will mitigate conflicts, support consumer choice, and deliver substantial gains for retirement investors and economic benefits that more than justify its costs.

Advisers' conflicts of interest take a variety of forms and can bias their advice in a variety of ways. For example, advisers and their affiliates often profit more when investors select some mutual funds or insurance products rather than others, or engage in larger or more frequent transactions. Advisers can capture varying price spreads from principal transactions and product providers reap different amounts of revenue from the sale of different proprietary products. Adviser compensation arrangements, which often are calibrated to align their interests with those of their affiliates and product suppliers, often introduce serious conflicts of interest between advisers and retirement investors. Advisers often are paid substantially more if they recommend investments and transactions that are highly profitable to the financial industry, even if they are not in investors' best interests. These financial incentives sometimes bias the advisers' recommendations. Many advisers do not provide biased advice, but the harm to investors from those that do can be large in many instances and is large on aggregate.

Following such biased advice can inflict losses on investors in several ways. They may choose more expensive and/or poorer performing investments. They may trade too much and thereby incur excessive transaction costs. They may chase returns and incur more costly timing errors, which are a common consequence of chasing returns.

A wide body of economic evidence supports the Department's finding that the impact of these conflicts of interest on retirement investment outcomes is large and negative. The supporting evidence includes, among other things, statistical comparisons of investment performance in more and less conflicted investment channels, experimental and audit studies, government reports documenting abuse, and economic theory on the dangers posed by conflicts of interest and by the asymmetries of information and expertise that characterize interactions between ordinary retirement investors and conflicted advisers. In addition, the Department conducted its own analysis of mutual fund performance across investment channels and within variable annuity sub-accounts, producing results broadly consistent with the academic literature.

A careful review of the evidence, which consistently points to a substantial failure of the market for retirement advice, suggests that IRA holders receiving conflicted investment advice can expect their investments to underperform by an average of 50 to 100 basis points per year over the next 20 years. The underperformance associated with conflicts of interest—in the mutual funds segment alone—could cost IRA investors between $95 billion and $189 billion over the next 10 years and between $202 billion and $404 billion over the next 20 years.

While these expected losses are large, they represent only a portion of what retirement investors stand to lose as a result of adviser conflicts. The losses quantified immediately above pertain only to IRA investors' mutual fund investments, and with respect to these investments, reflect only one of multiple types of losses that conflicted advice produces. The estimate does not reflect expected losses from so-called timing errors, wherein investors invest and divest at inopportune times and underperform pure buy-and-hold strategies. Such errors can be especially costly. Good advice can help investors avoid such errors, for example, by reducing panic-selling during large and abrupt downturns. But conflicted advisers often profit when investors choose actively managed funds whose deviation from market results (*i.e.,* positive and negative ''alpha'') can magnify investors' natural tendency to trade more and ''chase returns,'' an activity that tends to produce serious timing errors. There is some evidence that adviser conflicts do in fact magnify timing errors.

The quantified losses also omit losses that adviser conflicts produce in connection with IRA investments other than mutual funds. Many other products, including various annuity products, among others, involve similar or larger adviser conflicts, and these conflicts are often equally or more opaque. Many of these same products exhibit similar or greater degrees of complexity, magnifying both investors' need for good advice and their vulnerability to biased advice. As with mutual funds, advisers may steer investors to products that are inferior to, or costlier than, similar available products, or to excessively complex or costly product types when simpler, more affordable product types would be appropriate. Finally, the quantified losses reflect only those suffered by retail IRA investors and not those incurred by plan investors, when there is evidence that the latter suffer losses as well. Data limitations impede quantification of all of these losses, but there is ample qualitative and in some cases empirical evidence that they occur and are large both in instance and on aggregate.

Disclosure alone has proven ineffective to mitigate conflicts in advice. Extensive research has demonstrated that most investors have little understanding of their advisers' conflicts of interest, and little awareness of what they are paying via indirect channels for the conflicted advice. Even if they understand the scope of the advisers' conflicts, many consumers are not financial experts and therefore, cannot distinguish good advice or investments from bad. The same gap in expertise that makes investment advice necessary and important frequently also prevents investors from recognizing bad advice or understanding advisers' disclosures. Some research suggests that even if disclosure about conflicts could be made simple and clear, it could be ineffective—or even harmful.

This final rule and exemptions aim to ensure that advice is in consumers' best interest, thereby rooting out excessive fees and substandard performance otherwise attributable to advisers' conflicts, producing gains for retirement investors. Delivering these gains will entail some compliance costs,—mostly, the cost incurred by new fiduciary advisers to avoid prohibited transactions and/or satisfy relevant PTE conditions—but the Department has attempted to minimize compliance costs while maintaining an enforceable best interest standard.

The Department expects compliance with the final rule and exemptions to deliver large gains for retirement investors by reducing, over time, the losses identified above. Because of data limitations, as with the losses themselves, only a portion of the expected gains are quantified in this analysis. The Department's quantitative estimate of investor gains from the final rule and exemptions takes into account only one type of adviser conflict: the conflict that arises from variation in the share of front-end loads that advisers receive when selling different mutual funds that charge such loads to IRA investors. Published research provides evidence that this conflict erodes investors' returns. The Department estimates that the final rule and exemptions, by mitigating this particular type of adviser conflict, will produce gains to IRA investors worth between $33 billion and $36 billion over 10 years and between $66 and $76 billion over 20 years.

These quantified potential gains do not include additional potentially large, expected gains to IRA investors resulting from reducing or eliminating the effects of conflicts in IRA advice on financial products other than front-end-load mutual funds or the effect of conflicts on advice to plan investors on any financial products. Moreover, in addition to mitigating adviser conflicts, the final rule and exemptions raise adviser conduct standards, potentially yielding additional gains for both IRA and plan investors. The total gains to retirement investors thus are likely to be substantially larger than these particular, quantified gains alone.

The final exemptions include strong protections calibrated to ensure that adviser conflicts are fully mitigated such that advice is impartial. If, however, advisers' impartiality is sometimes compromised, gains to retirement investors consequently will be reduced correspondingly.

The Department estimates that the cost to comply with the final rule and exemptions will be between $10.0 billion and $31.5 billion over 10 years with a primary estimate of $16.1 billion, mostly reflecting the cost incurred by affected fiduciary advisers to satisfy relevant consumer-protective PTE conditions. Costs generally are estimated to be front-loaded, reflecting a substantial amount of one-time, start-up costs. The Department's primary 10-year cost estimate of $16.1 billion reflects the present value of $5.0 billion in first-year costs and $1.5 billion in subsequent annual costs. These estimates account for start-up costs in the first year following the final regulation's and exemptions' initial applicability. The Department understands that in practice some portion of these start-up costs may be incurred in advance of or after that year. These cost estimates may be overstated insofar as they generally do not take into account potential cost savings from technological innovations and market adjustments that favor lower-cost models. They may be understated insofar as they do not account for frictions that may be associated with such innovations and adjustments.

Just as with IRAs, there is evidence that conflicts of interest in the investment advice market also erode the retirement savings of plan participants and beneficiaries. For example, the U.S. Government Accountability Office (GAO) found that defined benefit pension plans using consultants with undisclosed conflicts of interest earned 1.3 percentage points per year less than other plans. Other GAO reports have found that adviser conflicts may cause plan participants to roll plan assets into IRAs that charge high fees or 401(k) plan officials to include expensive or underperforming funds in investment menus. A number of academic studies find that 401(k) plan investment options underperform the market, and at least one study attributes such underperformance to excessive reliance on funds that are proprietary to plan service providers who may be providing investment advice to plan officials that choose the investment options.

The final rule and exemptions' positive effects are expected to extend well beyond improved investment results for retirement investors. The IRA and plan markets for fiduciary advice and other services may become more efficient as a result of more transparent pricing and greater certainty about the fiduciary status of advisers and about the impartiality of their advice. There may be benefits from the increased flexibility that the final rule and related exemptions will provide with respect to fiduciary investment advice currently falling within the ambit of the 1975 regulation. The final rule's defined boundaries between fiduciary advice, education, and sales activity directed at independent fiduciaries with financial expertise may bring greater clarity to the IRA and plan services markets. Innovation in new advice business models, including technology-driven models, may be accelerated, and nudged away from conflicts and toward transparency, thereby promoting healthy competition in the fiduciary advice market.

A major expected positive effect of the final rule and exemptions in the plan advice market is improved compliance and the associated improved security of ERISA plan assets and benefits. Clarity about advisers' fiduciary status will strengthen the Department's ability to quickly and fully correct ERISA violations, while strengthening deterrence.

A large part of retirement investors' gains from the final rule and exemptions represents improvements in overall social welfare, as some resources heretofore consumed inefficiently in the provision of financial products and services are freed for more valuable uses. The remainder of the projected gains reflects transfers of existing economic surplus to retirement investors, primarily from the financial industry. Both the social welfare gains and the distributional effects can promote retirement security, and the distributional effects more fairly allocate a larger portion of the returns on retirement investors' capital to the investors themselves. Because quantified and additional unquantified investor gains from the final rule and exemptions comprise both welfare gains and transfers, they cannot be netted against estimated compliance costs to produce an estimate of net social welfare gains. Rather, in this case, the Department concludes that the final rule and exemptions' positive social welfare and distributional effects together justify their cost.

A number of comments on the Department's 2015 Proposal, including those from consumer advocates, some independent researchers, and some independent financial advisers, largely endorsed its accompanying impact analysis, affirming that adviser conflicts cause avoidable harm and that the proposal would deliver gains for retirement investors that more than justify compliance costs, with minimal or no unintended adverse consequences. In contrast, many other comments, including those from most of the financial industry (generally excepting only comments from independent financial advisers), strongly criticized the Department's analysis and conclusions. These comments collectively argued that the Department's evidence was weak, that its estimates of conflicts' negative effects and the proposal's benefits were overstated, that its compliance cost estimates were understated, and that it failed to anticipate predictable adverse consequences including increases in the cost of advice and reductions in its availability to small investors, which the commenters said would depress saving and exacerbate rather than reduce investment mistakes. Some of these comments took the form of or were accompanied by research reports that collectively offered direct, sometimes technical critiques of the Department's analysis, or presented new data and analysis that challenged the Department's conclusions. The Department took these comments into account in developing this analysis of its final rule and exemptions. Many of these comments were grounded in practical operational concerns which the Department believes it has alleviated through revisions to the 2015 Proposal reflected in this final rule and exemptions. At the same time, however, many of the reports suffered from analytic weaknesses that undermined the credibility of some of their conclusions.

Many comments anticipating sharp increases in the cost of advice neglected the costs currently attributable to conflicted advice including, for example, indirect fees. Many exaggerated the negative impacts (and neglected the positive impacts) of recent overseas reforms and/or the similarity of such reforms to the 2015 Proposal. Many implicitly and without support assumed rigidity in existing business models, service levels, compensation structures, and/or pricing levels, neglecting the demonstrated existence of low-cost solutions and potential for investor-friendly market adjustments. Many that predicted that only wealthier investors would be served appeared to neglect the possibility that once the fixed costs of serving wealthier investors was defrayed, only the relatively small marginal cost of serving smaller investors would remain for affected firms to bear in order to serve these consumers.

The Department expects that, subject to some short-term frictions as markets adjust, investment advice will continue to be readily available when the final rule and exemptions are applicable, owing to both flexibilities built into the final rule and exemptions and to the conditions and dynamics currently evident in relevant markets, Moreover, recent experience in the United Kingdom suggests that potential gaps in markets for financial advice are driven mostly by factors independent of reforms to mitigate adviser conflicts. Commenters' conclusions that stem from an assumption that advice will be unavailable therefore are of limited relevance to this analysis. Nonetheless, the Department notes that these commenters' claims about the consequences of the rule would still be overstated even if the availability of advice were to decrease. Many commenters arguing that costlier advice will compromise saving exaggerated their case by presenting mere correlation (wealth and advisory services are found together) as evidence that advice causes large increases in saving. Some wrongly implied that earlier Department estimates of the potential for fiduciary advice to reduce retirement investment errors—when accompanied by very strong anti-conflict consumer protections—constituted an acknowledgement that conflicted advice yields large net benefits.

The negative comments that offered their own original analysis, and whose conclusions contradicted the Department's, also are generally unpersuasive on balance in the context of this present analysis. For example, these comments collectively neglected important factors such as indirect fees, made comparisons without adjusting for risk, relied on data that are likely to be unrepresentative, failed to distinguish conflicted from independent advice, and/or presented as evidence median results when the problems targeted by the 2015 Proposal and the proposal's expected benefits are likely to be concentrated on one side of the distribution's median.

In light of the Department's analysis, its careful consideration of the comments, and responsive revisions made to the 2015 Proposal, the Department stands by its analysis and conclusions that adviser conflicts are inflicting large, avoidable losses on retirement investors, that appropriate, strong reforms are necessary, and that compliance with this final rule and exemptions can be expected to deliver large net gains to retirement investors. The Department does not anticipate the substantial, long-term unintended consequences predicted in the negative comments.

In conclusion, the Department's analysis indicates that the final rule and exemptions will mitigate adviser conflicts and thereby improve plan and IRA investment results, while avoiding greater than necessary disruption of existing business practices. The final rule and exemptions will deliver large gains to retirement investors, reflecting a combination of improvements in economic efficiency and worthwhile transfers to retirement investors from the financial industry, and a variety of other economic benefits, which, in the Department's view, will more than justify its costs.

The following accounting table summarizes the Department's conclusions:

TABLE I—PARTIAL GAINS TO INVESTORS AND COMPLIANCE COSTS ACCOUNTING TABLE

Category	Primary estimate	Low estimate	High estimate	Year dollar	Discount rate (%)	Period covered
Partial Gains to Investors (Includes Benefits and Transfers)						
Annualized	$3,420	$3,105		2016	7	April 2017–April 2027.
Monetized ($millions/year)	4,203	3,814		2016	3	April 2017–April 2027.

TABLE I—PARTIAL GAINS TO INVESTORS AND COMPLIANCE COSTS ACCOUNTING TABLE—Continued

Category	Primary estimate	Low estimate	High estimate	Year dollar	Discount rate (%)	Period covered
Gains to Investors Notes: The DOL expects the final rulemaking to deliver large gains for retirement investors. Because of limitations of the literature and other available evidence, only some of these gains can be quantified: up to $3.1 or $3.4 billion (annualized over Apr. 2017–Apr. 2027 with a 7 percent discount rate) or up to $3.8 or $4.2 billion (annualized over Apr. 2017–Apr. 2027 with a 3 percent discount rate). These estimates focus only on how load shares paid to brokers affect the size of loads IRA investors holding load funds pay and the returns they achieve. These estimates assume the rule will eliminate (rather than just reduce) underperformance associated with the practice of incentivizing broker recommendations through variable front-end-load sharing. If, however, the rule's effectiveness in reducing underperformance is substantially below 100 percent, these estimates may overstate these particular gains to investors in the front-end-load mutual fund segment of the IRA market. However, these estimates account for only a fraction of potential conflicts, associated losses, and affected retirement assets. The total gains to IRA investors attributable to the rule may be higher than the quantified gains alone for several reasons. For example, the proposal is expected to yield additional gains for IRA investors, including potential reductions in excessive trading and associated transaction costs and timing errors (such as might be associated with return chasing), improvements in the performance of IRA investments other than front-load mutual funds, and improvements in the performance of ERISA plan investments.						
The partial-gains-to-investors estimates include both economic efficiency benefits and transfers from the financial services industry to IRA holders.						
The partial gains estimates are discounted to April 2016.						
Compliance Costs						
Annualized	$1,960	$1,205	$3,847	2016	7	April 2017–April 2027.
Monetized ($millions/year)	1,893	1,172	3,692	2016	3	April 2017–April 2027.
Notes: The compliance costs of the final include the cost to BDs, Registered Investment Advisers, insurers, and other ERISA plan service providers for compliance reviews, comprehensive compliance and supervisory system changes, policies and procedures and training programs updates, insurance increases, disclosure preparation and distribution to comply with exemptions, and some costs of changes in other business practices. Compliance costs incurred by mutual funds or other asset providers have not been estimated.						
Insurance Premium Transfers						
Annualized	$73			2016	7	April 2017–April 2027.
Monetized ($millions/year)	73			2016	3	April 2017–April 2027.
From/To	From: Insured service providers without claims.			To: Insured service providers with claims—funded from a portion of the increased insurance premiums.		

II. RULEMAKING BACKGROUND

A. The Statute and Existing Regulation

ERISA is a comprehensive statute designed to protect the rights and interests of plan participants and beneficiaries, the integrity of employee benefit plans, and the security of retirement, health, and other critical benefits. The broad public interest in ERISA-covered plans is reflected in the Act's imposition of stringent fiduciary responsibilities on parties engaging in important plan activities, as well as in the tax-favored status of plan assets and investments. One of the chief ways in which ERISA protects employee benefit plans is by requiring that plan fiduciaries comply with fundamental obligations rooted in the law of trusts. In particular, plan fiduciaries must manage plan assets prudently and with undivided loyalty to the plans, their participants, and beneficiaries.[9] In addition, they must refrain from engaging in ''prohibited transactions,'' which the Act does not permit, absent an applicable statutory or administrative exemption, because of the dangers posed by the transactions that involve significant conflicts of interest.[10] Prohibited transactions include sales and exchanges between plans and parties with certain connections to the plan such as fiduciaries, other service providers, and employers of the plan's participants. They also specifically include self-dealing and other conflicted transactions involving plan fiduciaries. ERISA includes various exemptions from these provisions for certain types of transactions, and administrative exemptions on an individual or class basis may be granted if the Department finds the exemption to be in the interests of plan participants, protective of their rights, and administratively feasible.[11] When fiduciaries violate ERISA's fiduciary duties or the prohibited transaction rules, they may be held personally liable for any losses to the investor resulting from the breach.[12] Violations of the prohibited transaction rules are subject to excise taxes under the Code or civil penalties under ERISA.[13]

The Code also protects individuals who save for retirement through tax-favored accounts that are not generally covered by ERISA, such as IRAs, through a more limited regulation of fiduciary conduct. Although ERISA's statutory fiduciary obligations of prudence and loyalty do not govern the fiduciaries of IRAs and other plans not covered by ERISA, these fiduciaries are subject to prohibited transaction rules under the Code. The statutory exemptions in the Code apply and the Department of Labor has been given the statutory authority to grant administrative exemptions under the Code.[14] In this context, however, the sole statutory sanction for engaging in the illegal transactions is the assessment of an excise tax enforced by the Internal Revenue Service (IRS). Thus, unlike participants in plans covered by Title I of ERISA, IRA owners do not have a statutory right to bring suit against

[9] ERISA section 404(a).

[10] ERISA section 406 and Code section 4975.

[11] ERISA section 408 and Code section 4975.

[12] ERISA section 409; *see also* ERISA section 405.

[13] Code section 4975 and ERISA section 502(i).

[14] Under Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 1, 92 Stat. 3790, the authority of the Secretary of the Treasury to issue regulations, rulings, opinions, and exemptions under section 4975 of the Code has been transferred, with certain exceptions not here relevant, to the Secretary of Labor.

fiduciaries under ERISA for violation of the prohibited transaction rules.

Under this statutory framework, the determination of who is a ''fiduciary'' is of central importance. Many of ERISA's and the Code's protections, duties, and liabilities hinge on fiduciary status. In relevant part, section 3(21)(A) of ERISA provides that a person is a fiduciary with respect to a plan to the extent he or she (i) exercises any discretionary authority or discretionary control with respect to management of such plan or exercises any authority or control with respect to management or disposition of its assets; (ii) 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; or, (iii) has any discretionary authority or discretionary responsibility in the administration of such plan. Section 4975(e)(3) of the Code identically defines ''fiduciary'' for purposes of the prohibited transaction rules set forth in Code section 4975.

The statutory definition contained in section 3(21)(A) of ERISA deliberately casts a wide net in assigning fiduciary responsibility with respect to plan assets. Thus, ''any authority or control'' over plan assets is sufficient to confer fiduciary status, and any person who renders ''investment advice for a fee or other compensation, direct or indirect'' is an investment advice fiduciary, regardless of whether they have direct control over the plan's assets, and regardless of their status as an investment adviser or broker under the federal securities laws. The statutory definition and associated fiduciary responsibilities were enacted to ensure that plans can depend on persons who provide investment advice for a fee to make recommendations that are prudent, loyal, and untainted by conflicts of interest. In the absence of fiduciary status, persons who provide investment advice would neither be subject to ERISA's fundamental fiduciary standards, nor accountable under ERISA or the Code for imprudent, disloyal, or tainted advice, no matter how egregious the misconduct or how substantial the losses. Plans, individual participants and beneficiaries, and IRA owners often are not financial experts and consequently must rely on professional advice to make critical investment decisions. The broad statutory definition, prohibitions on conflicts of interest, and core fiduciary obligations of prudence and loyalty all reflect Congress' recognition in 1974 of the fundamental importance of such advice to protect savers' retirement nest eggs. In the years since then, the significance of financial advice has become still greater with increased reliance on participant-directed plans and self-directed IRAs for the provision of retirement benefits.

In 1975, the Department issued a regulation, at 29 CFR 2510.3–21(c), defining the circumstances under which a person is treated as providing ''investment advice'' to an employee benefit plan within the meaning of section 3(21)(A)(ii) of ERISA (the ''1975 regulation''), and the Department of the Treasury issued a virtually identical regulation under the Code.[15] The regulation narrowed the scope of the statutory definition of fiduciary investment advice by creating a five-part test that must be satisfied before a person can be treated as rendering investment advice for a fee. Under the regulation, for advice to constitute ''investment advice,'' an adviser who is not a fiduciary under another provision of the statute must—(1) render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing, or selling securities or other property (2) on a regular basis (3) pursuant to a mutual agreement, arrangement, or understanding with the plan or a plan fiduciary that (4) the advice will serve as a primary basis for investment decisions with respect to plan assets, and that (5) the advice will be individualized based on the particular needs of the plan or IRA. The regulation provides that an adviser is a fiduciary with respect to any particular instance of advice only if he or she meets each and every element of the five-part test with respect to the particular advice recipient or plan at issue.

The market for retirement advice has changed dramatically since the Department promulgated the 1975 regulation. Perhaps the greatest change is the fact that individuals, rather than large employers and professional money managers, have become increasingly responsible for managing retirement assets as IRAs and participant-directed plans, such as 401(k) plans, have supplanted defined benefit pensions. In 1975, private-sector defined benefit pensions—mostly large, professionally managed funds—covered over 27 million active participants and held assets totaling almost $186 billion. This compared with just 11 million active participants in individual account defined contribution plans with assets of just $74 billion.[16] Moreover, the great majority of defined contribution plans at that time were professionally managed, not participant-directed. In 1975, 401(k) plans did not yet exist and IRAs had just been authorized as part of ERISA's enactment the prior year. In contrast, by 2013 defined benefit plans covered just over 15 million active participants, while individual account-based defined contribution plans covered nearly 77 million active participants—including about 63 million active participants in 401(k)-type plans that are at least partially participant-directed.[17] By 2013, 97 percent of 401(k) participants were responsible for directing the investment of all or part of their own account, up from 86 percent as recently as 1999.[18] Also, in mid-2015, more than 40 million households owned IRAs.[19] At the same time, the variety and complexity of financial products have increased, widening the information gap between advisers and their clients. Plan

[15] The 1975 regulation provides in relevant part:

(c) Investment advice. (1) A person shall be deemed to be rendering ''investment advice'' to an employee benefit plan, within the meaning of section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 (the Act) and this paragraph, only if:

(i) Such person renders advice to the plan as to the value of securities or other property, or makes recommendation as to the advisability of investing in, purchasing, or selling securities or other property; and

(ii) Such person either directly or indirectly (*e.g.*, through or together with any affiliate)—

(A) Has discretionary authority or control, whether or not pursuant to agreement, arrangement or understanding, with respect to purchasing or selling securities or other property for the plan; or

(B) Renders any advice described in paragraph (c)(1)(i) of this section on a regular basis to the plan 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, that such services will serve as a primary basis for investment decisions with respect to plan assets, and that such person will render individualized investment advice to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.

40 FR 50842 (Oct. 31, 1975). The Department of the Treasury issued a virtually identical regulation, at 26 CFR 54.4975–9(c), which interprets Code section 4975(e)(3). 40 FR 50840 (Oct. 31, 1975). Under section 102 of Reorganization Plan No. 4 of 1978, the authority of the Secretary of the Treasury to interpret section 4975 of the Code has been transferred, with certain exceptions not here relevant, to the Secretary of Labor. References in this document to sections of ERISA should be read to refer also to the corresponding sections of the Code.

[16] U.S. Department of Labor, *Private Pension Plan Bulletin Historical Tables and Graphs,* (Dec. 2014), at *http://www.dol.gov/ebsa/pdf/historicaltables.pdf.*

[17] U.S. Department of Labor, *Private Pension Plan Bulletin Abstract of 2013 Form 5500 Annual Reports,* (Sep. 2015), at *http://www.dol.gov/ebsa/pdf/2013pensionplanbulletin.pdf.*

[18] U.S. Department of Labor, *Private Pension Plan Bulletin Historical Tables and Graphs, 1975–2013,* (Sep. 2015), at *http://www.dol.gov/ebsa/pdf/historicaltables.pdf.*

[19] Holden, Sarah, and Daniel Schrass. *The Role of IRAs in US Households' Saving for Retirement, 2015.* ICI Research Perspective 22, no. 1 (Feb. 2016).

fiduciaries, plan participants, and IRA investors must often rely on experts for advice, but are often unable to assess the quality of the expert's advice or effectively guard against the adviser's conflicts of interest. This challenge is especially true of small retail investors who typically do not have financial expertise and can ill-afford lower returns to their retirement savings caused by conflicts. As baby boomers retire, they are increasingly moving money from ERISA-covered plans, where their employer has both the incentive and the fiduciary duty to facilitate sound investment choices, to IRAs where both good and bad investment choices are myriad and advice that is conflicted is commonplace. As noted above, these rollovers are expected to approach $2.4 trillion over the next 5 years. These trends were not apparent when the Department promulgated the 1975 rule.

These changes in the marketplace, as well as the Department's experience with the rule since 1975, support the Department's efforts to reevaluate and revise the rule through a public process of notice and comment rulemaking. As the marketplace for financial services has developed in the years since 1975, the five-part test now undermines, rather than promotes, the statute's text and purposes. The narrowness of the 1975 regulation allows advisers, brokers, consultants, and valuation firms to play a central role in shaping plan and IRA investments, without ensuring the accountability that Congress intended for persons having such influence and responsibility. Even when plan sponsors, participants, beneficiaries, and IRA owners clearly rely on paid advisers for impartial guidance, the regulation allows many advisers to avoid fiduciary status and disregard ERISA's fiduciary obligations of care and prohibitions on disloyal and conflicted transactions. As a consequence, these advisers can steer customers to investments based on their own self-interest (*e.g.,* products that generate higher fees for the adviser even if there are identical lower-fee products available), give imprudent advice, and engage in transactions that would otherwise be prohibited by ERISA and the Code without fear of accountability under either ERISA or the Code.

Instead of ensuring that trusted advisers give prudent and unbiased advice in accordance with fiduciary norms, the 1975 regulation erects a multi-part series of technical impediments to fiduciary responsibility. The Department is concerned that the specific elements of the five-part test—which are not found in the text of the Act or Code—work to frustrate statutory goals and defeat advice recipients' legitimate expectations. In light of the importance of the proper management of plan and IRA assets, it is critical that the regulation defining investment advice draws appropriate distinctions between the sorts of advice relationships that should be treated as fiduciary in nature and those that should not. The 1975 regulation does not do so. Instead, the lines drawn by the five-part test frequently permit evasion of fiduciary status and responsibility in ways that undermine the statutory text and purposes.

One example of the five-part test's shortcomings is the requirement that advice be furnished on a ''regular basis.'' As a result of the requirement, if a small plan hires an investment professional on a one-time basis for an investment recommendation on a large, complex investment, the adviser has no fiduciary obligation to the plan under ERISA. Even if the plan is considering investing all or substantially all of the plan's assets, lacks the specialized expertise necessary to evaluate the complex transaction on its own, and the consultant fully understands the plan's dependence on his professional judgment, the consultant is not a fiduciary because he does not advise the plan on a ''regular basis.'' The plan could be investing hundreds of millions of dollars in plan assets, and it could be the most critical investment decision the plan ever makes, but the adviser would have no fiduciary responsibility under the 1975 regulation. While a consultant who regularly makes less significant investment recommendations to the plan would be a fiduciary if he satisfies the other four prongs of the regulatory test, the one-time consultant on an enormous transaction has no fiduciary responsibility.

In such cases, the ''regular basis'' requirement, which is not found in the text of ERISA or the Code, fails to draw a sensible line between fiduciary and non-fiduciary conduct, and undermines the law's protective purposes. A specific example is the one-time purchase of a group annuity to cover all of the benefits promised to substantially all of a plan's participants for the rest of their lives when a defined benefit plan terminates or a plan's expenditure of hundreds of millions of dollars on a single real estate transaction with the assistance of a financial adviser hired for purposes of that one transaction. Despite the clear importance of the decisions and the clear reliance on paid advisers, the advisers would not be fiduciaries. On a smaller scale that is still immensely important for the affected individual, the ''regular basis'' requirement also deprives individual participants and IRA owners of statutory protection when they seek specialized advice on a one-time basis, even if the advice concerns the investment of all or substantially all of the assets held in their account (*e.g.,* as in the case of an annuity purchase or a rollover from a plan to an IRA or from one IRA to another).

Under the five-part test, fiduciary status can also be defeated by arguing that the parties did not have a *mutual* agreement, arrangement, or understanding that the advice would serve as a *primary basis* for investment decisions. Investment professionals in today's marketplace frequently market retirement investment services in ways that clearly suggest the provision of tailored or individualized advice, while at the same time disclaiming in fine print the requisite ''mutual'' understanding that the advice will be used as a primary basis for investment decisions.

Similarly, there appears to be a widespread belief among broker-dealers that they are not fiduciaries with respect to plans or IRAs because they do not hold themselves out as registered investment advisers, even though they often market their services as financial or retirement planners. The import of such disclaimers—and of the fine legal distinctions between brokers and registered investment advisers—is often completely lost on plan participants and IRA owners who receive investment advice. As shown in a study conducted by the RAND Institute for Civil Justice for the Securities and Exchange Commission (SEC), consumers often do not read the legal documents and do not understand the difference between brokers and registered investment advisers, particularly when brokers adopt such titles as ''financial adviser'' and ''financial manager.'' [20]

Even in the absence of boilerplate fine print disclaimers, however, it is far from evident how the ''primary basis'' element of the five-part test promotes the statutory text or purposes of ERISA and the Code. If, for example, a prudent plan fiduciary hires multiple specialized advisers for an especially complex transaction, it should be able to rely upon all of the consultants' advice,

[20] Hung, Angela A., Noreen Clancy, Jeff Dominitz, Eric Talley, Claude Berrebi, Farrukh Suvankulov, *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers,* RAND Institute for Civil Justice, commissioned by the U.S. Securities and Exchange Commission, 2008, at *http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.*

regardless of whether one could characterize any particular consultant's advice as primary, secondary, or tertiary. Presumably, paid consultants make recommendations—and retirement investors seek their assistance—with the hope or expectation that the recommendations could, in fact, be relied upon in making important decisions. When a plan, participant, beneficiary, or IRA owner directly or indirectly pays for advice upon which it can rely, there appears to be little statutory basis for drawing distinctions based on a subjective characterization of the advice as ''primary,'' ''secondary,'' or other.

In other respects, the current regulatory definition could also benefit from clarification. For example, a number of parties have argued that the regulation, as currently drafted, does not encompass paid advice as to the selection of money managers or mutual funds. Similarly, they have argued that the regulation does not cover advice given to the managers of pooled investment vehicles that hold plan assets contributed by many plans, as opposed to advice given to particular plans. Parties have even argued that advice was insufficiently ''individualized'' to fall within the scope of the regulation because the advice provider had failed to prudently consider the ''particular needs of the plan,'' notwithstanding the fact that both the advice provider and the plan agreed that individualized advice based on the plan's needs would be provided, and the adviser actually made specific investment recommendations to the plan. Although the Department disagrees with each of these interpretations of the 1975 regulation, the arguments nevertheless suggest that clarifying regulatory text would be helpful.

As noted above, changes in the financial marketplace have further enlarged the gap between the 1975 regulation's effect and the congressional intent as reflected in the statutory definition. With this transformation, plan participants, beneficiaries, and IRA owners have become major consumers of investment advice that is paid for directly or indirectly. Increasingly, important investment decisions have been left to inexpert plan participants and IRA owners who depend upon the financial expertise of their advisers, rather than professional money managers who have the technical expertise to manage investments independently. In today's marketplace, many of the consultants and advisers who provide investment-related advice and recommendations receive compensation from the financial institutions whose investment products they recommend. This gives the consultants and advisers a strong reason, conscious or unconscious, to favor investments that provide them greater compensation rather than those that may be most appropriate for the participants. Unless they are fiduciaries, however, these consultants and advisers are free under ERISA and the Code, not only to receive such conflicted compensation, but also to act on their conflicts of interest to the detriment of their customers. In addition, plans, participants, beneficiaries, and IRA owners now have a much greater variety of investments to choose from, creating a greater need for expert advice. Consolidation of the financial services industry and innovations in compensation arrangements have multiplied the opportunities for self-dealing and reduced the transparency of fees.

The absence of adequate fiduciary protections and safeguards is especially problematic in light of the growth of participant-directed plans and self-directed IRAs, the gap in expertise and information between advisers and the customers who depend upon them for guidance, and the advisers' significant conflicts of interest.

When Congress enacted ERISA in 1974, it made a judgment that plan advisers should be subject to ERISA's fiduciary regime and that plan participants, beneficiaries, and IRA owners should be protected from conflicted transactions by the prohibited transaction rules. More fundamentally, however, the statutory language was designed to cover a much broader category of persons who provide fiduciary investment advice based on their functions and to limit their ability to engage in self-dealing and other conflicts of interest than is currently reflected in the 1975 regulation's five-part test. While many advisers are committed to providing high-quality advice and always put their customers' best interests first, the 1975 regulation makes it far too easy for advisers in today's marketplace not to do so and to avoid fiduciary responsibility even when they clearly purport to give individualized advice and to act in the client's best interest, rather than their own.

B. The 2010 Proposal

On October 22, 2010, the Department published the 2010 Proposal in the **Federal Register** that would have replaced the five-part test with a new definition of what counted as fiduciary investment advice for a fee. At that time, the Department did not propose any new prohibited transaction exemptions and acknowledged uncertainty regarding whether existing exemptions would be available, but specifically invited comments on whether new or amended exemptions should be proposed. The 2010 Proposal also provided exclusions or limitations for conduct that would not result in fiduciary status. The general definition included the following types of advice: (1) Appraisals or fairness opinions concerning the value of securities or other property; (2) recommendations as to the advisability of investing in, purchasing, holding or selling securities or other property; and (3) recommendations as to the management of securities or other property. Reflecting the Department's longstanding interpretation of the 1975 regulations, the 2010 Proposal made clear that investment advice under the proposal includes advice provided to plan participants, beneficiaries and IRA owners as well as to plan fiduciaries.

Under the 2010 Proposal, a paid adviser would have been treated as a fiduciary if the adviser provided one of the above types of advice and either: (1) Represented that he or she was acting as an ERISA fiduciary; (2) was already an ERISA fiduciary to the plan by virtue of having control over the management or disposition of plan assets, or by having discretionary authority over the administration of the plan; (3) was already an investment adviser under the Investment Advisers Act of 1940 (Advisers Act); or (4) provided the advice pursuant to an agreement, arrangement or understanding that the advice may be considered in connection with plan investment or asset management decisions and would be individualized to the needs of the plan, plan participant or beneficiary, or IRA owner. The 2010 Proposal also provided that, for purposes of the fiduciary definition, relevant fees included any direct or indirect fees received by the adviser or an affiliate from any source. Direct fees are payments made by the advice recipient to the adviser including transaction-based fees, such as brokerage, mutual fund or insurance sales commissions. Indirect fees are payments to the adviser from any source other than the advice recipient such as revenue sharing payments with respect to a mutual fund.

The 2010 Proposal included specific provisions for the following actions that the Department believed should not result in fiduciary status. In particular, a person would not have become a fiduciary by—

1. Providing recommendations as a seller or purchaser with interests adverse to the plan, its participants, or IRA owners, if the advice recipient reasonably should have known that the adviser was not providing impartial investment advice and the adviser had not acknowledged fiduciary status.

2. Providing investment education information and materials in connection with an individual account plan.

3. Marketing or making available a menu of investment alternatives that a plan fiduciary could choose from, and providing general financial information to assist in selecting and monitoring those investments, if these activities include a written disclosure that the adviser was not providing impartial investment advice.

4. Preparing reports necessary to comply with ERISA, the Code, or regulations or forms issued thereunder, unless the report valued assets that lack a generally recognized market, or served as a basis for making plan distributions.

The 2010 Proposal applied to the definition of an ''investment advice fiduciary'' in section 4975(e)(3)(B) of the Code as well as to the parallel ERISA definition. The 2010 Proposal, like this final rule, applies to both ERISA-covered plans and certain non-ERISA plans, such as individual retirement accounts.

In the preamble to the 2010 Proposal, the Department also noted that it had previously interpreted the 1975 regulation as providing that a recommendation to a plan participant on how to invest the proceeds of a contemplated plan distribution was not fiduciary investment advice. Advisory Opinion 2005–23A (Dec. 7, 2005). The Department specifically asked for comments as to whether the final rule should cover such recommendations as fiduciary advice.

The Department made special efforts to encourage the regulated community's participation in this rulemaking. The 2010 Proposal prompted a large number of comments and a vigorous debate. The Department received over 300 comment letters. A public hearing on the 2010 Proposal was held in Washington, DC on March 1 and 2, 2011, at which 38 speakers testified. In addition to an extended comment period, additional time for comments was allowed following the hearing. The transcript of that hearing was made available for additional public comment and the Department received over 60 additional comment letters. The Department also participated in many meetings requested by various interested stakeholders. Many of the comments concerned the Department's conclusions regarding the likely economic impact of the 2010 Proposal, if adopted. A number of commenters urged the Department to undertake additional analysis of expected costs and benefits particularly with regard to the 2010 Proposal's coverage of IRAs. After consideration of these comments and in light of the significance of this rulemaking to the retirement plan service provider industry, plan sponsors and participants, beneficiaries and IRA owners, the Department decided to take more time for review and to issue a new proposed regulation for comment. On September 19, 2011 the Department announced that it would withdraw the 2010 Proposal and propose a new rule defining the term ''fiduciary'' for purposes of section 3(21)(A)(ii) of ERISA and section 4975(e)(3)(B) of the Code.

C. The 2015 Proposal

On April 20, 2015, the Department published in the **Federal Register** a Notice withdrawing the 2010 Proposal and issuing the 2015 Proposal, a new proposed amendment to 29 CFR 2510.3–21(c). On the same date, the Department published proposed new and amended exemptions from ERISA's and the Code's prohibited transaction rules designed to allow certain broker-dealers, insurance agents and others that act as investment advice fiduciaries to nevertheless continue to receive common forms of compensation that would otherwise be prohibited, subject to appropriate safeguards.

The 2015 Proposal made many revisions to the 2010 Proposal, although it also retained aspects of that proposal's essential framework. Paragraph (a)(1) of the 2015 Proposal set forth the following types of advice, which, when provided in exchange for a fee or other compensation, whether directly or indirectly, and given under circumstances described in paragraph (a)(2), would be ''investment advice'' unless one of the ''carve-outs'' in paragraph (b) applied. The listed types of advice were—(i) a recommendation as to the advisability of acquiring, holding, disposing of, or exchanging securities or other property, including a recommendation to take a distribution of benefits or a recommendation as to the investment of securities or other property to be rolled over or otherwise distributed from the plan or IRA; (ii) a recommendation as to the management of securities or other property, including recommendations as to the management of securities or other property to be rolled over or otherwise distributed from the plan or IRA; (iii) an appraisal, fairness opinion, or similar statement whether verbal or written concerning the value of securities or other property if provided in connection with a specific transaction or transactions involving the acquisition, disposition, or exchange, of such securities or other property by the plan or IRA; or (iv) a recommendation of a person who is also going to receive a fee or other compensation to provide any of the types of advice described in paragraphs (i) through (iii) above.

As provided in paragraph (a)(2) of the 2015 Proposal, unless a carve-out applied, a category of advice listed in the proposal would constitute ''investment advice'' if the person providing the advice, either directly or indirectly (*e.g.,* through or together with any affiliate)—(i) represents or acknowledges that it is acting as a fiduciary within the meaning of the Act or Code with respect to the advice described in paragraph (a)(1); or (ii) renders the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is individualized to, or that such advice is specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA.

The 2015 Proposal included several carve-outs for persons who do not represent that they are acting as ERISA fiduciaries, some of which were included in some form in the 2010 Proposal but many of which were not. Subject to specified conditions, these carve-outs covered—

(1) statements or recommendations made to a ''large plan investor with financial expertise'' by a counterparty acting in an arm's length transaction;

(2) offers or recommendations to plan fiduciaries of ERISA plans to enter into a swap or security-based swap that is regulated under the Securities Exchange Act or the Commodity Exchange Act;

(3) statements or recommendations provided to a plan fiduciary of an ERISA plan by an employee of the plan sponsor if the employee receives no fee beyond his or her normal compensation;

(4) marketing or making available a platform of investment alternatives to be selected by a plan fiduciary for an ERISA participant-directed individual account plan;

(5) the identification of investment alternatives that meet objective criteria specified by a plan fiduciary of an ERISA plan or the provision of objective financial data to such fiduciary;

(6) the provision of an appraisal, fairness opinion or a statement of value to an Employee Stock Ownership Plan

(ESOP) regarding employer securities, to a collective investment vehicle holding plan assets, or to a plan for meeting reporting and disclosure requirements; and

(7) information and materials that constitute ''investment education'' or ''retirement education.''

The 2015 Proposal applied the same definition of ''investment advice'' to the definition of ''fiduciary'' in section 4975(e)(3) of the Code and thus applied to investment advice rendered to IRAs. ''Plan'' was defined in the proposal to mean any employee benefit plan described in section 3(3) of the Act and any plan described in section 4975(e)(1)(A) of the Code. For ease of reference the proposal defined the term ''IRA'' inclusively to mean any account described in Code section 4975(e)(1)(B) through (F), such as an individual retirement account described under Code section 408(a) and a health savings account described in section 223(d) of the Code.[21] Under paragraph (f)(1) of the proposal, a recommendation was 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. The Department specifically requested comments on whether the Department should adopt the standards that the Financial Industry Regulatory Authority (FINRA) uses to define ''recommendation'' for purposes of the suitability rules applicable to brokers.

Many of the differences between the 2015 Proposal and the 2010 Proposal reflect the input of commenters on the 2010 Proposal as part of the public notice and comment process. For example, some commenters argued that the 2010 Proposal swept too broadly by making investment recommendations fiduciary in nature simply because the adviser was a plan fiduciary for purposes unconnected with the advice or an investment adviser under the Advisers Act. In their view, such status-based criteria were in tension with the Act's functional approach to fiduciary status and would have resulted in unwarranted and unintended compliance issues and costs. Other commenters objected to the lack of a requirement for these status-based categories that the advice be individualized to the needs of the advice recipient. The 2015 Proposal incorporated these suggestions: An adviser's status as an investment adviser under the Advisers Act or as an ERISA fiduciary for reasons unrelated to advice were not explicit factors in the definition. In addition, the 2015 Proposal provided that unless the adviser represented that he or she is a fiduciary with respect to advice, the advice must be provided pursuant to a written or verbal agreement, arrangement, or understanding that the advice is individualized to, or that such advice is specifically directed to, the recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA.

Furthermore, under the 2015 Proposal, the carve-outs that treat certain conduct as non-fiduciary in nature were modified, clarified, and expanded in response to comments to the 2010 Proposal. For example, the carve-out for certain valuations from the definition of fiduciary investment advice was modified and expanded. Under the 2010 Proposal, appraisals and valuations for compliance with certain reporting and disclosure requirements were not treated as fiduciary investment advice. The 2015 Proposal additionally provided a carve-out from fiduciary treatment for appraisal and fairness opinions for ESOPs regarding employer securities. Although, the Department remained concerned about valuation advice concerning an Employee Stock Ownership Plan's (ESOP's) purchase of employer stock and about a plan's reliance on that advice, the Department concluded, at the time, that the concerns regarding valuations of closely held employer stock in ESOP transactions raised issues that were more appropriately addressed in a separate regulatory initiative. Additionally, the carve-out for valuations conducted for reporting and disclosure purposes was expanded to include reporting and disclosure obligations outside of ERISA and the Code, and was applicable to both ERISA plans and IRAs.

The Department took significant steps to give interested persons an opportunity to comment on the new proposal and proposed related exemptions. The 2015 Proposal and proposed related exemptions initially provided for 75-day comment periods, ending on July 6, 2015, but the Department extended the comment periods to July 21, 2015. The Department held a public hearing in Washington, DC on August 10–13, 2015, at which over 75 speakers testified. The transcript of the hearing was made available on September 8, 2015, and the Department provided additional opportunity for interested persons to submit comments on the proposal and proposed related exemptions or transcript until September 24, 2015. A total of over 3,000 comment letters were received on the new proposals. There were also over 300,000 submissions made as part of 30 separate petitions submitted on the proposal. These comments and petitions came from consumer groups, plan sponsors, financial services companies, academics, elected government officials, trade and industry associations, and others, both in support of, and in opposition to, the proposed rule and proposed related exemptions.

III. Coordination With Other Federal Agencies and Other Regulators

Many comments throughout the rulemaking have emphasized the need to harmonize the Department's efforts with potential rulemaking and rulemaking activities under the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. Law No. 111–203, 124 Stat. 1376 (2010) (Dodd-Frank Act), in particular, the SEC's standards of care for providing investment advice and the Commodity Futures Trading Commission's (CFTC) business conduct standards for swap dealers. In addition, some commenters questioned the adequacy of coordination with other agencies regarding IRA products and services in particular. They argued that subjecting SEC-regulated investment advisers and broker-dealers to a special set of ERISA rules for plans and IRAs could lead to additional costs and complexities for individuals who may have several different types of accounts at the same financial institution some of which may be subject only to the SEC rules, and others of which may be subject to both SEC rules and new regulatory requirements under ERISA.

Other commenters questioned the extent to which the Department had engaged with federal and state securities, insurance and banking regulators to ensure that regulatory regimes already in place would not be adversely affected. They expressed concern that subjecting parties to overlapping regulatory requirements from multiple oversight organizations would make compliance difficult and costly. One commenter asserted, however, that when service providers are subject to different legal standards of conduct, the easiest compliance approach is to meet the higher standard of care, which would benefit consumers, even outside the context of plans and IRAs.

[21] The Department solicited comments on whether it is appropriate for the regulation to cover the full range of these arrangements. These non-ERISA plan arrangements are tax-favored vehicles under the Code like IRAs, but are not specifically intended like IRAs for retirement savings.

In the course of developing the 2015 Proposal, the final rule, and the related prohibited transaction exemptions, the Department has consulted with staff of the SEC; other securities, banking, and insurance regulators, the U.S. Treasury Department's Federal Insurance Office, and FINRA, the independent regulatory authority of the broker-dealer industry, to better understand whether the rule and exemptions would subject investment advisers and broker-dealers who provide investment advice to requirements that create an undue compliance burden or conflict with their obligations under other federal laws. As part of this consultative process, SEC staff has provided technical assistance and information with respect to the agencies' separate regulatory provisions and responsibilities, retail investors, and the marketplace for investment advice. Some commenters argued that the SEC's regulation of advisers and brokers is sufficient. Other commenters noted, however, that plans and IRAs invest in more products than those regulated by the SEC alone, and asserted that the regulatory framework under ERISA and the Code was more protective of retirement investors. Some commenters also questioned the extent to which the SEC's disclosure framework would adequately protect retirement investors. Others thought the Department should coordinate with the SEC on the initiative and some advocated for a uniform fiduciary standard to lessen confusion about various standards of care owed to investors.

Commenters were also divided when it came to FINRA, with some commenters contending that FINRA sufficiently regulates brokers and that the Department should incorporate FINRA concepts or defer to FINRA and SEC regulation under the federal securities laws. Other commenters expressed concern about relying on FINRA and SEC regulations and guidance, in part, because FINRA's guidance would not be directly applicable to an array of ERISA investment advisers that are not subject to FINRA rules or SEC oversight.

In pursuing its consultations with other regulators, the Department aimed to avoid conflict with other federal laws and minimize duplicative provisions between ERISA, the Code and federal securities laws. However, the governing statutes do not permit the Department to make the obligations of fiduciary investment advisers under ERISA and the Code identical to the duties of advice providers under the securities laws. ERISA and the Code establish consumer protections for some investment advice that does not fall within the ambit of federal securities laws, and vice versa. Even if each of the relevant agencies were to adopt an identical definition of "fiduciary," the legal consequences of the fiduciary designation would vary between agencies because of differences in the specific duties and remedies established by the different federal laws at issue. ERISA and the Code place special emphasis on the elimination or mitigation of conflicts of interest and adherence to substantive standards of conduct, as reflected in the prohibited transaction rules and ERISA's standards of fiduciary conduct. The specific duties imposed on fiduciaries by ERISA and the Code stem from legislative judgments on the best way to protect the public interest in tax-preferred benefit arrangements that are critical to workers' financial and physical health. The Department has taken great care to honor ERISA and the Code's specific text and purposes.

At the same time, the Department has worked hard to understand the impact of the 2015 Proposal and the final rule on firms subject to the federal securities and other laws, and to take the effects of those laws into account so as to appropriately calibrate the impact of the rule on those firms. The final rule reflects these efforts. In the Department's view, it neither undermines, nor contradicts, the provisions or purposes of the securities laws, but instead works in harmony with them. The Department has coordinated—and will continue to coordinate—its efforts with other federal agencies to ensure that the various legal regimes are harmonized to the fullest extent possible.

The Department has also consulted with the Department of the Treasury, particularly on the subject of IRAs. Although the Department has responsibility for issuing regulations and prohibited transaction exemptions under section 4975 of the Code, which applies to IRAs, the IRS maintains general responsibility for enforcing the tax laws. The IRS' responsibilities extend to the imposition of excise taxes on fiduciaries who participate in prohibited transactions.[22] As a result, the Department and the IRS share responsibility for combating self-dealing by fiduciary investment advisers to tax-qualified plans and IRAs. Paragraph (f) of the final regulation, in particular, recognizes this jurisdictional intersection.

The Department received comments from the North American Securities Administrators Association (NASAA), whose membership includes all U.S. state securities regulators. NASAA generally supported the proposal and the Department's goal of enhancing the standard of care available to retirement investors, including those who invest through IRAs. NASAA said the proposal is an important step in raising the standard of care available to retirement investors, and paves the way for additional regulatory initiatives to raise the standard of care for investors in general. NASAA asked that the Department include language in its final rule that explicitly acknowledges that state securities laws are not superseded or preempted and remain subject to the ERISA section 514(b)(2)(A) savings clause. NASAA also offered suggestions on individual substantive provisions of the proposal. For example, NASAA suggested the final rule prohibit pre-dispute binding arbitration agreements with respect to individual contract claims.[23]

The National Association of Insurance Commissioners (NAIC) also submitted a comment stating that it recognizes that oversight of the retirement plans marketplace is a shared regulatory responsibility, and has been so for decades. The NAIC agreed that state insurance regulators, the DOL, SEC and FINRA, each have an important role in the administration and enforcement of standards for retirement plans and products within their jurisdiction. It said that state insurance regulators share the DOL's commitment to protect, educate and empower consumers as they make important decisions to provide for their retirement security. The NAIC noted that the states have acted to implement a robust set of consumer protection and education standards for annuity and insurance transactions, have extensive enforcement authority to examine companies, revoke producer and company licenses to operate, as well as to collect and analyze industry data, and have a strong record of protecting consumers, especially seniors, from inappropriate sales practices or unsuitable products. The NAIC pointed out that it is important that the approaches regulators take within their respective regulatory framework be as consistent as possible, and that it would carefully evaluate the stakeholder input on the proposal submitted during the

[22] Reorganization Plan No. 4 of 1978.

[23] The NASAA comment on pre-dispute binding arbitration concerns a provision in the Best Interest Contract Exemption, not this rule. The arbitration provision in the exemption and the comments on the provision are discussed in the preamble to the final exemption published elsewhere in today's **Federal Register**.

comment period and looked forward to further discussions with DOL.

Comments were submitted by the National Conference of Insurance Legislators and the National Association of Governors suggesting further dialogue with the NAIC, insurance legislators, and other state officials to ensure the federal and state approaches to consumer protection in this area are consistent and compatible.

The Department carefully considered the comments that were submitted by interested state regulators, and had meetings during the comment period on the 2015 Proposal with NASAA staff and with the NAIC (including insurance commissioners and NAIC staff). The Department also received input on the interaction between state and federal regulation of investment advice from various groups and organizations that are subject to state insurance or securities regulations. The Department's obligation and overriding objective in developing regulations implementing ERISA (and the relevant prohibited transaction provisions in the Code) is to achieve the consumer protection objectives of ERISA and the Code. The Department believes the final rule reflects that obligation and objective while also reflecting that care was taken to craft the rule so that it does not require people subject to state banking, insurance or securities regulation to take steps that would conflict with applicable state statutory or regulatory requirements. The Department notes that ERISA section 514 expressly saves state regulation of insurance, banking, or securities from ERISA's express preemption provision. The Department agrees that it would be appropriate for the final rule to include an express provision acknowledging the savings clause in ERISA section 514(b)(2)(A) for state insurance, banking, and securities laws to emphasize the fact that those state regulators all have important roles in the administration and enforcement of standards for retirement plans and products within their jurisdiction. Accordingly, the final rule includes a new paragraph (i).

IV. The Provisions of the Final Rule and Public Comments

After carefully evaluating the full range of public comments and extensive record developed on the proposal, the final rule as described below amends the definition of investment advice in 29 CFR 2510.3–21 (1975) to replace the restrictive five-part test with a new definition that better comports with the statutory language in ERISA and the Code. Some commenters offered general support for, or opposition to, the Department's proposal to replace the 1975 regulation's five-part test. The Department did not attempt to separately identify or discuss these general comments in this Notice, although the preamble, in its entirety, addresses the reasons for undertaking this regulatory initiative and the rationales for the Department's specific regulatory choices. Most commenters, however, gave the Department feedback on the specific provisions of the proposal and whether they believed them to be preferable to the 1975 regulation.

Several commenters argued for withdrawal of the proposed rule stating that the proposal neither demonstrated a compelling need for regulatory action nor employed the least burdensome method to effect any necessary change. They believed that to make the rule and exemptions workable, such significant modifications were necessary that a second re-proposal was required. Some comments suggested that the Department should engage in extensive testing of the rule and exemptions before going final, for example, via focus groups or a negotiated rulemaking process. Some commenters complained that the Administrative Procedures Act requires that a decision to re-propose be based on the public record and that informal comments from the Department suggested that the Department had prejudged that issue before evaluating all the public comments. Another commenter disagreed and maintained that the proposal should be finalized since the Department had followed the proper regulatory process and no one, in testimony or comment, had made a credible argument for any change that is "material" enough to warrant a re-proposal. Moreover, a number of organizations also offered nearly unqualified support for the rule, and endorsed the Department's efforts in moving forward with the proposal. Although some organizations expressed concern about the rule's complexity and posited possible attendant high compliance costs and uncertain legal liabilities, they deemed these costs justified by moving to a higher standard for investors. Other commenters pointed to specific demographic groups and noted their need for the increased protections offered by the rule. One international organization articulated the hope that efforts in the United States may influence its government to similarly act to hold persons offering financial advice to a fiduciary duty. The Department believes it has engaged in sufficient public outreach to establish a valid and comprehensive public record as detailed above in discussions of the 2010 Proposal and the re-proposal in 2015 to substantiate promulgating a final rule at this time. In the Department's judgment, this final rulemaking, which follows a robust regulatory process, fulfills the Department's mission to protect, educate, and empower retirement investors as they face important choices in saving for retirement in their IRAs and employee benefit plans.

The final rule largely adopts the general structure of the 2015 Proposal but with modifications in response to commenters seeking changes or clarifications of certain provisions in the proposal. Similar to the proposal, the final rule in paragraph (a)(1) first describes the kinds of communications that would constitute investment advice. Then paragraph (a)(2) sets forth the types of relationships that must exist for such recommendations to give rise to fiduciary investment advice responsibilities. The rule covers: Recommendations by a person who represents or acknowledges that it is acting as a fiduciary within the meaning of the Act or the Code; advice rendered pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the particular investment needs of the advice recipient; and recommendations directed 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. Paragraph (b)(1) describes when a communication based on its context, content, and presentation would be viewed as a "recommendation," a fundamental element in establishing the existence of fiduciary investment advice. Paragraph (b)(2) sets forth examples of certain types of communications which are not "recommendations" under that definition. The examples include certain activities that were classified as "carve-outs" under the proposal, but which are better understood as not constituting investment "recommendations" in the first place. Paragraph (c) describes and clarifies conduct and activities that the Department determined should not be considered investment advice activity although they may otherwise meet the criteria established by paragraph (a). Thus, paragraph (c) includes communications and activities that were appropriately classified as "carve-outs" under the proposal. Paragraph (c) also adds to, clarifies, or modifies certain of the "carve-outs" in response to public comments. Except for minor clarifying changes, paragraph (d)'s description of the scope of the investment advice fiduciary duty, and paragraph (e) regarding the mere execution of a securities transaction at the direction of a plan or IRA owner, remain unchanged from the 1975 regulation. Paragraph (f) also remains unchanged from paragraph (e) of the proposal and articulates the application of the final rule to the parallel definitions in the prohibited transaction provisions of Code section 4975. Paragraph (g) includes definitions. Paragraph (h) describes the effective and applicability dates associated with the final rule, and paragraph (i) includes an express provision acknowledging the savings clause in ERISA section 514(b)(2)(A) for state insurance, banking, and securities laws.

Under the final rule, whether a "recommendation" has occurred is a threshold issue and the initial step in determining whether investment advice has occurred. The 2015 Proposal included a definition of recommendation in paragraph (f)(1): "[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." The Department received a wide range of comments that asked that the final rule include a clearer statement of when particular communications rise to the level of covered investment "recommendations." As described more fully below, the Department, in response, has added a new section to the regulation that is intended to clarify the standard for determining whether a person has made a "recommendation" covered by the final rule.

A. 29 CFR 2510.3–21(a)(1)—Categories and Types of Fiduciary Advice

Paragraph (a) of the final rule states that a person renders investment advice with respect to moneys or other property of a plan or IRA described in paragraph (g)(6) of the final rule if such person provides the types of advice described in paragraphs (a)(1)(i) or (ii). The final rule revises and clarifies this provision from the 2015 Proposal in the manner described below. Specifically, paragraph (a)(1) of the final rule provides that person(s) provide investment advice if they provide for a fee or other compensation certain categories or types of investment recommendations. The listed types of advice are—

(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; and

(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, selection of other persons to provide investment advice or investment management services; selection of investment account arrangements (*e.g.,* brokerage versus advisory); 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.

The final rule thus maintains the general structure of the 2015 Proposal, but the operative text of the rule includes several changes to clarify the provisions. In addition, the Department reserves the possible coverage of appraisals, fairness opinions, and similar statements for a future rulemaking project.

In general, paragraph (a)(1)(i) covers recommendations regarding the investment of plan or IRA assets, including recommendations regarding the investment of assets that are being rolled over or otherwise distributed from plans to IRAs. Paragraph (a)(1)(ii) covers recommendations regarding investment management of plan or IRA assets. In response to comments that the term "management" should be clarified, the Department included text from the 1975 regulation and added additional examples to clarify the scope of the definition. In particular, the management recommendations covered by (a)(1)(ii) include recommendations on rollovers, distributions, and transfers from a plan or IRA, including recommendations on whether to take a rollover, distribution, or transfer; recommendations on the form of the rollover, distribution, or transfer; and recommendations on the insurance issuer or investment provider to receive the rollover, distribution or transfer. Some commenters expressed concern that advice providers could avoid fiduciary responsibility for recommendations to roll over plan assets, for example, to a mutual fund provider by not including in that recommendation any advice on how to invest the assets after they are rolled over. The revisions to paragraph (a)(1)(ii) are intended to make clear that such recommendations would be investment advice covered by the rule.

In addition, (a)(1)(ii) has been amended to include recommendations on the selection of persons to perform investment advice or investment management services. The proposal had contained a separate provision covering recommendations to hire investment advisers, but that provision has been merged into paragraph (a)(1)(ii) as one type of recommendation on management of investments. The Department may have contributed to some commenters' uncertainty about the breadth of the proposal and whether it covered recommendations of persons providing investment management services by setting forth the recommendation of fiduciary investment advisers as a separate provision of the rule, rather than as merely one example of a recommendation on investment management. The Department has always viewed the recommendation of persons to perform investment management services for plans or IRAs as investment advice. The final rule more clearly and simply sets forth the scope of the subject matter covered by the rule. Below is a more detailed discussion of various comments that relate to these changes.

(1) Recommendations With Respect to Moneys or Other Property

Several commenters argued that the language of the proposal referring to advice regarding "moneys or other property" of the plan was sufficiently broad that it could be read to cover advice on purchasing insurance policies that do not have an investment component. Those commenters observed that such a reading of the proposal did not appear to be what the Department intended, and, moreover, asserted that a regulation defining "investment advice" as having such scope would likely exceed the Department's authority. Thus, they asked that the final rule confirm that advice as to the purchase of health, disability, and term life insurance policies to provide benefits to plan participants or IRA owners would not be fiduciary investment advice within the meaning of ERISA section 3(21)(A)(ii). Other commenters asked whether the rule would apply to 403(b) plans, SIMPLE–IRA plans, SEPs, fraternal benefit societies, and health savings accounts. Lastly, many commenters requested clarification as to whether and when traditional service providers such as lawyers, actuaries, and accountants would become subject to the final rule and argued that such service providers should not become fiduciaries under the rule merely because they provide professional assistance in connection with a particular investment transaction.[24]

It was not the intent of the proposal to treat as fiduciary investment advice, advice as to the purchase of health, disability, and term life insurance policies to provide benefits to plan participants or IRA owners if the policies do not have an investment component. The Department believes it would depart from a plain and natural reading of the term ''investment advice'' to conclude that recommendations to purchase group health and disability insurance constitute investment advice. The definition of an ''investment advice'' fiduciary in ERISA itself, as adopted in 1974, uses the same terms as the proposal to define an investment advice fiduciary—a person that renders ''investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan.'' The Department's 1975 regulation implementing that definition similarly covers ''investment advice'' regarding ''securities or other property.''

The Department is not aware of any substantial concern or confusion regarding whether the 1975 regulation covered recommendations to purchase health, disability, or term life insurance policies. Additionally, the Securities Exchange Act of 1934 in section 3(a)(35) uses the term ''securities and other property'' to define ''investment discretion,'' and the Investment Company Act of 1940 in section 2(a)(20) refers to ''securities or other property'' in defining an ''investment adviser.'' The Department does not believe that these statutory provisions have created the type of confusion that commenters attached to the Department's proposal. Thus, although there can be situations in which a person recommending group health or disability insurance, for example, effectively exercises such control over the decision that he or she is functionally exercising discretionary control over the management or administration of the plan within the meaning of the fiduciary definition in ERISA section 3(21)(A)(i) or section 3(21)(A)(iii), the Department does not believe that the definition of investment advice in ERISA's statutory text, the Department's 1975 regulation, or the prior proposals are properly interpreted or understood to cover a recommendation to purchase group health, disability, term life insurance or similar insurance policies that do not have an investment component.

As a result, and to expressly make this point, the Department has modified the final rule to make it clear that, in order to render investment advice with respect to moneys or other property of a plan or IRA, the adviser must make a recommendation with respect to the advisability of acquiring, holding, disposing or exchanging securities or other ''investment'' property. The Department similarly modified the final rule to make it clear that the covered recommendation must concern the management or manager of securities or other ''investment'' property to fall under that prong of the investment advice fiduciary definition. Further, the Department added new paragraph (g)(4) to define investment property as expressly not including health or disability insurance policies, term life insurance policies, or other assets to the extent that they do not include an investment component.

A few commenters argued that bank certificates of deposit (CDs) and other similar bank deposit accounts should not be treated as investments for purposes of the rule and communications regarding them should not be treated as investment advice because the purposes for which plan and IRA investors use them do not present the same concerns about conflicts of interest as other covered investment recommendations. The commenters also argued, similar to other commenters in other industries, that educational communications from bank branch personnel to customers about bank products will be impaired if possibly subject to ERISA rules governing fiduciary investment advice.

In the Department's view, the definition of investment property in paragraph (g)(4) should include bank CDs and similar investment products. The Department does not see any basis for differentiating advice regarding investments in CDs, including investment strategies involving CDs (*e.g.,* laddered CD portfolios), from other investment products. To the extent an adviser will receive a fee or other compensation as a result of a recommended investment in a CD, that communication presents the type of conflict of interest that is the focus of the rule. With respect to educational communications regarding bank products, just as with other investment products, the Department has emphasized in the final rule the fundamental requirement that a recommendation is necessary for a communication to be considered investment advice. Specifically, the Department has included a new paragraph (b)(1) defining recommendation for purposes of the rule, and paragraph (b)(2) provides detailed examples of communications involving investment education and general communications that do not constitute investment recommendations. Whether a recommendation occurs in any particular instance would be a determination based on facts and circumstances.

Many commenters questioned the application of the proposal in connection with recommendations of proprietary investment products. These commenters objected that the proposal would make recommending proprietary products on a commission basis a per se violation of ERISA's fiduciary duties and the fiduciary self-dealing prohibitions, and contended the proposal was flawed by a ''bias'' against proprietary products. Some of these commenters raised specific issues related to insurers marketing their own insurance products and contended that subjecting insurers to fiduciary investment advice duties would impede their ability to give participants and IRA owners guidance about lifetime income guarantees and other insurance features in their proprietary products. Commenters suggested that some mechanism, for example, a requirement to disclose potential conflicts of interest or a specific carve-out for proprietary and/or insurance products, was needed to ensure that affected providers can market purely proprietary investment products. These commenters argued that the potential for ''conflict of interest'' abuses is limited in the case of proprietary products because it is obvious to consumers that companies and their agents are marketing ''their'' products. Several other commenters, however, disagreed and argued that proprietary or affiliated investment products present substantial conflicts of interest resulting in biased advice that is detrimental to investors. These commenters argued that the Department should narrowly define provisions of the proposal designed to address advisers whose business involves proprietary or limited menu products to mitigate this potential conflict of interest.

[24] Some commenters argued that the final rule should not apply to IRAs because the Department lacked regulatory authority over IRAs. The Department's authority to issue this final rule and to make it applicable to IRAs under section 4975 of the Code is discussed in detail elsewhere in this Notice and in the preamble to the final Best Interest Contract exemption published elsewhere in today's **Federal Register**.

A couple of commenters recommended that the Department consider these proprietary product issues in the context of fraternal benefit societies exempt from tax under section 503(c)(8) of the Code, including those engaged in religious and benevolent activities, suggesting that a carve-out or similar exception is needed to protect these not-for-profit organizations because their religious and benevolent activities have been funded in large part through the sale of insurance and financial products to fraternal lodge members.

The Department does not believe that it is appropriate for a rule defining fiduciary investment advice to provide special treatment for sales and marketing of proprietary products. The Department agrees that a person's status as a fiduciary investment adviser presents inherent conflicts with sales and marketing activities that restrict recommendations to only proprietary products. The fact that conflicts of interest may be inherent in the sale and marketing of proprietary products, in the Department's view, would not be a compelling basis for excluding those communications from a rule designed to protect consumers from just such conflicts of interest. Rather, the Department believes that the model reflected in the ERISA statutory structure is the way, at least in the retail market, to acknowledge and address the fact that providers of proprietary products will, in selling their products, engage in communications and activities that constitute fiduciary investment advice under the final rule.

Specifically, just as ERISA contains broadly protective rules and prohibited transaction restrictions with carefully crafted exemptions, including conditions designed to mitigate possible abuses, the Department believes a generally applicable definition of fiduciary investment advice focused on investment ''recommendations,'' coupled with carefully crafted exemptions from the prohibited transaction rules, is also the appropriate solution in this context. In addition, with respect to institutional investors and plan fiduciaries with financial expertise, the Department has included in the final rule a special provision under which sales communications and activities in arm's length transactions with such persons would not constitute fiduciary investment advice. Insurers and others selling proprietary products can rely on that provision when dealing with such financially sophisticated plan fiduciaries. The Best Interest Contract Exemption also specifically addresses advice concerning proprietary products, and provides a means for firms and advisers to recommend such products, while safeguarding retirement investors from the dangers posed by conflicts of interest.

With respect to fraternal benefit societies, the concerns raised by these commenters regarding the proposed rule largely mirrored the concerns raised by other sellers of proprietary products. The fact that an organization is exempt from tax under the Code or that it has an educational or charitable mission does not, in the Department's view, provide a basis for excluding investment advice provided to retirement investors by those organizations from fiduciary duties. Similarly, if fraternal benefit societies adopt business structures and compensation arrangements that present self-dealing concerns and financial conflicts of interest, the fact that revenues from sales may be used, in part, for religious and benevolent activities is not, in the Department's view, a basis for treating such sales differently from other sales under the prohibited transaction provisions of ERISA and the Code. Rather, those societies can avail themselves of the same provisions in the final rule and final exemptions as are available to other sellers of proprietary products.

Some commenters similarly argued that advisers to SIMPLE–IRA plans and SEPs should be excluded from coverage under the rule. However, such arrangements established or maintained by a private sector employer for its employees are ''employee benefit plans'' within the meaning of section 3(3) of ERISA, and, as such, are subject to the protections of the prohibited transaction rules. Such plans use IRAs as their investment and funding vehicles. In light of the fact that the 2015 Proposal covered investment advice with respect to the assets of employee benefit plans and IRAs, the Department does not see any basis for excluding employee benefit plans like SIMPLE–IRA plans and SEPs from the scope of the final rule. Nor is there any reason to believe that the small employers that rely upon such plans for the provision of benefits, and their employees, are any less in need of the rule's protections. The Department's authority to issue this rulemaking, including its application to IRAs is discussed more fully below.

With respect to 403(b) plans, because the final rule defines investment advice fiduciary for ''plans'' covered under Title I of ERISA or Code section 4975 (*e.g.,* IRAs), and because 403(b) plans are not included in the definition of ''plan'' under Code section 4975, only 403(b) plans covered under Title I of ERISA are within the scope of this final rule. Specifically, a plan under section 403(b) of the Code (''403(b) plan'') is a retirement plan for employees of public schools, employees of certain tax-exempt organizations, and certain ministers. Under a 403(b) plan, employers may purchase for their eligible employees annuity contracts or establish custodial accounts invested only in mutual funds for the purpose of providing retirement income. Under ERISA section 4(b)(1) and (2), ''governmental plans'' and ''church plans'' generally are excluded from coverage under Title I of ERISA. Therefore, Code section 403(b) contracts and custodial accounts purchased or provided under a program that is either a ''governmental plan'' under section 3(32) of ERISA or a non-electing ''church plan'' under section 3(33) of ERISA are not subject to the final rule. Similarly, the Department in 1979 issued a ''safe harbor'' regulation at 29 CFR 2510.3–2(f) which states that a program for the purchase of annuity contracts or custodial accounts in accordance with section 403(b) of the Code and funded solely through salary reduction agreements or agreements to forego an increase in salary are not ''established or maintained'' by an employer under section 3(2) of the Act, and, therefore, are not employee pension benefit plans that are subject to Title I, provided that certain factors are present. Those non-Title I 403(b) plans would also be outside the scope of the final rule. A 403(b) plan established or maintained by a tax-exempt organization, however, would fall outside of the safe harbor regulation and would be a ''pension plan'' within the meaning of section 3(2) of ERISA that would be covered by Title I pursuant to section 4(a) of ERISA.

Several commenters also asserted that it was unclear whether investment advice under the scope of the proposal would include the provision of information and plan services that traditionally have been performed in a non-fiduciary capacity. The Department agrees that actuaries, accountants, and attorneys, who historically have not been treated as ERISA fiduciaries for plan clients, would not become fiduciary investment advisers by reason of providing actuarial, accounting, and legal services. The Department does not believe anything in the 2010 or 2015 Proposals, or the final rule, suggested a different conclusion. Rather, in the Department's view, the provisions in the final rule defining investment advice make it clear that attorneys, accountants, and actuaries would not be treated as investment advice fiduciaries merely because they provide such professional assistance in connection with a particular investment transaction. Only when these professionals act outside their normal roles and recommend specific investments in connection with particular investment transactions, or otherwise engage in the provision of fiduciary investment advice as defined under the final rule, would they be subject to the fiduciary definition. Similarly, the final rule does not alter the principle articulated in ERISA Interpretive Bulletin 75–8, D–2 at 29 CFR 2509.75–8 (1975). Under the bulletin, the plan sponsor's human resources personnel or plan service providers who have no power to make decisions as to plan policy, interpretations, practices or procedures, but who perform purely administrative functions for an employee benefit plan, within a framework of policies, interpretations, rules, practices and procedures made by other persons, are not thereby investment advice fiduciaries with respect to the plan.

(2) Recommendations on Rollovers, Benefit Distributions or Transfers From Plan or IRA

Paragraph (a)(1)(i) and (ii) of the final rule specifically includes recommendations concerning the investment, management, or manager of securities or other investment property to be rolled over, transferred, or distributed from the plan or IRA, including recommendations 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 and recommendations with respect whether, in what amount, in what form, and to what destination such a rollover, transfer or distribution should be made. The final rule thus supersedes the Department's position in Advisory Opinion 2005–23A (Dec. 7, 2005) that it is not fiduciary advice to make a recommendation as to distribution options even if accompanied by a recommendation as to where the distribution would be invested.

The comments on this issue tended to mirror the comments submitted on this same question the Department posed in its 2010 Proposal. Some commenters, mainly those representing consumers, stated that exclusion of recommendations on rollovers and benefit distributions from the final rule would fail to protect participant accounts from conflicted advice in connection with one of the most significant financial decisions that participants make concerning retirement savings. These comments particularly noted the critical nature of retirement and rollover decisions and the existence of incentives for advice and investment providers to steer plan participants into higher cost, subpar investments. Other commenters, mainly those representing financial services providers, argued that including such communications as fiduciary investment advice would significantly restrict the type of investment education that would be provided regarding rollover and plan distributions by employers and other plan service providers because of concerns about possible fiduciary liability and prohibited transactions. They argued that such potential fiduciary liability would disrupt the routine process that occurs when a worker leaves a job and contacts a financial services firm for help rolling over a 401(k) balance, and the firm explains the investments it offers and the benefits of a rollover. They also asserted that plan sponsors and plan service providers would stop assisting participants and beneficiaries with these important decisions, including recommendations to keep retirement savings in the plan or advice regarding lifetime income products and investment strategies. Some commenters claimed that the proposal would discourage or impede rollovers into IRAs or other vehicles that give them access to annuities and other lifetime income products that often are unavailable in their 401(k) plans. The commenters argued that such a result would conflict with the Department's recent guidance and initiatives designed to enhance the availability of lifetime income products in 401(k) and similar employer-sponsored defined contribution pension plans. Other commenters questioned the legal authority of the Department to classify rollover advice as fiduciary in nature. Others asked that the Department exclude rollover recommendations into IRAs when there is no accompanying recommendation on how to invest the funds once in the IRA. Other commenters asked for clarifications or broad exclusions in various specific circumstances, such as advice with respect to benefit distributions that are required by tax law such as required minimum distributions. Others asked that the principles of FINRA guidance on rollovers under Notice 13–45 be incorporated in the advice definition and suggested that compliance with the guidance could act as a safe harbor for rollover advice.

The Department continues to believe that decisions to take a benefit distribution or engage in rollover transactions are among the most, if not the most, important financial decisions that plan participants and beneficiaries, and IRA owners are called upon to make. The Department also continues to believe that advice provided at this juncture, even if not accompanied by a specific recommendation on how to invest assets, should be treated as investment advice under the final rule. The final rule thus adopts the provision in the proposal and supersedes Advisory Opinion 2005–23A. The advisory opinion failed to consider that advice to take a distribution of assets from a plan is actually advice to sell, withdraw, or transfer investment assets currently held in a plan. Thus, a distribution recommendation involves either advice to change specific investments in the plan or to change fees and services directly affecting the return on those investments. Even if the assets will not be covered by ERISA or the Code when they are moved outside the plan or IRA, the recommendation to change the plan or IRA investments is investment advice under ERISA and the Code. Thus, recommendations on distributions (including rollovers or transfers into another plan or IRA) or recommendations to entrust plan or IRA assets to a particular IRA provider would fall within the scope of investment advice in this regulation, and would be covered by Title I of ERISA, including the enforcement provisions of section 502(a). Further, in the Department's view, recommendations to take a distribution or rollover to an IRA and recommendations not to take a distribution or to keep assets in a plan should be treated the same in terms of evaluating whether the communication constitutes fiduciary investment advice.

The Department acknowledges commenters' concerns that some employers and service providers could restrict the type of investment education they provide regarding rollovers and plan distributions based on concerns about fiduciary liability. Accordingly, the final rule (like the 2015 Proposal) includes provisions that describe in detail the distinction between recommendations that are fiduciary investment advice and educational and informational materials. For example, the provisions specifically state that educational materials can describe the terms or operation of the plan or IRA, inform a plan fiduciary, plan participant, beneficiary, or IRA owner about the benefits of plan or IRA participation, the benefits of increasing plan or IRA contributions, the impact of preretirement withdrawals on retirement income, retirement income needs, varying forms of distributions, including rollovers, annuitization and other forms of lifetime income payment options (*e.g.,* immediate annuity, deferred annuity, or incremental purchase of deferred annuity), advantages, disadvantages and risks of different forms of distributions, or describe investment objectives and philosophies, risk and return characteristics, historical return information or related prospectuses of investment alternatives under the plan or IRA. The provisions also state that education includes information on general methods and strategies for managing assets in retirement (*e.g.,* systematic withdrawal payments, annuitization, guaranteed minimum withdrawal benefits), including those offered outside the plan or IRA. Similarly, the rule states that education includes interactive materials, such as questionnaires, worksheets, software, and similar materials, that provide a plan fiduciary, plan participant or beneficiary, or IRA owner the means to: estimate future retirement income needs and assess the impact of different asset allocations on retirement income; or to use various types of educational information to evaluate distribution options, products, or vehicles. Accordingly, the Department believes that the rule enables employers and service providers to continue to provide important educational information without undue risk that the conduct could be characterized as fiduciary investment advice under the final rule.

To the extent that an individual adviser goes beyond providing education and gives investment advice in a particular case, the Department does not believe it is appropriate to broadly exempt those communications from fiduciary liability. Moreover, the Department believes that such an exemption would be especially inappropriate in cases where a service provider offers educational services that systematically exceed the boundaries of education. In such cases, when firms or individuals make specific investment recommendations to plan participants, they should adhere to basic fiduciary norms of prudence and loyalty, and take appropriate measures to protect plan participants and beneficiaries from the potential harm caused by conflicts of interest.

Comments from various sources also expressed concern about employers and plan sponsors becoming fiduciary investment advisers as a result of educational communications and activities designed to inform employees about plans, plan investments, distribution options, retirement planning, and similar subjects. In many cases, those comments were submitted by financial services companies that might be engaged by an employer as opposed to the employer itself.

In the Department's view, in the case of an employer or other plan sponsor, an employer or plan sponsor would not become an investment advice fiduciary merely because the employer or plan sponsor engaged a service provider to provide investment advice or because a service provider engaged to provide investment education crossed the line and provided investment advice in a particular case. On the other hand, whether the service provider renders fiduciary advice or non-fiduciary education, the final rule does not change the well-established fiduciary obligations that arise in connection with the selection and monitoring of plan service providers. These issues were discussed in the 1996 Interpretive Bulletin (IB 96–1) on investment education (that many commenters urged the Department to adopt in full as the final rule). Specifically, as pointed out in the preamble to the proposal, although IB 96–1 would be formally removed from the CFR and replaced by the final rule, paragraph (e) of IB 96–1 provides generalized guidance under sections 405 and 404(c) of ERISA with respect to the selection by employers and plan fiduciaries of investment educators and the limits of their responsibilities. Specifically, paragraph (e) states:

As with any designation of a service provider to a plan, the designation of a person(s) to provide investment educational services or investment advice to plan participants and beneficiaries is an exercise of discretionary authority or control with respect to management of the plan; therefore, persons making the designation must act prudently and solely in the interest of the plan participants and beneficiaries, both in making the designation(s) and in continuing such designation(s). See ERISA sections 3(21)(A)(i) and 404(a), 29 U.S.C. 1002 (21)(A)(i) and 1104(a). In addition, the designation of an investment adviser to serve as a fiduciary may give rise to co-fiduciary liability if the person making and continuing such designation in doing so fails to act prudently and solely in the interest of plan participants and beneficiaries; or knowingly participates in, conceals or fails to make reasonable efforts to correct a known breach by the investment advisor. See ERISA section 405(a), 29 U.S.C. 1105(a). The Department notes, however, that, in the context of an ERISA section 404(c) plan, neither the designation of a person to provide education nor the designation of a fiduciary to provide investment advice to participants and beneficiaries would, in itself, give rise to fiduciary liability for loss, or with respect to any breach of part 4 of Title I of ERISA, that is the direct and necessary result of a participant's or beneficiary's exercise of independent control. 29 CFR 2550.404c–1(d). The Department also notes that a plan sponsor or fiduciary would have no fiduciary responsibility or liability with respect to the actions of a third party selected by a participant or beneficiary to provide education or investment advice where the plan sponsor or fiduciary neither selects nor endorses the educator or adviser, nor otherwise makes arrangements with the educator or adviser to provide such services.

The Department explained in the preamble to the 2015 Proposal that, unlike the remainder of the IB 96–1, this text does not belong in the investment advice regulation, and since the principles articulated in paragraph (e) are generally understood and accepted, re-issuing the paragraph as a stand-alone IB does not appear necessary or appropriate. *See* 80 FR 21944.

Although not specifically raised by these comments, it is important to emphasize that ERISA section 404(c) and the Department's regulations thereunder do not limit the liability of fiduciary investment advisers for the provision of investment advice regardless of whether or not they provide that advice pursuant to a statutory or administrative exemption. In fact, the statutory exemption in ERISA section 408(b)(14) and the administrative exemptions being finalized with this rule generally require the fiduciary investment adviser to specifically assume and acknowledge fiduciary responsibility for the provision of investment advice. ERISA section 404(c) provides relief for acts which are the direct and necessary result of a participant's or beneficiary's exercise of control. Although a participant or beneficiary may direct a transaction in his or her account pursuant to fiduciary investment advice, that direction would not mean that any imprudence in the advice or self-dealing violation by the fiduciary investment adviser in connection with the advice was the direct and necessary result of the participant's action. Accordingly, section 404(c) of ERISA would not provide any relief from liability for a fiduciary investment adviser for investment advice provided to a participant or beneficiary. This position is consistent with the position the Department took regarding the application of section 404(c) of ERISA to managed accounts in participant-directed individual account plans. *See* 29 CFR 2550.404c–1, paragraphs (f)(8) and (f)(9).

Moreover, in the case of an employer or plan sponsor, neither the employer, plan sponsor, nor their employees ordinarily receive fees or other compensation in connection with the educational services and materials that they provide to plan participants and beneficiaries. Thus, even if they crossed the line from education to actual investment advice, the absence of a fee or other compensation would generally preclude a finding that the communication constituted fiduciary investment advice. It is important to note, however, that communications from the plan administrator or other person in a fiduciary capacity would be subject to ERISA's general prudence duties notwithstanding the fact that the communications may not result in the person also becoming a fiduciary under ERISA's investment advice provisions.[25]

In response to the comments suggesting that the Department adopt FINRA Notice 13–45 as a safe harbor for communications on benefit distributions, the FINRA notice did not purport to define a line between education and advice. The final rule seeks to ensure that all investment advice to retirement investors adheres to fiduciary norms, particularly including advice as critically important as recommendations on how to manage a lifetime of savings held in a retirement plan and on whether to roll over plan accounts. Following FINRA and SEC guidance on best practices is a good way for advisers to look out for the interests of their customers, but it does not give them a pass from ERISA fiduciary status.

[25] The Department has acknowledged that a plan sponsor may wish merely to provide office space or make computer terminals available for use by a service provider that has been selected by a participant or beneficiary to provide investment education using interactive materials. The Department said that whether a plan sponsor or fiduciary has effectively endorsed or made an arrangement with a particular service provider is an inherently factual inquiry that depends upon all the relevant facts and circumstances. The Department explained, however, that a uniformly applied policy of providing office space or computer terminals for use by participants or beneficiaries who have independently selected a service provider to provide investment education would not, in and of itself, constitute an endorsement of or an arrangement with the service provider. See Preamble to Interpretative Bulletin 96–1, 61 FR 29586, 29587–88, June 11, 1996.

With respect to the tax code provisions regarding required minimum distributions, the Department agrees with commenters that merely advising a participant or IRA owner that certain distributions are required by tax law would not constitute investment advice. Whether such "tax" advice is accompanied by a recommendation that constitutes "investment advice" would depend on the particular facts and circumstances involved.

(3) Recommendations on the Management of Securities or Other Investment Property

As in the 2015 Proposal, paragraph (a)(1)(ii) of the final rule provides that a recommendation as to the "management" of securities or other investment property is fiduciary investment advice. Some commenters contended this provision could be read very broadly and asked for clarification as to the scope of activities covered by the term. These commenters were concerned that "management" could be read as duplicative of paragraph (a)(1)(i) of the proposal, which concerned recommendations on the "investment" of plan or IRA assets. The Department also received comments seeking clarification regarding this provision's impact on, for example, foreign exchange transactions, the internal operation of stable value funds, and options trading. Others questioned whether the recommendation of a general investment strategy or recommending use of a class of investment products fall within the meaning of the term "management" of plan or IRA assets, even in cases where a particular product is not recommended.

The Department agrees that further clarification of the concept of "management" in the final rule would be helpful. Accordingly, the final rule includes text from the 1975 regulation that gives examples of "investment management" that the Department believes will clarify the difference between investment recommendations and investment management recommendations. Specifically, the final rule includes text that describes management of securities or other investment property, as including, among other things, recommendations on investment policies or strategies, portfolio composition, or recommendations on distributions, including rollovers, from a plan or IRA. The final rule also adds another example to make it clear that recommendations to move from commission-based accounts to advisory fee based accounts would be fiduciary investment advice under this provision. As explained above and more fully below, the final rule also includes recommendations on the selection of other persons to provide investment advice or investment management services in this provision rather than in a separate provision.

The new text is consistent with FINRA guidance that makes it clear that recommendations on investment strategy are subject to the federal securities laws' "suitability" requirements regardless of whether the recommendation results in a securities transaction or even references a specific security or securities. Specifically, FINRA explained this requirement in a set of FAQs on Rule 2111:

The rule explicitly states that the term "strategy" should be interpreted broadly. The rule would cover a recommended investment strategy regardless of whether the recommendation results in a securities transaction or even references a specific security or securities. For instance, the rule would cover a recommendation to purchase securities using margin or liquefied home equity or to engage in day trading, irrespective of whether the recommendation results in a transaction or references particular securities. The term also would capture an explicit recommendation to hold a security or securities. While a decision to hold might be considered a passive strategy, an explicit recommendation to hold does constitute the type of advice upon which a customer can be expected to rely. An explicit recommendation to hold is tantamount to a "call to action" in the sense of a suggestion that the customer stay the course with the investment. The rule would apply, for example, when an associated person meets with a customer during a quarterly or annual investment review and explicitly advises the customer not to sell any securities in or make any changes to the account or portfolio. . . . (footnotes omitted)

FINRA Rule 2111 (Suitability) FAQ (available at *www.finra.org/industry/faq-finra-rule-2111-suitability-faq*). The Department agrees that recommendations on investment strategies for a fee or other compensation with respect to assets of an employee benefit plan or IRA should be fiduciary investment advice under ERISA. The final rule includes text that makes this clear.

Some commenters suggested that the concept of "management" covered only proxy voting, and pointed to the preamble to the 2010 Proposal which stated that the "management of securities or other property" would include advice and recommendations as to the exercise of rights appurtenant to shares of stock (*e.g.,* voting proxies). 75 FR 65266 (Oct. 22, 2010). As discussed elsewhere in this Notice, the concept of investment management recommendations is not that limited. Nonetheless, the Department has long viewed the exercise of ownership rights as a fiduciary responsibility because of its material effect on plan investment goals. 29 CFR 2509.08–2 (2008). Consequently, recommendations on the exercise of proxy or other ownership rights are appropriately treated as fiduciary in nature. Accordingly, the final rule's inclusion of advice regarding the management of securities or other property within the term ''investment advice'' in paragraph (a)(1)(ii) covers recommendations as to proxy voting and the management of retirement assets. As with other types of investment advice, guidelines or other information on voting policies for proxies that are provided to a broad class of investors without regard to a client's individual interests or investment policy, and which are not directed or presented as a recommended policy for the plan or IRA to adopt, would not rise to the level of fiduciary investment advice under the final rule. Similarly, a recommendation addressed to all shareholders in an SEC-required proxy statement in connection with a shareholder meeting of a company whose securities are registered under Section 12 of the Securities Exchange Act of 1934, for example soliciting a shareholder vote on the election of directors and the approval of other corporate action, would not constitute fiduciary investment advice under the rule from the person who creates or distributes the proxy statement.

With respect to the comments seeking clarification of this provision's application to foreign exchange transactions, the internal operation of stable value funds, and options trading, the Department does not believe there is a need for special clarification. For example, recommendations on foreign exchange transactions and options trading clearly can involve recommendations on investment policies or strategies and portfolio composition. Whether any particular communication rises to the level of a recommendation would depend, as with any other communication to a plan or IRA investor, on context, content, and presentation. Thus, merely explaining the general importance of maintaining a diversified portfolio or describing how options work would not generally meet the regulation's definition of a covered ''recommendation.'' But if, on the other hand, the adviser recommends that the investor change the composition of her portfolio or pursue an option strategy, the adviser makes a recommendation covered by the rule. Similarly, a recommendation to transition from a commissionable account to a fee-based account would constitute a recommendation on the management of assets covered by the rule, and compensation received as a result of that recommendation could be a prohibited transaction for which an exemption would be required. The impact of the final rule in this regard should largely be limited to retail retirement investors because, to the extent the communications involve sophisticated financial professional or large money managers, the final rule's provision that allows such communications to be excluded from fiduciary investment advice should address the commenters' request for clarification.

(4) Recommendations on Selection of an Investment Adviser or Investment Manager

The proposal included paragraph (a)(1)(iv) that separately treated recommendations on the selection of investment advisers for a fee as fiduciary investment advice. In the Department's view, the current 1975 regulation already covered such advice, as well as recommendations on the selection of other persons providing investment management services. The Department continues to believe that such recommendations should be treated as fiduciary in nature but concluded that presenting such hiring recommendations as a separate provision may have created some confusion among commenters, as discussed above.

Many commenters expressed concern about the effect of the proposal's paragraph (a)(1)(iv) on a service or investment provider's solicitation efforts on its own (or an affiliate's) behalf to potential clients, including routine sales or promotion activity, such as the marketing or sale of one's own products or services to plans, participants, or IRA owners. These commenters argued that the provision in the proposal could be interpreted broadly enough to capture as investment advice nearly all marketing activity that occurs during initial conversations with plan fiduciaries or other potential clients associated with hiring a person who would either manage or advise as to plan assets. Service providers argued that the proposal could preclude them from being able to provide information and data on their services to plans, participants, and IRA owners, during the sales process in a non-fiduciary capacity. For example, commenters questioned whether the mere provision of a brochure or a sales presentation, especially if targeted to a specific market segment, plan size, or group of individuals, could be fiduciary investment advice under the 2015 Proposal based on the express or implicit recommendation to hire the service provider. Commenters stated that a similar issue exists in the distribution and rollover context regarding a sales pitch to participants about potential retention of an adviser to provide retirement investment services outside of the plan.

Many commenters were also concerned that the provision would treat responses to requests for proposal (RFP) as investment advice, especially in cases where the RFP requires some degree of individualization in the response or where specific representations were included about the quality of services being offered. For example, a service provider may include a sample fund line up or discuss specific products or services as part of its RFP presentation. Commenters argued that this or similar individualization should not trigger fiduciary status in an RFP context. A specific example of this issue is whether and how providers can respond to inquiries concerning the mapping of plan investments, in which case they often are asked to provide specific examples of alternative investments; a few commenters indicated that the Department should clarify application of the rule in this context. Other commenters stated that the proposed regulation conflates two separate acts—(i) the recommendation to hire the adviser and (ii) the recommendation to make particular investments or to pursue particular investment strategies. Some commenters said the proposal would create a fiduciary obligation for the adviser to tell the potential investor if some other adviser could provide the same services for lower fees, for example. They described such an obligation as unprecedented and not commercially viable.

Some other commenters argued that recommendations on the engagement of an adviser is not ''investment'' advice at all, and suggested that the final rule should be limited to an adviser's recommendation on investments and services. These commenters explained that plan fiduciaries commonly look to existing consultants, attorneys, and other professionals for referrals to other service providers, and that service providers should not be stifled in their ability to refer other service providers, including advisers. Commenters also offered suggestions for possible conditions that the Department could impose to ensure there is no abuse in this context, for example requiring that the plan fiduciary enter into a separate contract or arrangement with the other service provider, that the referring provider disclose that its referral is not a recommendation or endorsement, or that the referring party be far removed from the ultimate recommendation or advice. Finally, some commenters requested that the Department state that the provision would not apply to specific types of referrals, for example a recommendation to hire ''an'' adviser rather than any particular adviser, referrals to non-fiduciary service providers, and recommendations to a colleague.

The Department continues to believe that the recommendation of another person to be entrusted with investment advice or investment management authority over retirement assets is often critical to the proper management and investment of those assets and should be fiduciary in nature. Recommendations of investment advisers or managers are no different than recommendations of investments that the plan or IRA may acquire and are often, by virtue of the track record or information surrounding the capabilities and strategies that are employed by the recommended fiduciary, inseparable from the types of investments that the plan or IRA will acquire. For example, the assessment of an investment fund manager or management is often a critical part of the analysis of which fund to pick for investing plan or IRA assets. That decision thus is clearly part of a prudent investment analysis, and advice on that subject is, in the Department's view, fairly characterized as investment advice. Failing to include such advice within the scope of the final rule carries the risk of creating a significant gap or loophole.

It was not the intent of the Department, however, that one could become a fiduciary merely by engaging in the normal activity of marketing oneself or an affiliate as a potential fiduciary to be selected by a plan fiduciary or IRA owner, without making an investment recommendation covered by (a)(1)(i) or (ii). Thus, the final rule was revised to state, as an example of a covered recommendation on investment management, a recommendation on the selection of ''other persons'' to provide investment advice or investment management services. Accordingly, a person or firm can tout the quality of his, her, or its own advisory or investment management services or those of any other person known by the investor to be, or fairly identified by the adviser as, an affiliate, without triggering fiduciary obligations.

However, the revision in the final rule does not, and should not be read to, exempt a person from being a fiduciary with respect to any of the investment recommendations covered by paragraphs (a)(1)(i) or (ii). The final rule draws a line between an adviser's marketing of the value of its own advisory or investment management services, on the one hand, and making recommendations to retirement investors on how to invest or manage their savings, on the other. An adviser can recommend that a retirement investor enter into an advisory relationship with the adviser without acting as a fiduciary. But when the adviser recommends, for example, that the investor pull money out of a plan or invest in a particular fund, that advice is given in a fiduciary capacity even if part of a presentation in which the adviser is also recommending that the person enter into an advisory relationship. The adviser also could not recommend that a plan participant roll money out of a plan into investments that generate a fee for the adviser, but leave the participant in a worse position than if he had left the money in the plan. Thus, when a recommendation to ''hire me'' effectively includes a recommendation on how to invest or manage plan or IRA assets (*e.g.,* whether to roll assets into an IRA or plan or how to invest assets if rolled over), that recommendation would need to be evaluated separately under the provisions in the final rule.

Some commenters stated that it is common practice for some service providers, such as recordkeepers, to be asked by customers to provide a list of names of investment advisers with whom the recordkeepers have existing relationships (*e.g.,* systems interfaces). The commenters asked that the final rule expressly address when such ''simple referrals'' constitute a recommendation of an investment adviser or investment manager covered by the rule. The Department does not believe a specific exclusion for ''referrals'' is an appropriate way to address this concern. Rather, the issue presented by these comments, in the Department's view, is more properly treated as a question about when a ''referral'' rises to the level of a ''recommendation,'' and whether the recommendation was given for a fee or other compensation as the rule requires. As described above, the final rule has a new provision that further defines the term ''recommendation.'' That definition requires that the communication, ''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 referral rises to the level of a recommendation, then, depends on the content, context, and manner of presentation. If, in context, the investor would reasonably believe that the service provider is recommending that the plan base its hiring decision on the specific list provided by the adviser, and the service provider receives compensation or referral fees for providing the list, the communication would be fiduciary in nature.

With respect to the question about whether a general recommendation to hire ''an adviser'' would constitute fiduciary investment advice even if the recommendation did not identify any particular person or group of persons to engage, the Department does not intend to cover such a recommendation within the prong of the final rule that requires a recommendation of an unaffiliated person. While it is possible that such a communication could be presented in a way that constituted a recommendation regarding the management of securities or other investment property, it seems unlikely, in most circumstances, for such a general recommendation to result in the person's receipt of a fee or compensation that would give rise to a prohibited transaction requiring compliance with the conditions of an exemption.

There was also concern that recommendations of service providers who themselves are not fiduciary investment advisers or investment managers, for example, because of a carve-out under the proposal, may be considered fiduciary advice whereas the underlying activity of the recommended service provider would not. The Department did not intend the proposal to reach recommendations of persons to provide services that did not constitute fiduciary investment advice or fiduciary investment management services. Although the Department agrees that potential conflicts of interest may exist with respect to recommendations to hire non-fiduciary service providers (*e.g.,* recommendations to hire a particular firm to execute securities transactions on a non-discretionary basis or to act as a recordkeeper with respect to investments), the Department concluded that a more expansive definitional approach could result in coverage of recommendations that fell outside the scope of investment "management" and cause undue uncertainty about the fiduciary definition's application to particular hiring recommendations. Accordingly, the final rule was not expanded to include recommendations of such other service providers within the scope of recommendations regarding management of plan or IRA assets.

(5) Appraisals and Valuations

After carefully reviewing the comments, the Department has concluded that the issues related to valuations are more appropriately addressed in a separate regulatory initiative. Therefore, unlike the proposal, the final rule does not address appraisals, fairness opinions, or similar statements concerning the value of securities or other property in any way. Consequently, in the absence of regulations or other guidance by the Department, appraisals, fairness opinions and other similar statements will not be considered fiduciary investment advice for purposes of the final rule.

Paragraph (a)(1)(iii) of the 2015 Proposal, like the 1975 regulation, which included advice as to "the value of securities or other property," covered certain appraisals and valuation reports. However, it was considerably more focused than the 2010 Proposal. Responding to comments to the 2010 Proposal, the 2015 Proposal in paragraph (a)(1)(iii) covered only appraisals, fairness opinions, or similar statements that relate to a particular investment transaction. Under paragraph (b)(5)(iii), the proposal also expanded the 2010 Proposal's carve-out for general reports or statements of value provided to satisfy required reporting and disclosure rules under ERISA or the Code. In this manner, the proposal focused on instances where the plan or IRA owner is looking to the appraiser for advice on the market value of an asset that the investor is considering to acquire, dispose, or exchange. The proposal also contained a carve-out at paragraph (b)(5)(ii) specifically addressing valuations or appraisals provided to an investment fund (*e.g.,* collective investment fund or pooled separate account) holding assets of various investors in addition to at least one plan or IRA. In paragraph (b)(5)(i) of the proposal, the Department decided not to extend fiduciary coverage to valuations, fairness opinions, or appraisals for ESOPs relating to employer securities because it concluded that its concerns in this space raise unique issues that would be more appropriately addressed in a separate regulatory initiative.

Many commenters requested that the Department narrow the scope of this provision of the proposal, or alternatively, expand the carve-outs on valuations to clarify that routine or ministerial, non-discretionary valuation functions that are necessary and appropriate to plan administration or integral to the offering and reporting of investment products are not fiduciary advice. Commenters also requested an explanation of what was meant by "in connection with a specific transaction" and explained that many appraisals support fairness opinions that fiduciary investment managers render in connection with specific transactions. Some commenters asked that the Department remove valuations of all types from the definition of investment advice because, in their view, valuations and appraisals are conceptually different from investment advice in that they involve questions of fact as to what an investment "is" worth, rather than qualitative assessments of what investment "should" be held, how they "should" be managed, and who "should" be hired. Further these commenters believe that the Department had not established the abuse that it is attempting to curb with this provision. Other commenters suggest that the Department reserve the issue of valuations pending further study. Other commenters suggested that the Department make certain exceptions for valuations provided to ESOPs regardless of whether the valuation is conducted on a transactional basis or if independent plan fiduciaries engaged the valuation provider. Some others suggested that the current professional standards for appraisers are sufficient or that the Department should develop its own.

Other commenters agree with the Department that appraisal and valuation information is extremely important to plans when acquiring or disposing of assets. Some also expressed concern that valuations can steer participants toward riskier assets at the point of distribution.

It continues to be the Department's opinion that, in many transactions, a proper appraisal of hard-to-value assets is the single most important factor in determining the prudence of the transaction. Accordingly, the Department believes that employers and participants could benefit from the imposition of fiduciary standards on appraisers when they value assets in connection with investment transactions. The Department believes that this is particularly true in the employer security valuation context in which the Department has seen some extreme cases of abuse. In the case of closely-held companies, ESOP trustees typically rely on professional appraisers and advisers to value the stock, often do not proceed with a transaction in the absence of an appraisal, and sometimes engage in little or no negotiation over price. In these cases, the appraiser effectively determines the price the plan pays for the stock with plan assets. Unfortunately, in investigations and enforcement actions, the Department has seen many instances of improper ESOP appraisals—often involving most or all of a plan's assets—resulting in hundreds of millions of dollars in losses.

After carefully considering the comments, the Department is persuaded that ESOP valuations present special issues that should be the focus of a separate project. The Department also believes that piecemeal determinations as to inclusions or exclusions of particular valuations may produce unfair or inconsistent results. Accordingly, rather than single out ESOP appraisers for special treatment under the final rule, the Department has concluded that it is preferable to broadly address appraisal issues generally in a separate project so that it can ensure consistent treatment of appraisers under ERISA's fiduciary provisions. Given the common issues and problems appraisers face, it is quite likely that the comments and issues presented to the Department by ESOP appraisers will be relevant to other appraisers as well.

B. 29 CFR 2510.3–21(a)(2)—The Circumstances Under Which Advice Is Provided

As provided in paragraph (a)(2) of the final rule, a person would be considered a fiduciary investment adviser in connection with a recommendation of a type listed paragraph (a)(1) of the final rule, if 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 the Act or Code with respect to the advice described in paragraph (a)(1);

(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.

As in the proposal, under paragraph (a)(2)(i) of the final rule, advisers who claim fiduciary status under ERISA or the Code are required to honor their words. They may not say they are acting as fiduciaries and later argue that the advice was not fiduciary in nature. Several commenters focused on the provision in the proposal covering investment recommendations ''if the person providing the advice, either directly or indirectly (*e.g.,* through or together with an affiliate)'' acts in one of the three ways specified. With respect to representations of fiduciary status, comments said that the Department should change the final rule to require ''direct'' representations in this context. They argued that the representation should be made only by the person or entity that will be the investment advice fiduciary and that a loose reference by an affiliate should not suffice, nor should acknowledgement of fiduciary status by one party extend such status to such fiduciary's affiliates. One commenter suggested that this provision be clarified by requiring the representation or acknowledgement of fiduciary status to be ''with respect to a particular account and a particular recommendation or series of recommendations.'' A few commenters asked whether the provision requires the person to explicitly use the word ''fiduciary'' or to refer to ERISA or the Code in describing his or her status, or whether the Department intended to include characterizations that imply fiduciary status are included, for example words and phrases such as ''trusted adviser,'' ''personalized advice,'' or that advice will be in the client's ''best interest.'' One commenter asked whether the acknowledgement of fiduciary status had to be in writing.

The Department does not agree that the suggested changes are necessary or appropriate. In general, it has been the longstanding view of the Department that when an individual acts as an employee, agent or registered representative on behalf of an entity engaged to provide investment advice to a plan, that individual, as well as the entity, would be investment advice fiduciaries under the final rule. The Department's intent also is to ensure that persons holding themselves out as fiduciaries with respect to investment advice to retirement investors cannot deny their fiduciary status if a dispute subsequently arises, but rather must honor their words. There is no one formulation that must be used to trigger fiduciary status in this regard, but rather the question is whether the person was reasonably understood to hold itself out as a fiduciary with respect to communications with the plan or IRA investor. If a person or entity does not want investment-related communications to be treated as fiduciary in nature, it should exercise care not to suggest otherwise. Moreover, some of the suggested changes with respect to affiliates could encourage ''bait and switch'' tactics where a person encourages individuals to seek fiduciary investment advice from an affiliate, but then later claims those communications are not relevant unless expressly ratified by the person in direct communications with an advice recipient. This is particularly true given the interrelated nature of affiliated financial service companies and their operations, and the likelihood that ordinary retirement investors will not know the details of a corporate family's legal structure or draw fine lines between different segments of the same corporate family. On the other hand, the mere fact that an affiliate acknowledged its fiduciary status for purposes other than rendering advice (for example, as a trustee) would not constitute a representation or acknowledgement that the person was acting as a fiduciary ''with respect to'' that person's investment-related communications.

The proposal alternatively required that ''the advice be rendered pursuant to a written or verbal agreement, arrangement or understanding that the advice is individualized to, or that such advice is specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to the plan or IRA.'' Commenters focused on several aspects of this provision. First, they argued that the ''specifically directed'' and ''individualized'' prongs were unclear, overly broad, and duplicative, because any advice that was individualized would also be specifically directed at the recipient. Second, they said it was not clear whether there had to be an agreement, arrangement, or understanding that advice was specifically directed to a recipient, and, if so, what would be required for such an agreement, arrangement or understanding to exist. They expressed concern about fiduciary status possibly arising from a subjective belief of a participant or IRA investor. And third, they requested modification of the phrase ''for consideration,'' believing the phrase was overly broad and set the threshold too low for requiring that recommendations be made for the purpose of making investment decisions. A number of other commenters explicitly endorsed the phrases ''specifically directed,'' and ''individualized to,'' believing that these are appropriate and straightforward thresholds to attach fiduciary status.

As explained in the preamble to the 2015 Proposal, the parties need not have a subjective meeting of the minds on the extent to which the advice recipient will actually rely on the advice, but the circumstances surrounding the relationship must be such that a reasonable person would understand that the nature of the relationship is one in which the adviser is to consider the particular needs of the advice recipient. 80 FR 21940. The Department agrees, however, that the provision in the proposal could be improved and clarified. The final rule changes this provision in two respects. First, the phrase ''for consideration'' has been removed from the provision. After reviewing the comments, the Department believes that clause as drafted was largely redundant to the provisions in paragraph (a)(1) of the proposal and that the final rule sets forth the subject matter areas to which a recommendation must relate to constitute investment advice. The final rule thus revises the condition to require that advice be ''directed to'' a specific advice recipient or recipients regarding the advisability of a particular investment or management decision.'' Second, although the preamble to the proposal stated that the ''specifically directed to'' provision, like the individualized advice provision, required that there be an agreement, arrangement or understanding that advice was specifically directed to the recipient, the Department agrees that using that terminology for both the individualized advice prong and the specifically directed to prong serves no useful purpose for defining fiduciary investment advice. The point of the proposal's language concerning advice specifically directed to an individual was to distinguish specific investment recommendations to an individual from ''recommendations made to the general public, or to no one in particular.'' 75 FR 21940. Examples included general circulation newsletters, television talk show commentary, and remarks in speeches and presentations at conferences. The final rule now includes a new provision (paragraph (b)(2)) to make clear that such general communications generally are not advice because they are not recommendations within the meaning of the final rule. A showing that an adviser directed a specific investment recommendation to a specific person necessarily carries with it a reasonable basis for both the adviser and the advice recipient to understand what the adviser was doing. The Department thus agrees with the commenters who said this element of the condition was unnecessary and could lead to confusion. The Department does not view this change as enlarging the definition of investment advice from what was set forth in the proposal.

As the Department indicated in the preamble to the proposed regulation, advisers should not be able to specifically direct investment recommendations to individual persons, but then deny fiduciary responsibility on the basis that they did not, in fact, consider the advice recipient's individual needs or intend that the recipient base investment decisions on their recommendations. Nor should they be able to continue the practice of advertising advice or counseling that is one-on-one or tailored to the investor's individual needs and then use boilerplate language to disclaim that the investment recommendations are fiduciary investment advice.

C. 29 CFR 2510.3–21(b)—Definition of Recommendation

Paragraph (b)(1) describes when a communication based on its context, content, and presentation would be viewed as a "recommendation," a fundamental element in establishing the existence of fiduciary investment advice. Paragraph (b)(2) sets forth examples of certain types of communications which are not "recommendations" under that definition. With respect to paragraph (b) in the final rule, the Department noted in the proposal that the proposed general definition of investment advice was intentionally broad to avoid weaknesses of the 1975 regulation and to reflect the broad sweep of the statutory text. But, at the same time, the Department recognized that, standing alone, it could sweep in some relationships that are not appropriately regarded as fiduciary in nature. The proposal included "carve-outs" to exclude certain specified communications and activities from the scope of the definition of investment advice. Various public comments expressed concern or confusion regarding several of the carve-outs. The commenters said certain conduct under the carve-outs did not seem to fall within the scope of the general definition such that a "carve-out" was not necessary. They also expressed concern that classifying such conduct as within a "carve-out" might carry an implication that anything that did not technically meet the conditions of the carve-out would automatically meet the definition of investment advice. The Department agrees that the "carve-out" approach, both as a structural matter and as a matter of terminology, was not the best way to address the issue of delineating the scope of fiduciary investment advice. Accordingly, the final rule in paragraphs (b) (and (c) discussed below) uses an alternative approach, more analogous to that used by FINRA in addressing a similar issue under the securities laws, that involves expanding the definition of what constitutes a "recommendation."

(1) Communications and Activities That Constitute Recommendations

In the Department's view, whether a "recommendation" has occurred is a threshold issue and the initial step in determining whether investment advice has occurred. The proposal included a definition of recommendation in paragraph (f)(1): "[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." For example, FINRA Policy Statement 01–23 sets forth guidelines to assist brokers in evaluating whether a particular communication could be viewed as a recommendation, thereby triggering application of FINRA's Rule 2111 that requires that a firm or associated person have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer.[26] In the proposal, the Department specifically solicited comments on whether it should adopt some or all of the standards developed by FINRA in defining communications that rise to the level of a recommendation for purposes of distinguishing between investment education and investment advice under ERISA.

[26] FINRA Rule 2111 requires, in part, that a broker-dealer or associated person "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the [firm] or associated person to ascertain the customer's investment profile." In a set of FAQs on Rule 2111, FINRA explained that "[i]n general, a customer's investment profile would include the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs and risk tolerance. The rule also explicitly covers recommended investment strategies involving securities, including recommendations to 'hold' securities."

Some commenters argued that the definition captured too broad a range of communications, citing as an example use of the term "suggestion" in the proposed definition and argued that it could be read so broadly that nearly every casual conversation between an adviser and a client could constitute investment advice. The commenters suggested that the definition require a "clear and affirmative endorsement" of a particular course of action. Some argued that their concerns could be addressed by formally adopting and citing FINRA standards as the operative text in the rule because they consider FINRA's standards to be appropriate in the context of defining fiduciary investment advice. Further, this would create consistency for service providers who must comply with both ERISA's and FINRA's requirements. Other commenters opposed wholesale adoption of FINRA standards because the final rule then would be subject to future changes or interpretations of the FINRA guidance that might not be consistent with the purposes of the conflict of interest rule. They also argued that such an approach would introduce ambiguities into the final rule because the concepts and terminology in the FINRA guidance pertained primarily to transactions involving brokers and securities, and those concepts and terminology might not be easily applied to other types of investment advisers and other types of investment advice transactions. For example, the FINRA guidance applies to recommendations to invest in securities, but the ERISA rule would also cover recommendations regarding investment advisory services.

In the final rule, the initial threshold of whether a person is a fiduciary by virtue of providing investment advice continues to be whether that person makes a recommendation as to the various activities described in paragraphs (a)(1)(i) and (ii). Paragraph (b)(1) of the final rule continues to define "recommendation" for purposes of paragraph (a) 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. Thus, communications that require the adviser to comply with suitability requirements under applicable securities or insurance laws will be viewed as a recommendation. The final rule also includes additional text intended to clarify the nature of communications that would constitute recommendations. The final rule makes it clear that the determination of whether a ''recommendation'' has been made is an objective rather than subjective inquiry. The final rule mirrors the FINRA guidance in stating that the more individually tailored the communication is to a particular customer or customers about a specific security or investment strategy, the more likely the communication will be viewed as a recommendation. It also tracks SEC staff guidance in explaining that advice about securities for purposes of the Investment Advisers Act includes providing a selective list of securities as appropriate for an investor even if no recommendation is made with respect to any one security.[27] Furthermore, the final rule conforms to the FINRA guidance under which a series of actions, directly or indirectly (*e.g.,* through or together with any affiliate), that may not constitute recommendations when viewed individually may amount to a recommendation when considered in the aggregate. It also adopts the FINRA position that it makes no difference in determining the existence of a recommendation whether the communication was initiated by a person or a computer software program.

With respect to the comments that emphasized the breadth of the term ''suggestion,'' the Department notes that the same term is used in the FINRA guidance and securities laws and related regulations to define and establish standards related to investment recommendations. Accordingly, the Department does not believe the use of that term in the rule reasonably carries the risk alleged by some commenters. Nonetheless, the final rule includes new text to emphasize that there must be an investment ''recommendation'' as a threshold issue and initial step in determining whether investment advice has occurred, and clarifies that a recommendation requires that there be a call to action that a reasonable person would believe was a suggestion to make or hold a particular investment or pursue a particular investment strategy.

With respect to comments that suggested adopting the FINRA standard for recommendation, in the Department's view, FINRA guidance does not specifically define the term recommendation in a way that can be directly incorporated into the final rule. The Department agrees with commenters that strictly adopting FINRA guidance would mean that the final rule could be subject to changes in FINRA interpretations announced in the future and not reviewed or separately adopted by the Department as the appropriate ERISA standard. The Department, however, as described both here and elsewhere in the preamble, has taken an approach to defining ''recommendation'' that is consistent with and based upon FINRA's approach.

(2) Communications and Activities That Do Not Constitute Recommendations

To further clarify the meaning of recommendation, the Department has stated that the rendering of services or materials in conformance with paragraphs (b)(2)(i) through (iv) would not be treated as a recommendation for purposes of the final rule. These paragraphs describe services or materials that provide general communications and commentary on investment products such as financial newsletters, which, with certain modifications, were identified as carve-outs under paragraph (b) of the proposal, such as marketing or making available a menu of investment alternatives that a plan fiduciary could choose from, identifying investment alternatives that meet objective criteria specified by a plan fiduciary, and providing information and materials that constitute investment education or retirement education.

Before discussing the specific carve-outs themselves, many commenters suggested that the Department clarify the relationship between the fiduciary definition under paragraph (a)(1) and (2) of the proposal and the carve-outs. Some commenters suggested that conduct described in certain carve-outs would not have been fiduciary in nature to begin with under the general definition of investment advice in the proposal under paragraph (a)(1) and (2). Others suggested that the Department clarify that the carve-outs are interpretative examples and do not imply that any particular conduct is otherwise fiduciary in nature.

As the Department described in the proposal, the purpose of the carve-outs was to highlight that in many circumstances, plan fiduciaries, participants, beneficiaries, and IRA owners may receive recommendations that, notwithstanding the general definition set forth in paragraph (a) of the proposal, should not be treated as fiduciary investment advice. The Department believed that the conduct and information described in those carve-outs were beneficial for plans, plan fiduciaries, participants, beneficiaries and IRA owners and wanted to make it clear that the furnishing of the described information would not be considered investment advice. However, the Department agrees with many of the commenters that much of the conduct and information described in the proposal for certain of the carve-outs did not meet the technical definition of investment advice under paragraph (a)(1) and (2) of the proposal such that they should be excluded from that definition. Some were more in the nature of examples of education or other information which would not rise to the level of a recommendation to begin with. Thus, the final rule retains these provisions, with changes made in response to comments, but presents them as examples to clarify the definition of recommendation and does not characterize them as carve-outs.

(i) Platform Providers and Selection and Monitoring Assistance

Paragraph (b)(2)(i) and (ii) of the final rule is directed to service providers, such as recordkeepers and third-party administrators, that offer a ''platform'' or selection of investment alternatives to participant-directed individual account plans and plan fiduciaries of these plans who choose the specific investment alternatives that will be made available to participants for investing their individual accounts. Paragraph (b)(2)(i) makes clear that such persons would not make recommendations covered under paragraph (b)(1) simply by making available, without regard to the individualized needs of the plan or its participants and beneficiaries, a platform of investment vehicles from which plan participants or beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts, as long as the plan fiduciary is independent of the person who markets or makes available the investment alternatives and the person discloses in writing to the plan fiduciary that they are not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity. For purposes of this paragraph, a plan participant or beneficiary will not be considered a plan fiduciary. Paragraph (b)(2)(ii) additionally makes clear that certain common activities that platform providers may carry out to assist plan fiduciaries in selecting and monitoring the investment alternatives that they make available to plan participants are not recommendations. Under paragraph (b)(2)(ii), identifying offered investment alternatives meeting objective criteria specified by the plan fiduciary,

[27] See Report entitled ''Regulation of Investment Advisers by the U.S. Securities and Exchange Commission,'' dated March 2013, prepared by the Staff of the Investment Adviser Regulation Office, Division of Investment Management, U.S. Securities and Exchange Commission (available at *www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf.*).

responding to RFPs, or providing objective financial data regarding available alternatives to the plan fiduciary would not cause a platform provider to be a fiduciary investment adviser.

These two paragraphs address certain common practices that have developed with the growth of participant-directed individual account plans and recognize circumstances where the platform provider and the plan fiduciary clearly understand that the provider has financial or other relationships with the offered investment alternatives and is not purporting to provide impartial investment advice. They also accommodate the fact that platform providers often provide general financial information that falls short of constituting actual investment advice or recommendations, such as information on the historic performance of asset classes and of the investment alternatives available through the provider. The provisions also reflect the Department's agreement with commenters that a platform provider who merely identifies investment alternatives using objective third-party criteria (*e.g.,* expense ratios, fund size, or asset type specified by the plan fiduciary) to assist in selecting and monitoring investment alternatives should not be considered to be making investment recommendations.

As an initial matter, while the provisions in paragraphs (b)(2)(i) and (b)(2)(ii) of the final rule are intended to facilitate the effective and efficient operation of plans by plan sponsors, plan fiduciaries and plan service providers, the Department reiterates its longstanding view, recently codified in 29 CFR 2550.404a–5(f) and 2550.404c–1(d)(2)(iv) (2010), that ERISA plan fiduciaries selecting the platform or investment alternatives are always responsible for prudently selecting and monitoring providers of services to the plan or designated investment alternatives offered under the plan.

Commenters requested confirmation that these provisions cover related services that are ''bundled'' with investment platforms. They claimed such services are an integral part of the platform offering. Some of these commenters focused on third-party administrative services and other assistance in connection with establishing a plan and its platform, such as standardized form 401(k) plans and information on investment options. Other commenters stated that platform providers must be able to communicate and explain services such as elective managed account programs, Qualified Default Investment Alternatives (QDIAs), investment adviser/manager options for participants, and non-affiliated registered investment adviser services that will provide platform selection and monitoring services. In response, the Department believes that much of this information described by these commenters does not involve an investment recommendation within the meaning of the rule. Further, other provisions in the final rule, such as the provisions on education, and selection and monitoring assistance, more directly address the issues raised by the commenters. Accordingly, the Department did not make any change in this provision based on these comments.

Several commenters also noted that the ''platform'' concept was not defined in the proposal, and stated that it was unclear, for example, whether the term ''platform'' encompassed a variety of lifetime income investment options, including group or individual annuities, or whether some other criteria also applied to the assessment of whether a proposed investment lineup constituted a platform (*e.g.,* that the lineup not be limited to proprietary products or that it have a certain number of investment alternatives). In developing the final rule, the Department has neither limited the type of investment alternatives (*e.g.,* by excluding lifetime income products) nor mandated a specific number of alternatives that may be offered by a platform provider on its platforms. The Department anticipates that the marketplace will influence both the investment alternatives and the size of platforms offered by platform providers to plans while plan fiduciaries retain their responsibility for selection of their plan's investment alternatives. The Department agrees with the commenters' acknowledgement that specific recommendations as to underlying investments on a platform would continue, of course, to be fiduciary investment advice.

Commenters also sought clarification as to the persons who could rely on both of the carve-outs relating to platform providers. As finalized by the Department, the language of the provisions in paragraphs (b)(2)(i) and (b)(2)(ii) of the final rule does not categorize or limit the persons who are engaged in the activities or communications. The language of these provisions deals with the activities themselves rather than classifying types of service providers that may evolve with market changes.

Some commenters requested clarification of the language requiring that the platform must be ''without regard to the individual needs of the plan'' in paragraph (b)(3) of the proposal. Commenters believe that platform providers often beneficially offer to plan sponsors one or more sample investment platforms that are tailored to the needs of plans in different industries or market segments. They believe some level of customization or individualization (an act they referred to as ''segmentation'') should be permitted as offering the full array of product alternatives to every plan could be counter-productive to helping plan sponsors, especially in the small employer segment of the market. The commenters claimed that these winnowed bundles are not individualized offerings for particular plans, but rather are targeted categories of investments for different general types of plans in different market segments.

The Department generally agrees with these commenters that the marketing and making available of platforms segmented based on objective criteria would not result in providing fiduciary advice solely by virtue of the segmentation. Thus, for example, a platform provider who offers different platforms for small, medium, and large plans would not be providing investment advice merely because of this segmentation. In the Department's view, this type of activity is more akin to product development and is within the provider's discretion as a matter of business judgment, the same as if the provider decided not to offer platforms at all. Plan fiduciaries always are free to deal with vendors who do not design and offer platforms by market segment. Of course, a provider could find itself providing investment advice depending on the particular marketing technique used to promote a segmented platform. For example, if a provider were to communicate to the plan fiduciary of a small plan that a particular platform has been designed for small plans in general, and is appropriate for this plan in particular, the communication would likely constitute advice based on the individual needs of the plan and, therefore, very likely would be considered a recommendation.

In response to the Department's request for comment on whether the platform provider provision as it appeared in the proposal should be limited to large plans, many commenters opposed such a limitation arguing that the platform provider provision was needed to preserve assistance to small plan sponsors with respect to the composition of investment platforms in 401(k) and similar individual account plans. The final rule does not limit the platform provider provision to large plans.

Several commenters also asked the Department to clarify that the platform provider carve-out is available in the 403(b) plan marketplace. Since 403(b) plans are not subject to section 4975 of the Code, this issue is relevant only for 403(b) plans that are subject to Title I of ERISA. In the Department's view, a 403(b) plan that is subject to Title I of ERISA would be an individual account plan within the meaning of ERISA section 3(34) for purposes of the final rule. Thus, the platform provider provision is available with respect to such Title I plans.

Other commenters asked that the platform provider provision be generally extended to apply to IRAs. In the IRA context, however, there typically is no separate independent fiduciary who interacts with the platform provider to protect the interests of the account owners, or who is responsible for selecting the investments included in the platform. In the Department's view, when a firm or adviser narrows the wide universe of potential investments in the marketplace to a limited lineup that it holds out for consideration by an individual IRA owner, the fiduciary status of the communication is best evaluated under the general ''recommendation'' test, rather than under the specific exclusion for platform providers communicating with independent plan fiduciaries. Without an independent plan fiduciary overseeing the investment lineup and signing off on any disclaimers of reliance on the advice, there is too great a danger that the exclusion would effectively shield fiduciary recommendations from treatment as such, even though the IRA owner reasonably understood the communications as constituting individualized recommendations on how to manage assets for retirement. The Department is of a similar view with respect to plan participants who have individually directed brokerage accounts. Consequently, the final rule declines to extend application of the platform provider provisions to plan participants and beneficiaries, and IRAs.

Nonetheless, the Department notes that the separate provision in the final rule regarding transactions with independent plan fiduciaries with financial expertise would be available for persons providing advice to IRAs and plans regarding investment platforms. With respect to employee benefit plans in particular, the Department notes that the 2014 ERISA Advisory Council recently conducted a study and issued a report on ''outsourcing'' employee benefit plan services with a particular focus on functions that historically have been handled by employers, such as ''named fiduciary'' responsibilities. The Council report includes the following observation:

Outsourcing of benefit plan functions, administrative, investment and otherwise, is a practice that predates ERISA. However, its prevalence and scope have grown significantly since ERISA's passage, and has accelerated over the last ten years. Certain functions by their nature must be outsourced to a third party (*e.g.,* auditing a plan's financial statements), while others for practical reasons have been outsourced by most plan sponsors (*e.g.,* defined contribution recordkeeping). In addition, there appears to be an emerging trend toward outsourcing functions that have traditionally been exercised by plan sponsors or other employer fiduciaries (*e.g.,* administrative committee, investment committee, etc.), including functions such as investment fund selection, discretionary plan administration, and investment strategy. There also have been trends towards using multiple employer plan arrangements as a mechanism to ''outsource'' the provision of retirement plan benefits, particularly in the small company market.

The Council's report is available at *http://www.dol.gov/ebsa/publications/2014ACreport3.html.* Accordingly, the Department believes the provision in the final rule on transactions with independent plan fiduciaries with financial expertise is consistent with and could facilitate this trend in the fiduciary investment advice area, including transactions involving selection and monitoring of investment platforms.

Several commenters asked the Department to clarify whether the platform provider carve-out would cover a response to a RFP if the response were to contain a sample plan investment line-up based on the existing investment alternatives under the plan, the size of the plan or sponsor, or some combination of both. According to the commenters, responding to RFPs in this manner is a common practice when the plan fiduciary does not specify any, or sufficient, objective criteria, such as fund expense ratio, size of fund, type of asset, market capitalization, or credit quality. The commenters essentially argued that the plan's current investment line-up effectively serves as a proxy for objective criteria specified by the plan fiduciary. The commenters did admit, however, that even though such RFP responses typically present the line-ups as just ''samples,'' the responses customarily identify specific investment alternatives by name and are quite individualized to the needs of the requesting plan. The commenters, of course, emphasized that the plan fiduciary is under no obligation to hire the platform provider or to adopt the sample line-up of investments even if hired.

In response to these comments, minor changes were made to the proposal to accommodate such RFP responses, but with some protections for plan fiduciaries to prevent abuse. It was never the intent of the Department to displace common RFP practices related to platforms. The Department recognizes that RFPs can be a valuable cost-saving mechanism for plans by fostering competition among interested plan service providers, which can redound to the benefit of plan participants and beneficiaries in the form of lower costs for comparable services. Indeed, it is for this very reason that plan fiduciaries often use RFPs as part of the process of satisfying their duty of prudence under ERISA. On the other hand, without something more to counterbalance the RFP response with a sample line-up identifying investments by name, such communication could be viewed as suggesting the appropriateness of specific investments to the plan fiduciary—which, of course, would constitute a clear call to action to the fiduciary thereby triggering fiduciary status.

As revised, the platform provider provisions now explicitly clarify that a RFP response with a sample line-up of investments is not a ''recommendation'' for purposes of the final rule. Such treatment, however, is conditioned on written notification to the plan fiduciary that the person issuing the RFP response is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity. Further, the RFP response containing the sample line-up must disclose whether the person identifying the investment alternatives has a financial interest in any of the alternatives, and if so the precise nature of such interest. Collectively, these disclosures will put the plan fiduciary on notice that it should not have an expectation of trust in the RFP response and that composition of the sample line-up may be influenced by financial incentives not necessary aligned with the best interests of the plan and its participants.[28]

[28] In the Department's view, platform providers may have a financial incentive to recommend proprietary funds or an otherwise limited menu based on such non-aligned financial interests. In fact, researchers have found evidence that platform providers act on this conflict of interest, and that

Commenters also requested that the platform provider carve-out be extended to allow the platform provider to furnish for the plan fiduciary's consideration the objective criteria that the plan fiduciary may wish to adopt. Commenters state that plan sponsors are often unsure of what criteria are appropriate and that a service provider's objective assistance is often critical by suggesting factors that may be considered in evaluating and selecting investments. Although the Department does not believe that general advice as to the types to qualitative and quantitative criteria that similarly situated plan fiduciaries might consider in selecting and monitoring investment alternatives will ordinarily rise to the level of a recommendation of a particular investment, the Department does not believe it can craft text for this example that adequately addresses the potential for abuse and steering that could arise, and, therefore, believes the issue of whether such communications are investment advice would best be left to an examination on a case-by-case basis under the definition of recommendation provided by paragraph (b)(1) and educational communications under paragraphs (b)(2)(iii) and (b)(2)(iv).

(ii) Investment Education

The proposal under paragraph (b)(6) carved out investment education from the definition of investment advice. Paragraph (b)(6) of the proposal incorporated much of the Department's earlier Interpretive Bulletin, 29 CFR 2509.96–1 (IB 96–1), issued in 1996, but with important exceptions relating to communications regarding specific investment options available under the plan or IRA. Consistent with IB 96–1, paragraph (b)(6) of the proposal made clear that furnishing or making available the specified categories of information and materials to a plan, plan fiduciary, plan participant or beneficiary, or IRA owner does not constitute the rendering of investment advice, irrespective of who provides the information (*e.g.,* plan sponsor, fiduciary or service provider), the frequency with which the information is shared, the form in which the information and materials are provided (*e.g.,* on an individual or group basis, in writing or orally, via a call center, or by way of 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 investment or retirement information and materials identified in paragraph (b)(6), or the type of plan or IRA involved. As a departure from IB 96–1, a condition of the carve-out was that the asset allocation models and interactive investment materials could not include or identify any specific investment product or specific investment alternative available under the plan or IRA. The Department understood that not incorporating these provisions of IB 96–1 into the proposal represented a significant change in the information and materials that may constitute investment education. Accordingly, the Department specifically invited comments on whether the change was appropriate. The final rule largely adopts the proposal's provision on investment education, but, as discussed below, differentiates between education provided in the plan and IRA markets and includes minor edits to expressly confirm that merely providing information to IRA and plan investors about features, terms, fees and expenses, and other characteristics of investment products available to the IRA or plan investor falls within the "plan information" category of investment education under the final rule.

This subject received extensive input from a range of stakeholders with varying perspectives on how to draw the line between investment advice and investment education. Many commenters representing consumers and retail investors urged the Department not to create a carve-out that would allow investment advice to be presented as non-fiduciary "education." These commenters cautioned that the final rule should not create a carve-out that is so broad that it covers communications or behavior that may fairly be interpreted by plan participants as "advice" rather than education. They cited the current practice by investment advice providers who present their services as individually tailored or "one-on-one" advice, but then use boilerplate disclaimers to avoid fiduciary responsibility for the advice under the Department's current "five-part" test regulation as a consumer protection failure that should not be repeated. Other commenters representing a range of interests and stakeholders expressed concern that the rule, and presumably the education carve-out, would adversely affect the availability of information to plan participants and beneficiaries, and IRA owners about the general characteristics and options available under the plan or IRA and general education about investments and retirement savings strategies.

There was general consensus, however, that investment education and financial literacy tools are valuable resources for retail retirement investors, that there is a difference between educational communications and activities, and that certain communications and activities should be subject to fiduciary standards as investment advice. Commenters, however, held varying views as to how the final rule should define the line between investment education and investment advice. A substantial number of the comments expressing concern about the proposal's impact on the availability of investment education to retail retirement investors appeared to be based on a misunderstanding of the proposal. For example, some commenters expressed concern that product providers could not provide general descriptions or information about their products and services without the communication being treated as investment advice under the rule. The proposal, as noted above, adopted almost without change an Interpretive Bulletin issued by the Department in 1996. IB 96–1 had been almost uniformly supported by the financial services industry. Admittedly IB 96–1 was issued against the backdrop of the current five-part test so that some of the commenters may have been less interested in its specifics because the five-part test allowed them to avoid fiduciary status for communications that fell outside the scope of non-fiduciary "education" as described in the IB 96–1. Nonetheless, IB 96–1 received substantial support from commenters as drawing an appropriate line between investment advice and investment education. IB 96–1 and, by extension, the proposal which adopted the IB, recognized four categories of non-fiduciary education:

○ *Information and materials that describe investments or plan alternatives without specifically recommending particular investments*

plan participants suffer as a result. In a study examining the menu of mutual fund options offered in a large sample of defined contribution plans, underperforming non-propriety funds are more likely to be removed from the menu than propriety funds. Similarly, the study found that platform providers are substantially more likely to add their own funds to the menu, and the probability of adding a proprietary fund is less sensitive to performance than the probability of adding a non-proprietary fund. The study also concluded that proprietary funds do not perform better in later periods, which indicates that they are left on the menu for the benefit of the service provider and not due to additional information the service provider would have about their own funds. *See* Pool, Veronika, Clemens Sialm, and Irina Stefanescu, *It Pays to Set the Menu: Mutual Fund Investment Options in 401(K) Plans* (August 14, 2015) Journal of Finance, Forthcoming (avaialble at SSRN: *http://ssrn.com/abstract =2112263* or *http://dx.doi.org/10.2139/ssrn.2112263*).

or strategies. Thus, for example, a firm/adviser would not act as an investment advice fiduciary merely by virtue of describing the investment objectives and philosophies of plan investment options, mutual funds, or other investments; their risk and return characteristics; historical returns; the fees associated with the investment; distribution options; contract features; or similar information about the investment.

○ *General financial, investment, and retirement information.* Similarly, one would not become a fiduciary merely by providing information on standard financial and investment concepts, such as diversification, risk and return, tax deferred investments; historic differences in rates of return between different asset classes (*e.g.,* equities, bonds, cash); effects of inflation; estimating future retirement needs and investment time horizons; assessing risk tolerance; or general strategies for managing assets in retirement. All of this is non-fiduciary education as long as the adviser doesn't cross the line to recommending a specific investment or investment strategy.

○ *Asset allocation models.* Here too, without acting as a fiduciary, firms and advisers can provide information and materials on hypothetical asset allocations as long as they are based on generally accepted investment theories, explain the assumptions on which they are based, and don't cross the line to making specific investment recommendations or referring to specific products (*i.e.,* recommending that the investor purchase specific assets or follow very specific investment strategies).

○ *Interactive investment materials.* Again, without acting as a fiduciary, firms and advisers can provide a variety of questionnaires, worksheets, software, and similar materials that enable workers to estimate future retirement needs and to assess the impact of different investment allocations on retirement income, as long as the adviser meets conditions similar to those described for asset allocation models. These interactive materials can even consider the impact of specific investments, as long as the specific investments are specified by the investor, rather than the firm/adviser.

The Department, accordingly, disagrees with commenters who contended that the 2015 Proposal would make such communications and activities fiduciary investment advice. In the Department's view the proposal was clear that investment education included providing information and materials that describe investments or plan alternatives without specifically recommending particular investments or strategies. Nonetheless, some of the text in the proposal that covered this point appeared under the heading "Plan Information" and commenters may have failed to fully appreciate the fact that information about investment alternatives available under the plan or IRA was included in that section. Accordingly, the Department added text to that section to emphasize that element in the final rule.

Furthermore, some comments from groups representing employers that sponsor plans, expressed concern that the proposal would lead employers to stop providing education about their plans to their employees. In the Department's view, since only investment advice for a fee or compensation falls within the fiduciary definition, the fact that employers do not generally receive compensation in connection with their educational communications provides employers with a high level of confidence that their educational activities would not constitute investment advice under the rule. In that regard, the Department does not believe that incidental economic advantages that may accrue to the employer by reason of sponsorship of an employee benefit plan would constitute fees or compensation within the meaning of the rule. For example, the Department does not believe that an employer would be receiving a fee or compensation under the rule merely because the plan is structured so the employer does not pay plan expenses that are paid out of an ERISA budget account funded with revenue sharing generated by investments under the plan.

Related comments similarly expressed concern that employers may not engage service providers to provide investment education to their plan participants and beneficiaries because of concern that the vendors may be investment advice fiduciaries under the rule, and the employers would have a fiduciary obligations or co-fiduciary liability in connection with the activities of those vendors. They contended that, without a blanket carve-out for plan sponsors and service providers that operate call centers to assist participants and IRA owners, educational assistance or similar participant outreach would be dramatically reduced or eliminated because, notwithstanding appropriate training and supervision, the plan sponsors and service providers could not be certain that individual communications would not carry potential fiduciary liability if individual communications actually crossed the line to give fiduciary investment advice. They similarly recommended that a blanket carve-out was necessary to protect against investment advice claims and litigation from participants and IRA owners dissatisfied with decisions they made with the benefit of education provided by the plan sponsor or service provider.

The Department notes that plan sponsors already have fiduciary obligations in connection with the selection and monitoring of plan service providers (both fiduciary and non-fiduciary service providers), including service providers that provide educational materials and assistance to plan participants and beneficiaries. In light of the investment education provisions in the final rule, the Department does not believe the rule significantly expands the obligations or potential liabilities of plan sponsors in this regard. It also bears emphasis that the chief consequence of making covered investment recommendations, rather than merely providing non-fiduciary education is that the fiduciary must give recommendations that are prudent and in the participants' best interest. The Department does not believe it would be appropriate to create a rule that relieves service providers from fiduciary responsibility when they in fact make such recommendations and thereby provide investment advice for a fee, nor would it be appropriate to have a rule that relieved plan sponsors or service providers from having to address complaints from participants and IRA owners that they in fact provided imprudent investment advice or provided investment advice tainted by prohibited self-dealing. The Department believes that such steps would be particularly inappropriate in the case of service providers who are paid to provide participant assistance services.

The final rule is intended to reflect the Department's continued view that the statutory reference to "investment advice" is not meant to encompass general investment information and educational materials, but rather is targeted at more specific recommendations and advice on the investment of plan and IRA assets. Further, as explained above, the Department agrees with those commenters who argued that classifying this provision as a "carve-out" was a misnomer because the educational activity covered by the provision are not investment recommendations in the first place. As a result, although the substance of the proposal is largely unchanged in this final rule, the "investment education" provision in paragraph (b)(2)(iv) of the rule is presented as an example of what would not constitute a recommendation within the meaning of paragraph (b)(2).

The final rule in paragraph (b)(2)(iv) divides investment education information and materials which will not be treated as recommendations into the same four general categories as set forth in the proposal: (A) Plan information; (B) general financial, investment, and retirement information; (C) asset allocation models; and (D) interactive investment materials. The final regulation also adopts the provision from the proposal (also in IB 96–1) stating that there may be other examples of information, materials and educational services which, if furnished, would not constitute investment advice or recommendations within the meaning of the final regulation and that no inference should be drawn regarding materials or information which are not specifically included in paragraph (b)(2)(iv).

Paragraph (b)(2)(iv), like the proposal, makes clear that the distinction between non-fiduciary education and fiduciary advice applies equally to information provided to plan fiduciaries as well as information provided to plan participants and beneficiaries, and IRA owners, and that it applies equally to participant-directed plans and other plans. In addition, the provision applies without regard to whether the information is provided by a plan sponsor, fiduciary, or service provider.

The Department did not receive adverse comments on the provisions in the proposal that were intended to make it clear that investment education included the provision of information and education relating to retirement income issues that extend beyond a participant's or beneficiary's date of retirement. Some commenters explicitly encouraged education in the context of fixed and variable annuities and other lifetime income products. Accordingly, paragraph (b)(2)(iv) of the final rule, as with the proposal, includes specific language to make clear that the provision of certain general information that helps an individual assess and understand retirement income needs past retirement and associated risks (*e.g.,* longevity and inflation risk), or explains general methods for the individual to manage those risks both within and outside the plan, would not result in fiduciary status.

Similarly, the Department does not believe that any change in the regulatory text or addition of a specific safe harbor is necessary to address commenters' concerns regarding distinguishing advice from education in the context of benefit distribution decisions. As to the comments that suggested the Department expressly adopt FINRA's guidance in its Notice 13–45 as the standard for non-fiduciary educational information and materials, the Department does not agree that such an express incorporation of specific FINRA guidance into the regulation is advisable. In addition to the obvious problems that can arise from a federal agency adopting guidance from a self-regulatory organization as a formal regulation with the force of law, the Department is concerned that some of that guidance under the FINRA notice encompasses communications regarding individual investment alternatives or benefit distribution options that would be fiduciary investment advice under the final rule. Moreover, to the extent the commenters found the FINRA guidance useful because it allows descriptions of the typical four options available to participants when retiring—leaving the money in his former employer's plan, if permitted; rolling over the assets to his new employer's plan if available; rolling over to an IRA; or cashing out—those options, including discussions of the advantages and disadvantages of each are already clearly permitted under the education provision. The Department also believes the final rule contains appropriate examples of activities with respect to particular products sufficient to make it clear that education can convey information about investment concepts, such as annuities and lifetime income products, and does not believe amending the regulatory text to specifically emphasize or encourage particular classes of investment or benefit products would improve the provision.

The main focus of the commenters expressing concern, many representing financial services providers, about the education provisions in the proposal was the one substantive change the proposal made to the Department's IB 96–1. Specifically, the proposal did not allow asset allocation models and interactive investment materials to identify specific investment alternatives and distribution options unless they were affirmatively inserted into the interactive materials by the plan participant, beneficiary or IRA owner. A few commenters supported this change. They argued that participants are highly vulnerable to subtle, but powerful, influences by advisers when they receive asset allocation information. They believe that ordinary participants may view these models, particularly when accompanied by references to specific investments, as investment recommendations even if the provider does not intend it as advice and even if the provider includes caveats or statements about the availability of other products. In contrast, other commenters argued—particularly with respect to ERISA-covered plans—that it is a mistake to prohibit the use of specific investment options in asset allocation models used for educational purposes. They said this information is a critical step to ''connect the dots'' for retirement investors in understanding how to apply educational tools to the specific options or options available in their plan or IRA. They claimed that the inability to reference specific investment options in asset allocation models and interactive materials would greatly undermine the effectiveness of these models and materials as educational tools. They said that without the ability to include specific investment products, participants could have a hard time understanding how the educational materials relate to specific investment options. Further, some commenters argued that the Department had presented no evidence that there is actual abuse under the guidance in IB 96–1 that would support a change. With the change, the commenters asserted that the Department has effectively shifted the obligation to populate asset allocation models to plan participants, who for a variety of reasons are unlikely to do so, thereby significantly undermining what has become a valuable tool for participants.

Many commenters suggested ideas for how to address this issue. Some told the Department that it should not depart from the original IB 96–1 on this point. Some commenters argued that the value that plan participants and beneficiaries, and IRA owners, get from having specific investment options identified in asset allocation models and interactive materials was so important that the Department should adopt a safe harbor specifically for communications designed to assist plan participants and beneficiaries and IRA owners with decisions regarding investment alternatives and distribution options. Others suggested that the final rule should permit the identification of designated investment alternatives (DIAs) in asset allocation models with restrictions such as fee neutrality across the presented options, allow the selection of the investment options for the model by an independent third party, or require the model to offer at least three DIAs within each asset class (which may require some plans to increase the number of DIAs available in each asset class).

Some commenters drew a distinction between ERISA-covered plans and IRAs, and agreed with the Department's concern about permitting specific product references to be treated as non-fiduciary education when associated with asset allocation guidance for IRA customers. In the ERISA plan context, a separate fiduciary is responsible for overseeing the funds on the plan lineup and for making sure that the plan's designated investment alternatives are prudent and otherwise consistent with ERISA's standards. Potential ''steering'' by use of an asset allocation model can be effectively constrained by an already approved menu of DIAs, but no analogous protection exists for IRA investors. An adviser's limited explanation of how specific plan-designated alternatives line up with particular asset categories, without more, is far less likely to be perceived by the investor as an investment recommendation—and far less prone to abuse—than is an IRA adviser's discussion of particular asset allocations tied to specific investment products chosen by the adviser or his firm. In the IRA context, the adviser both presents the customer with an allocation and populates the allocation with specific products that the adviser or his firm screened from the entire universe of investments. A broad safe harbor for such communications could permit advisers to steer customers by effectively making specific investment recommendations under the guise of education, with no fiduciary protection.

Some commenters proposed different solutions for the presentation of specific investments to IRA owners. These proposed solutions tried to introduce somewhat analogous protections for IRA owners as for plan participants by making the identification of specific investment alternatives contingent on investment platforms selected or approved by independent third parties. Other commenters sought to eliminate the concern about asset allocation models and interactive materials being used to steer IRA investors to particular products that generated better fees for investment providers by requiring the available investment options to be ''fee neutral'' or paid for on a fixed basis.

After evaluation of the comments and considerations above, the Department has made the following adjustments in the final rule. Paragraphs (b)(2)(iv)(C)(*4*) and (b)(2)(iv)(D)(*6*) now provide that asset allocation models and interactive investment materials can identify a specific investment product or specific alternative available under plans if (1) the alternative is a designated investment alternative under an employee benefit plan (as described in section 3(3) of the Act); (2) the alternative is subject to fiduciary oversight by a plan fiduciary independent of the person who developed or markets the investment alternative or distribution option; (3) the asset allocation models and interactive investment materials identify all the other designated investment alternatives available under the plan that have similar risk and return characteristics, if any; and (4) the asset allocation models and interactive investment materials are accompanied by a statement that identifies where information on those investment alternatives may be obtained; including information described in paragraph (b)(2)(iv)(A) of this regulation and, if applicable, paragraph (d) of 29 CFR 2550.404a–5. When these conditions are satisfied with respect to asset allocation or interactive investment materials, the communications can be appropriately treated as non-fiduciary ''education'' rather than fiduciary investment recommendations, and the interests of plan participants are protected by fiduciary oversight and monitoring of the DIAs as required under paragraph (f) of 29 CFR 2550.404a–5 and paragraph (d)(2)(iv) of 29 CFR 2550.404c–1.

In this connection, it is important to emphasize that a responsible plan fiduciary would also have, as part of the ERISA obligation to monitor plan service providers, an obligation to evaluate and periodically monitor the asset allocation model and interactive materials being made available to the plan participants and beneficiaries as part of any education program.[29] That evaluation should include an evaluation of whether the models and materials are in fact unbiased and not designed to influence investment decisions towards particular investments that result in higher fees or compensation being paid to parties that provide investments or investment-related services to the plan. In this context and subject to the conditions above, the Department believes such a presentation of a specific designated investment alternative in a hypothetical example would not rise to the level of a recommendation within the meaning of paragraph (b)(1).

The Department does not agree that the same conclusion applies in the case of presentations of specific investments to IRA owners because of the lack of review and prudent selection of the presented options by an independent plan fiduciary, and because of the likelihood that such ''guidance'' or ''education'' amounts to specific investment recommendations in the IRA context. The Department was not able to reach the conclusion that it should create a broad safe harbor from fiduciary status for circumstances in which the IRA provider effectively narrows the entire universe of investment alternatives available to IRA owners to just a few coupled with asset allocation models or interactive materials.

When an adviser couples a suggestion of a particular asset allocation with specific investment options that the adviser has specifically selected from the entire universe of investments, he is doing more than explaining how the limited designated investment alternatives available under a plan's design fit the various categories in an asset allocation model. Instead, the adviser is pointing out particular investments for special consideration, and likely making a ''recommendation'' within the meaning of the rule about an investment in which he has a financial interest. In the Department's view, such recommendations should be subject to a best interest standard, not treated as falling within a potential loophole for specific investment recommendations that need not adhere to basic fiduciary norms. If the adviser were treated as a non-fiduciary, the Department could not readily import the other protective conditions applicable to such plan communications to IRA communications. For example, there would not necessarily be any other fiduciary exercising oversight over the adviser's recommendation. Additionally, the Department was unable to conclude that disclosures analogous to the disclosures regarding DIAs under 29 CFR 2550.404a–5 could be made available about the vast universe of other comparable investment alternatives available under an IRA.

Similarly, because the provision is limited to DIAs available under employee benefit plans, the use of asset allocation models and interactive materials with specific investment alternatives available through a self-directed brokerage account is not covered by the ''education'' provision in the final rule. Such communications lack the safeguards associated with DIAs, and pose many of the same problems and dangers as identified with respect to IRAs.

These tools and models are important in the IRA and self-directed brokerage account context, just as in the plan context more generally. An asset

[29] *See* 29 CFR 2550.404a–5(f) and 2550.404c–1(d)(2)(iv).

allocation model for an IRA could still qualify as ''education'' under the final rule, for example, if it described a hypothetical customer's portfolio as having certain percentages of investments in equity securities, fixed-income securities and cash equivalents. The asset allocation could also continue to be ''education'' under the final rule if it described a hypothetical portfolio based on broad-based market sectors (*e.g.,* agriculture, construction, finance, manufacturing, mining, retail, services, transportation and public utilities, and wholesale trade). The asset allocation model would have to meet the other criteria in the final and could not include particular securities. In the Department's view, as an allocation becomes narrower or more specific, the presentation of the portfolio gets closer to becoming a recommendation of particular securities.[30] Although the Department is open to continuing a dialog on possible approaches for additional regulatory or other guidance in this area, when advisers use such tools and models to effectively recommend particular investments, they should be prepared to adhere to fiduciary norms and to make sure their investment recommendations are in the investors' best interest.

(iii) General Communications

Many commenters, as the Department noted above, expressed concern about the phrase ''specifically directed'' in the proposal under paragraph (a)(2)(ii) and asked that the Department clarify the application of the final rule to certain communications including casual conversations with clients about an investment, distribution, or rollovers; responding to participant inquiries about their investment options; ordinary sales activities; providing research reports; sample fund menus; and other similar support activities. For example, they were concerned about communications made in newsletters, media commentary, or remarks directed to no one in particular. Commenters specifically raised the issue of whether on-air personalities like Dave Ramsey, Jim Cramer, or Suze Orman would be treated as fiduciary investment advisers based on their broadcast communications. The concern is unfounded. With respect to media personalities, the rule is focused on ensuring that paid investment professionals make recommendations that are in the best interest of retirement investors, not on regulating journalism or the entertainment industry. Nonetheless, and although the Department believes that the definition of ''recommendation'' in the proposal sufficiently distinguished such communications from investment advice, the Department has concluded that it would be helpful if the final rule more expressly addressed these types of communications to alleviate commenters' continuing concerns. Thus, the final rule includes a new ''general communications'' paragraph (b)(2)(iii) as an example of communications that are not considered recommendations under the definition. This paragraph affirmatively excludes from investment advice the furnishing of general communications that a reasonable person would not view as an investment recommendation, including general circulation newsletters; television, radio, and public media talk show commentary; remarks in widely attended speeches and conferences; research reports prepared for general distribution; general marketing materials; general market data, including data on market performance, market indices, or trading volumes; price quotes; performance reports; or prospectuses.

In developing this paragraph, the Department adapted some terms from FINRA guidance addressing a similar issue under the suitability rules for brokers. See, for example, FINRA Rule 2111 (Suitability) (FAQs available at *www.finra.org/industry/faq-finra-rule-2111-suitability-faq#_edn3*). The FAQs provide guidance on FINRA Rule 2111 that consolidates the questions and answers in Regulatory Notices 12–55, 12–25 and 11–25.[31] See also RDM Infodustries, Inc., SEC Staff No-Action Letter (Mar. 25, 1996).

The Department notes that the requirement that a reasonable person would not view the materials as a recommendation is a recognition that even though the list includes very common communications that we do think could fairly be interpreted to cover communications that are investment recommendations under paragraph (b)(1), the label on the document or communication is not determinative under the final rule because there may be circumstances in which a person uses a label for a communications from the list but the communication nonetheless clearly meets the requirements of a recommendation under paragraph (b)(1).[32] The Department does not intend to suggest by this proviso that all general communications always present a question about whether a reasonable person could fairly view the communication as an investment recommendation. For example, even though on-air personalities may suggest that viewers buy or sell particular stocks or engage in particular investment courses of action, the Department does not believe that a reasonable person could fairly conclude that such communications constitute actionable investment advice or recommendations within the meaning of the rule.

D. 29 CFR 2510.3–21(c)—Persons Not Deemed Investment Advice Fiduciaries

Paragraph (c) of the final rule provides that certain communications and activities shall not be deemed to be fiduciary investment advice within the meaning of section 3(21)(A)(ii) of the Act. This paragraph incorporates, with modifications, the ''carve-outs'' from the proposal that addressed counterparty transactions, swaps transactions, and

[30] In the Department's view, this approach in general terms is consistent with FINRA guidance on the application of the ''suitability'' standard to asset allocation models. Compare FAQ 4.7 in FINRA Rule 2111 (Suitability) FAQ (available at *www.finra.org/industry/faq-finra-rule-2111-suitability-faq*).

[31] Endnote 2 in the FAQs included the following citations: SEC Adoption of Rules Under Section 15(b)(10) of the Exchange Act, 32 FR 11637, 11638 (Aug. 11, 1967) (noting that the SEC's now-rescinded suitability rule would not apply to ''general distribution of a market letter, research report or other similar material''); Suitability Requirements for Transactions in Certain Securities, 54 FR 6693, 6696 (Feb. 14, 1989) (stating that proposed SEC Rule 15c2–6, which would have required documented suitability determinations for speculative securities, ''would not apply to general advertisements not involving a direct recommendation to the individual''); *DBCC* v. *Kunz,* No. C3A960029, 1999 NASD Discip. LEXIS 20, at * 63 (NAC July 7, 1999) (stating that, under the facts of the case, the mere distribution of offering material, without more, did not constitute a recommendation triggering application of the suitability rule), aff'd, 55 S.E.C. 551, 2002 SEC LEXIS 104 (2002); *FINRA Interpretive Letter, Mar. 4, 1997* (''[T]he staff agrees that a reference to an investment company or an offer of investment company shares in an advertisement or piece of sales literature would not by itself constitute a 'recommendation' for purposes of [the suitability rule].''). *See also* Regulatory Notice 10–06, at 3–4 (providing guidance on recommendations made on blogs and social networking Web sites); Notice to Members 01–23 (announcing the guiding principles and providing examples of communications that likely do and do not constitute recommendations); *Michael F. Siegel,* Exchange Act Rel. No. 58737, 2008 SEC LEXIS 2459, at *21–27 (Oct. 6, 2008) (applying the guiding principles to the facts of the case to find a recommendation), *aff'd in relevant part,* 592 F.3d 147 (D.C. Cir.), *cert. denied,* 130 S.Ct. 3333 (2010).

[32] *See* NASD (Predecessor to FINRA) Notice to Members 01–23, April 2001, which provided examples of electronic communications which may or may not be within the definition of recommendation for purposes of the suitability rule but concludes that ''many other types of electronic communications are not easily characterized . . . and changes to the factual predicates upon which these examples are based (or the existence of additional factors) could alter the determination of whether similar communications may or may not be viewed as 'recommendations' for purposes of the suitability rule.''

certain employee communications. The final rule does not use the term ''carve-outs,'' as in the proposal, but these provisions still recognize circumstances in which plans, plan fiduciaries, plan participants and beneficiaries, IRAs, and IRA owners may receive recommendations the Department does not believe should be treated as fiduciary investment advice notwithstanding the general definition set forth in paragraph (a) of the final rule. Each of the provisions has been modified from the proposal to address public comments and refine the provision.

(1) Transactions With Independent Plan Fiduciaries With Financial Expertise

Paragraph (b)(1)(i) of the proposed rule provided a carve-out (referred to as the ''seller's'' or ''counterparty'' carve-out) from the general definition for incidental advice provided in connection with an arm's length sale, purchase, loan, or bilateral contract between an expert plan investor and the adviser. The exclusion also applied in connection with an offer to enter into such an arm's length transaction, and when the person providing the advice acts as a representative, such as an agent, for the plan's counterparty. In particular, paragraph (b)(1)(i) of the proposal provided a carve-out for incidental advice provided in connection with counterparty transactions with a plan fiduciary with financial expertise. As a proxy for financial expertise the rule required that the advice recipient be a fiduciary of a plan with 100 or more participants or have responsibility for managing at least $100 million in plan assets. Additional conditions applied to each of these two categories of sophisticated investors that were intended to ensure the parties understood the non-fiduciary nature of the relationship.

Some commenters on the 2015 Proposal offered threshold views on whether the Department should include a seller's carve-out as a general matter or whether, for example, an alternative approach such as requiring specific disclosures would be preferable. Others strongly supported the inclusion of a seller's carve-out, believing it to be a critical component of the proposal. As explained in the proposal, the purpose of the proposed carve-out was to avoid imposing ERISA fiduciary obligations on sales pitches that are part of arm's length transactions where neither side assumes that the counterparty to the plan is acting as an impartial or trusted adviser. The premise of the proposed carve-out was that both sides of such transactions understand that they are acting at arm's length, and neither party expects that recommendations will necessarily be based on the buyer's best interests, or that the buyer will rely on them as such.

Consumer advocates generally agreed with the Department's views expressed in the preamble that it was appropriate to limit the carve-out to large plans and sophisticated asset managers. These commenters encouraged the Department to retain a very narrow and stringent carve-out. They argued that the communications to participants and retail investors are generally presented as advice and understood to be advice. Indeed, both FINRA and state insurance law commonly require that recommendations reflect proper consideration of the investment's suitability in light of the individual investor's particular circumstances, regardless of whether the transaction could be characterized as involving a ''sale.'' Additionally commenters noted that participants and IRA owners cannot readily ascertain the nuanced differences among different types of financial professionals (including differences in legal standards that apply to different professionals) or easily determine whether advice is impartial or potentially conflicted, or assess the significance of the conflict. Similar points were made concerning advice in the small plan marketplace.

These commenters expressed concern, shared by the Department, that allowing investment advisers to claim non-fiduciary status as ''sellers'' across the entire retail market would effectively open a large loophole by allowing brokers and other advisers to use disclosures in account opening agreements, investor communications, advertisements, and marketing materials to avoid fiduciary responsibility and accountability for investment recommendations that investors rely upon to make important investment decisions. Just as financial service companies currently seek to disclaim fiduciary status under the five-part test through standardized statements disclaiming the investor's right to rely upon communications as individualized advice, an overbroad seller's exception could invite similar statements that recommendations are made purely in a sales capacity, even as oral communications and marketing materials suggest expert financial assistance upon which the investor can and should rely.

On the other hand, many commenters representing financial services providers argued for extending the ''seller's'' carve-out to include transactions in the market composed of smaller plans and individual participants, beneficiaries and IRA owners. These commenters contended that the lines drawn in the proposal were based on a flawed assumption that representatives of small plans and individual investors cannot understand the difference between a sales pitch and advice. They argued that failure to extend the carve-out to these markets will limit the ability of small plans and individual investors to obtain advice and to choose among a variety of services and products that are best suited to their needs. They also argued that there is no statutory basis for distinguishing the scope of fiduciary responsibility based on plan size. Some commenters suggested that the Department could extend the carve-out to individuals that meet financial or net worth thresholds or to ''accredited investors,'' ''qualified purchasers,'' or ''qualified clients'' under federal securities laws. Some commenters also requested that the Department expand the persons and entities that would be considered ''sophisticated'' fiduciaries for purposes of the carve-out, for example asking that banks, savings and loan associations, and insurance companies be explicitly covered. Others alternatively argue that the carve-out should be expanded to fiduciaries of participant-directed plans regardless of plan size, which they said is not a reliable predictor for financial sophistication, or if the plan is represented by a financial expert such as an ERISA section 3(38) investment manager or an ERISA qualified professional asset manager. Other commenters asked that the carve-out be expanded to all proprietary products on the theory that investors generally understand that a person selling proprietary products is going to be making recommendations that are biased in favor of the proprietary product. Others suggested that the Department could address its concern about retail investor confusion by requiring specified disclosures, warranties, or representations to investors or small plan fiduciaries.

Other commenters argued that communications by product manufacturers and other financial services providers directed to financial intermediaries who then directly advise plans, participants, beneficiaries or IRA owners should not be investment advice within the meaning of the rule. Some commenters referred to this as ''wholesaling'' activities or ''daisy chain'' relationships. Some assert that a wholesaler's suggestions or recommendations about funds and sample plan line-ups, even if viewed as specifically directed and provided to an acknowledged fiduciary, are distinguishable because they are made to non-discretionary intermediaries who have no discretion over a plan's or investor's investment choices. Other commenters similarly stressed that the intermediary is the person or entity with a nexus to the IRA owner or plan, which also benefits from an ERISA fiduciary to protect its participants, while the wholesaler has contractual privity with financial entities that may be investment advisers registered with the SEC, rather than with the ultimate plan or IRA owner. One commenter focused on whether the wholesaler's advice is provided to a professional investment adviser, whether acting in an ERISA section 3(21) nondiscretionary or 3(38) discretionary capacity, rather than to a plan or IRA owner. Some commenters argued that the original preparer of model portfolios similarly should not be treated as a fiduciary investment adviser when the model is used by a financial intermediary with a direct relationship with the plan and its participants.

Some commenters sought elimination of the requirement that counterparties obtain a representation concerning the plan fiduciary's sophistication. They argued that a counterparty's reasonable belief as to such sophistication should be sufficient or that there should be a presumption of such sophistication absent clear evidence otherwise. Finally, commenters questioned the requirement that no direct fee may be paid by the plan in connection with the transaction. Some argued that the condition should be removed, while others asked for clarification of what constitutes a fee for this purpose, for example whether it includes payments through plan assets and whether ''direct'' fees include the receipt of asset management or incentive fees received from a fund or other investment manager.

The Department does not believe it would be consistent with the language or purposes of ERISA section 3(21) to extend this exclusion to advice given to small retail employee benefit plan investors or IRA owners. The Department explained its rationale in the preamble to the proposal. In summary, retail investors were not included in this carve-out because (1) the Department did not believe the relationships fit the arm's length characteristics that the seller's carve-out was designed to preserve; (2) the Department did not believe disclaimers of adviser status were effective in alerting retail investors to nature and consequences of the conflicting financial interests; (3) IRA owners in particular do not have the benefit of a menu selected or monitored by an independent plan fiduciary; (4) small business sponsors of small plans are more like retail investors compared to large companies that often have financial departments and staff dedicated to running the company's employee benefit plans; (5) it would be inconsistent with congressional intent under ERISA section 408(b)(14) to create such a broad carve-out, as most recently reflected in enactment of a statutory provision that placed substantial conditions on the provision of investment advice to individual participants and IRA owners; and (6) there were other more appropriate ways to ensure that such retail investors had access to investment advice, such as prohibited transaction exemptions, and investment education. In addition, and perhaps more fundamentally, the Department rejects the purported dichotomy between a mere ''sales'' recommendation, on the one hand, and advice, on the other in the context of the retail market for investment products. As reflected in financial service industry marketing materials, the industry's comment letters reciting the guidance they provide to investors, and the obligation to ensure that recommended products are at least suitable to the individual investor, sales and advice go hand in hand in the retail market. When plan participants, IRA owners, and small businesses talk to financial service professionals about the investments they should make, they typically pay for, and receive, advice.

The Department continues to believe for all of those reasons that it would be an error to provide a broad ''seller's'' exemption for investment advice in the retail market. Recommendations to retail investors and small plan providers are routinely presented as advice, consulting, or financial planning services. In fact, in the securities markets, brokers' suitability obligations generally require a significant degree of individualization. Most retail investors and many small plan sponsors are not financial experts, are unaware of the magnitude and impact of conflicts of interest, and are unable effectively to assess the quality of the advice they receive. IRA owners are especially at risk because they lack the protection of having a menu of investment options chosen by an independent plan fiduciary charged to protect their interests. Similarly, small plan sponsors are typically experts in the day-to-day business of running an operating company, not in managing financial investments for others. In this retail market, such an exclusion would run the risk of creating a loophole that would result in the rule failing to make any real improvement in consumer protections because it could be used by financial service providers to evade fiduciary responsibility for their advice through the same type of boilerplate disclaimers that some advisers use to avoid fiduciary status under the current ''five-part test'' regulation.

The Department also is not prepared to conclude that written disclosures, including models developed by the Department, are sufficient to address investor confusion about financial conflicts of interest. Although some commenters urged the Department to focus on the delivery of comprehensive disclosures to investors as preferable to imposing a fiduciary duty with related exemptions and offered various views on format, content, e-disclosure, cost, and related issues, the Department was not persuaded. Other commenters, however, countered with the view that disclosure is not sufficient as a substitute for the establishment of an affirmative fiduciary duty. Disclosure alone has proven ineffective to mitigate conflicts in advice. Extensive research has demonstrated that most investors have little understanding of their advisers' conflicts of interest, and little awareness of what they are paying via indirect channels for the conflicted advice. Even if they understand the scope of the advisers' conflicts, many consumers are not financial experts and therefore, cannot distinguish good advice or investments from bad. The same gap in expertise that makes investment advice necessary and important frequently also prevents investors from recognizing bad advice or understanding advisers' disclosures. As noted above in the summary ''Benefit-Cost Assessment,'' some research suggests that even if disclosure about conflicts could be made simple and clear, it could be ineffective—or even harmful. In addition to problems with the effectiveness of such disclosures, the possibility of inconsistent oral representations raises questions about whether any boilerplate written disclosure could ensure that the person's financial interest in the transaction is effectively communicated as being in conflict with the interests of the advice recipient.

Further, the Department is not prepared to adopt the approach suggested by some commenters that the provision be expanded to include individual retail investors through an accredited or sophisticated investor test that uses wealth as a proxy for the type of investor sophistication that was the basis for the Department proposing some relationships as non-fiduciary. The Department agrees with the commenters that argued that merely concluding someone may be wealthy enough to be able to afford to lose money by reason of bad advice should not be a reason for treating advice given to that person as non-fiduciary.[33] Nor is wealth necessarily correlated with financial sophistication. Individual investors may have considerable savings as a result of numerous factors unrelated to financial sophistication, such as a lifetime of thrift and hard work, inheritance, marriage, business successes unrelated to investment management, or simple good fortune.

In developing this provision of the final rule, the Department carefully considered the comments from several financial services providers who argued that the Department's proposal violated traditional legal principles that they say recognize the right of businesses to market their products and services. These comments also argued that the proposal's protection for retail investors somehow disrespected the ability of retail investors to differentiate bad advice from good advice. The Department does not believe these comments have merit or require the adoption of a broad based ''seller's'' exception for the retail market. None of the commenters pointed to any provision in the federal securities laws containing a ''seller's'' carve-out or similar concept used to draw distinctions between advice relationships that are fiduciary from non-fiduciary under the federal securities laws. See also NAIC Model Regulation 275 on application of suitability standards to recommendations to retail investors involving annuity product transactions (available at *www.naic.org/store/free/MDL-275.pdf*). That fact too undermines the strength of the argument that investment recommendations provided to a retirement investor should be subject to a broad ''seller's'' exemption under Title I of ERISA.

Moreover, the Department does not believe there is merit to the arguments that traditional legal principles support such a broad-based carve out from fiduciary status. The commenters' arguments, in the Department's view, essentially ask the Department to adopt a modified version of a ''caveat emptor'' or ''buyer beware'' principle that once prevailed under traditional contract law. That principle does not govern regulation of modern market relationships, particularly in regulated industries, and is incongruent to what, absent a regulatory exemption of the sort requested by the commenters, would be a fiduciary relationship subject to the highest legal standards of trust and loyalty. It is particularly incongruent with a statutory scheme that is designed to protect the interests of workers in tax-preferred assets that support their financial security and physical health, and that broadly prohibits conflicted transactions because of the dangers they pose, unless the Department grants an exemption based on express findings that the exemption is in the interest of participants and IRA owners and protective of their interests. Also, while some commenters supporting such a broad carve out have suggested that an enhanced disclosure regime would protect investors from conflicts of interest, as described elsewhere in this Notice in more detail, their arguments are not persuasive. A disclosure regime, standing alone, would not obviate conflicts of interest in investment advice even if it were possible to flawlessly disclose complex fee and investment structures.

Nonetheless, the Department agrees with the commenters that criticized the proposal with arguments that the criteria in the proposal were not good proxies for appropriately distinguishing non-fiduciary communications taking place in an arm's length transaction from instances where customers should reasonably be able to expect investment recommendations to be unbiased advice that is in their best interest. The Department notes that the definition of investment advice in the proposal expressly required a recommendation directly to a plan, plan fiduciary, plan participant, or IRA owner. The use of the term ''plan fiduciary'' in the proposal was not intended to suggest that ordinary business activities among financial institutions and licensed financial professionals should become fiduciary investment advice relationships merely because the institution or professional was acting on behalf of an ERISA plan or IRA. The ''100 participant plan'' threshold was borrowed from annual reporting provisions in ERISA that were designed to serve different purposes related to simplifying reporting for small plans and reducing administrative burdens on small businesses that sponsor employee benefit plans. The ''$100 million in assets under management'' threshold was a better proxy for the type of financial capabilities the carve-out was intended to capture, but it failed to include a range of financial services providers that fairly could be said to have the financial capabilities and understanding that was the focus of the carve-out.

Thus, after carefully evaluating the comments, the Department has concluded that the exclusion is better tailored to the Department's stated objective by requiring the communications to take place with plan or IRA fiduciaries who are independent from the person providing the advice and are either licensed and regulated providers of financial services or plan fiduciaries with responsibility for the management of $50 million in assets. This provision does not require that the $50 million be attributable to only one plan, but rather allows all the plan and non-plan assets under management to be included in determining whether the threshold is met. Such parties should have a high degree of financial sophistication and may often engage in arm's length transactions in which neither party has an expectation of reliance on the counterparty's recommendations. The final rule revises and re-labels the carve-out in a new paragraph (c)(1) that provides that a person shall not be deemed to be a fiduciary within the meaning of section 3(21)(A)(ii) of the Act solely because of the provision of any advice (including the provision of asset allocation models or other financial analysis tools) to an independent person who is a fiduciary of the plan or IRA (including a fiduciary to an investment contract, product, or entity that holds plan assets as determined pursuant to sections 3(42) and 401 of the Act and 29 CFR 2510.3–101) with respect to an arm's length sale, purchase, loan, exchange, or other transaction involving the investment of

[33] The Department continues to believe that a broad based ''seller's'' exception for retail investors is not consistent with recent congressional action, the Pension Protection Act of 2006 (PPA). Specifically, the PPA created a new statutory exemption that allows fiduciaries giving investment advice to individuals (pension plan participants, beneficiaries, and IRA owners) to receive compensation from investment vehicles that they recommend in certain circumstances. 29 U.S.C. 1108(b)(14); 26 U.S.C. 4975(d)(17). Recognizing the risks presented when advisers receive fees from the investments they recommend to individuals, Congress placed important constraints on such advice arrangements that are calculated to limit the potential for abuse and self-dealing, including requirements for fee-leveling or the use of independently certified computer models. The Department has issued regulations implementing this provision at 29 CFR 2550.408g–1 and 408g–2. Thus, the PPA statutory exemption remains available to parties that would become investment advice fiduciaries because of the broader definition in this final rule, and the new and amended administrative exemptions published with this final rule (detailed elsewhere) provide alternative approaches to allow beneficial investment advice practices that are similarly designed to meet the statutory requirement that exemptions must be protective of the interests of retirement plan investors.

securities or other property, if the person knows or reasonably believes that they are dealing with a fiduciary of the plan or IRA who is independent from the person providing the advice and who is (1) a bank as defined in section 202 of the Investment Advisers Act of 1940 or similar institution that is regulated and supervised and subject to periodic examination by a State or Federal agency; (2) 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 [34]; (3) an investment adviser registered under the Investment Advisers Act of 1940 or, if not registered as an investment adviser under such Act by reason of paragraph (1) of section 203A of such Act, is registered as an investment adviser under the laws of the State (referred to in such paragraph (1)) in which it maintains its principal office and place of business; (4) a broker-dealer registered under the Securities Exchange Act of 1934; or (5) any other person acting as an independent fiduciary that holds, or has under management or control, total assets of at least $50 million.

Whether a party is ''independent'' for purposes of the final rule will generally involve a determination as to whether there exists a financial interest (*e.g.,* compensation, fees, etc.), ownership interest, or other relationship, agreement or understanding that would limit the ability of the party to carry out its fiduciary responsibility to the plan or IRA beyond the control, direction or influence of other persons involved in the transaction. The Department believes that consideration must be given to all relevant facts and circumstances, including evidence bearing on all relationships between the fiduciary and the other party. For example, if a fiduciary has an interest in or relationship with another party that may conflict with the interests of the plan for which the fiduciary acts or which may otherwise affect the fiduciary's best judgment as a fiduciary, the Department would not regard the person as independent. The nature and degree of any common ownership or control connections would be a relevant circumstance. Thus, parties belonging to a controlled group of corporations as described in Internal Revenue Code section 414(b), under common control as described in Code section 414(c), or that are members of an affiliated service group within the meaning of Code section 414(m), generally would be sufficiently affiliated so that such relationships would affect the fiduciary's best judgment. The Department also would not view the fiduciary as independent if the transaction includes an agreement, arrangement, or understanding with other parties involved in the transaction that is designed to relieve the fiduciary from any responsibility, obligation or duty to the plan or IRA. In other cases, a disqualifying affiliation or other significant relationship may be established by a showing of substantial control and close supervision by a common parent. Similarly, the Department would not regard a person as independent if the person received compensation or fees in connection with the transaction that involved a violation of the prohibitions of section 406(b)(1) of the Act (relating to fiduciaries dealing with the assets of plans in their own interest or for their own account), section 406(b)(2) of the Act (relating to fiduciaries in their individual or in any other capacity acting in any transaction involving the plan on behalf of a party (or representing a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries), or section 406(b)(3) of the Act (relating to fiduciaries receiving consideration for their own personal account from any party dealing with a plan in connection with a transaction involving the assets of the plan). Moreover, if a fiduciary has an interest in or relationship with another party that may affect the fiduciary's best judgment, as described in 29 CFR 2550.408b–2, the Department would not regard the person as independent.

Additional conditions are intended to ensure that this provision in the final rule is limited to circumstances that involve true arm's length transactions between investment professionals or large asset managers who do not have a legitimate expectation that they are in a relationship of trust and loyalty where they fairly can rely on the other person for impartial advice. Specifically, the person must also fairly inform the independent plan 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 must fairly inform the independent plan fiduciary of the existence and nature of the person's financial interests in the transaction. The person must know or reasonably believe 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. The final rule expressly provides that the person may rely on written representations from the plan or independent fiduciary to satisfy this condition. The person must know or reasonably believe that the independent fiduciary is a fiduciary under ERISA or the Code, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction (the person may rely on written representations from the plan or independent fiduciary to satisfy this requirement). In the Department's view, this condition is designed to ensure that the parties, including the plan or IRA, understand the nature of their relationships. Finally, the person must not receive a fee or other compensation directly from the plan, or plan fiduciary, for the provision of investment advice (as opposed to other services) in connection with the transaction. If a plan expressly pays a fee for advice, the essence of the relationship is advisory, and subject to the provisions of ERISA and the Code. Thus, the person may not charge the plan a direct fee to act as an adviser with respect to the transaction, and then disclaim responsibility as a fiduciary adviser by asserting that he or she is merely an arm's length counterparty.

In formulating this provision in the final rule, the Department considered FINRA guidance on a similar issue under the federal securities laws. Specifically, FINRA guidance provides that the suitability rule in federal securities law applies to a broker-dealer's or registered representative's recommendation of a security or investment strategy involving a security to a ''customer.'' FINRA's definition of a customer in FINRA Rule 0160 excludes a ''broker or dealer.'' In explaining this exclusion, FINRA has noted that:

[I]n general, for purposes of the suitability rule, the term customer includes a person who is not a broker or dealer who opens a brokerage account at a broker-dealer or purchases a security for which the broker-dealer receives or will receive, directly or indirectly, compensation even though the security is held at an issuer, the issuer's affiliate or a custodial agent (*e.g.,* 'direct application' business,

[34] Exemption (PTE 84–14) permits transactions between parties in interest to a plan and an investment fund in which the plan has an interest provided the fund is managed by a qualified professional plan asset manager (QPAM) that satisfies certain conditions. Among the entities that can qualify as a QPAM is ''an insurance company which is qualified under the laws of more than one state to manage, acquire or dispose of any assets of a plan. . .'' 49 FR 9494.

'investment program' securities, or private placements), or using another similar arrangement. (footnotes omitted) FINRA Rule 2111 (Suitability) FAQ at *www.finra.org/industry/faq-finra-rule-2111-suitability-faq#_edn3.*

The Department's final rule similarly says that recommendations to broker-dealers, registered investment advisers and other licensed financial professionals are not treated as fiduciary investment advice under ERISA and the Code when the rule's conditions are met.

The $50 million threshold in the final rule for ''other plan fiduciaries'' is similarly based upon the definition of ''institutional account'' in FINRA rule 4512(c)(3) to which the suitability rules of FINRA rule 2111 apply and responds to the requests of commenters that the test for sophistication be based on market concepts that are well understood by brokers and advisers. Specifically, FINRA Rule 2111(b) on suitability and FINRA's ''books and records'' Rule 4512(c) both use a definition of ''institutional account,'' which means the account of a bank, savings and loan association, insurance company, registered investment company, registered investment adviser, or any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million. Id. at Q&A 8.1. In regard to the ''other person'' category, FINRA's rule had used a standard of at least $10 million invested in securities and/or under management, but revised it to the current $50 million standard. Id. at footnote 80. In addition, the FINRA rule requires: (1) That the broker have ''a reasonable basis to believe the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities'' and (2) that ''the institutional customer affirmatively indicates that it is exercising independent judgment.'' [35]

The Department intends that a person seeking to avoid fiduciary status under this exception has the burden of demonstrating compliance with all applicable requirements of the limitation. Whether the burden is met in any particular case will depend on the individual facts and circumstances. For example, with regard to comments asking for clarification regarding the timing of the required disclosures, in particular whether the required representations have to be made on a transaction-by-transaction basis or could be made more generally when establishing the relationship, nothing in the final rule requires the disclosures to be on an individual transaction basis or prohibits the disclosures from being framed to cover a broader range of transactions. Whether particular disclosures satisfy the conditions in the final rule would depend on the transaction or transactions involved and the substance and timing of the disclosures that are being proffered as satisfying the condition.

Finally, although the seller's carve-out is not available under the final rule in the retail market for communications directly to retail investors, the Department notes that the final rule includes other provisions that are more appropriate ways to address some concerns raised by commenters and ensure that small plan fiduciaries, plan participants, beneficiaries, and IRA owners would be able to obtain essential information regarding important decisions they make regarding their investments without the providers of that information crossing the line into providing recommendations that would be fiduciary in nature. Under paragraph (b)(2) of the final rule, platform providers (*i.e.,* persons that provide access to securities or other property through a platform or similar mechanism) and persons that help plan fiduciaries select or monitor investment alternatives for their plans can perform those services without those services being labeled recommendations of investment advice. Similarly, under paragraph (b)(2) of the final rule, general plan information, financial, investment and retirement information, and information and education regarding asset allocation models would all be available to a plan, plan fiduciary, participant, beneficiary, or IRA owner and would not constitute the provision of an investment recommendation, irrespective of who receives that information.

Further, in the absence of a recommendation, nothing in the final rule would make a person an investment advice fiduciary merely by reason of selling a security or investment property to an interested buyer. For example, if a retirement investor asked a broker to purchase a mutual fund share or other security, the broker would not become a fiduciary investment adviser merely because the broker purchased the mutual fund share for the investor or executed the securities transaction. Such ''purchase and sales'' transactions do not include any investment advice component. The final rule has a specific provision in paragraph (e) that expressly confirms that conclusion in connection with the execution of securities transactions by broker-dealers, certain reporting dealers, and banks.

(2) Swap and Security-Based Swap Transactions

The proposal included a ''carve-out'' intended to make it clear that communications and activities engaged in by counterparties to ERISA-covered employee benefit plans in swap and security-based swap transactions did not result in the counterparties becoming investment advice fiduciaries to the plan. As explained in the preamble to the 2015 Proposal, swaps and security-based swaps are a broad class of financial transactions defined and regulated under amendments to the Commodity Exchange Act and the Securities Exchange Act of 1934 by the Dodd-Frank Act. Section 4s(h) of the Commodity Exchange Act (7 U.S.C. 6s(h)) and section 15F of the Securities Exchange Act of 1934 (15 U.S.C. 78o–10(h) establish similar business conduct standards for dealers and major participants in swaps or security-based swaps. Special rules apply for swap and security-based swap transactions involving ''special entities,'' a term that includes employee benefit plans covered under ERISA. Under the business conduct standards in the Commodity Exchange Act as added by the Dodd-Frank Act, swap dealers or major swap participants that act as counterparties to ERISA plans, must, among other conditions, have a reasonable basis to believe that the plans have independent representatives who are fiduciaries under ERISA. 7 U.S.C. 6s(h)(5). Similar requirements apply for security-based swap transactions. 15 U.S.C 78o–10(h)(4) and (5). The CFTC has issued a final rule to implement these requirements and the SEC has issued a proposed rule that

[35] FINRA has a separate advertising regulation with a different definition for ''institutional communications.'' Under FINRA Rule 2210, an institutional communication ''means any written (including electronic) communication that is distributed or made available only to institutional investors as defined but does not include a firm's internal communications. Institutional investors include banks, savings and loan associations, insurance companies, registered investment companies, registered investment advisors, a person or entity with assets of at least $50 million, government entities, employee benefit plans and qualified plans with at least 100 participants, FINRA member firms and registered persons, and a person acting solely on behalf of an institutional investor.'' See *www.finra.org/industry/issues/faq-advertising.* The Department believes that the FINRA requirements for institutional customers under its suitability and books and records rules serve purposes more analogous to the exemption in the final for sophisticated fiduciary investors.

would cover security-based swaps. 17 CFR 23.400 to 23.451 (2012); 70 FR 42396 (July 18, 2011). In the Department's view, when Congress enacted the swap and security based swap provisions in the Dodd-Frank Act, including those expressly applicable to ERISA covered plans, Congress did not intend that engaging in regulated conduct as part of a swap or security-based swap transaction with an employee benefit plan would give rise to additional fiduciary obligations or restrictions under Title I of ERISA.

A commenter asked that the Department confirm in the final rule that this provision includes communications and activities in swaps and security-based swaps that are not cleared by a central counterparty. In the view of the Department, there are differences in the characteristics of cleared and uncleared swaps. For example, uncleared swaps can be highly-customizable, bespoke agreements subject to extensive negotiation. In contrast, we understand that cleared swaps and cleared security-based swaps tend to offer greater standardization and increased transparency of terms and pricing. In addition, cleared swaps and cleared security-based swaps may have other beneficial characteristics that may be important to ERISA plans, such as greater liquidity and centrally managed counterparty risk. Thus, there are issues that a plan fiduciary must consider in evaluating whether to engage in a swap transaction through a cleared or uncleared channel. However, the Dodd-Frank Act provisions apply the business conduct standards similarly to cleared and uncleared swap transactions involving employee benefit plans. Accordingly, notwithstanding the difference between cleared and uncleared swap transactions, the Department does not believe the potential consequences under this final rule should be different for cleared versus uncleared swap and security-based swap transactions with respect to whether compliance with the business conduct standards could result in swap dealers, security-based swap dealers, major swap participants, and major security-based swap participants becoming investment advice fiduciaries under the final rule.[36]

Thus, paragraph (c)(2) of the final rule is intended to confirm that persons acting as swap dealers, security-based swap dealers, major swap participants, and major security-based swap participants do not become investment advice fiduciaries as a result of communications and activities conducted during the course of swap or security-based swap transactions regulated under the Dodd-Frank Act provisions in the Commodity Exchange Act or the Securities Exchange Act of 1934 and applicable CFTC and SEC implementing rules and regulations. The provision in the final rule requires in such transactions that (1) in the case of a swap dealer or security-based swap dealer, the person must not be acting as an advisor to the plan, within the meaning of the applicable business conduct standards under the Commodity Exchange Act or the Securities Exchange Act, (2) the employee benefit plan must be represented in the transaction by an independent plan fiduciary,[37] (3) the person does not receive a fee or other compensation directly from the plan or plan fiduciary for the provision of investment advice (as opposed to other services) in connection with the transaction, and (4) before providing any recommendation with respect to a swap or security-based swap transaction or series of transactions, the person providing the recommendation must obtain from the independent fiduciary a written representation that the independent plan fiduciary understands 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 that the independent plan fiduciary is exercising independent judgment in evaluating the recommendation.

Some commenters indicated that the swaps and security-based swaps provision in the proposal was too narrow because it was limited to "counterparties," and, accordingly, did not include other parties with roles in cleared swap or cleared security-based swap transactions. The commenters said it is common for a clearing firm to provide its customers with information, such as valuations, pricing and liquidity information that is important to customers in deciding whether to execute, maintain, or liquidate swap or security-based swap positions, or the collateral supporting these positions. Clearing firms in this context means members of a derivatives clearing organization or members of a clearing agency as compared to the derivatives clearing organization or clearing agency itself. According to this commenter, if clearing firms are deterred from providing these services due to the risk of being a fiduciary under the final rule, customers may receive less information and make less-informed decisions, which decisions could also result in greater risks for the clearing firms. The commenter indicated that as a result, the clearing role, which Congress considered important, could be compromised. The Department understands that a central concern of the comments in this area focused on the possibility that providing valuation, pricing, and liquidity information would constitute fiduciary investment advice under the provision in the 2015 Proposal that included appraisals and valuations. As noted elsewhere in this Notice, that provision was not carried forward in the final rule, but was reserved for future consideration. Thus, providing such valuation, pricing, and liquidity information would not give rise to potential status as an investment advice fiduciary under the final rule. Nonetheless, the commenters asked that clearing firms be expressly included in the swap and security-based swap provision in the final rule. The final rule has been adjusted accordingly.

The Department, however, is not prepared to include a more open-ended class of "other similar service providers" in the swap and security-based swap provision in the final rule. It was not clear from the information submitted by the commenter who requested such an expansion of the provision who these service providers

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[36] The Department has provided assurances to the CFTC and the SEC that the Department is fully committed to ensuring that any changes to the current ERISA fiduciary advice regulation are carefully harmonized with the final business conduct standards, as adopted by the CFTC and the SEC, so that there are no unintended consequences for swap and security-based swap dealers and major swap and security-based swap participants who comply with the business conduct standards. *See, e.g.,* Letter from Phyllis C, Borzi, Assistant Secretary, Employee Benefits Security Administration, U.S. Department of Labor, to The Hon. Gary Gensler *et al.,* CFTC (Jan. 17, 2012). In this regard, we note that the disclosures required under the business conduct standards, including those regarding material information about a swap or security-based swap concerning material risks, characteristics, incentives and conflicts of interest; disclosures regarding the daily mark of a swap or security-based swap and a counterparty's clearing rights; disclosures necessary to ensure fair and balanced communications; and disclosures regarding the capacity in which a swap or security-based swap dealer or major swap participant is acting when a counterparty to a special entity, do not in the Department's view compel counterparties to ERISA-covered employee benefit plans, other plans or IRAs to make a recommendation for purposes of paragraph (a) of the final rule or otherwise compel them to act as fiduciaries in swap and security-based swap transactions conducted pursuant to section 4s of the Commodity Exchange Act and section 15F of the Securities Exchange Act. This section of this Notice discusses these issues in the context of the express provisions in the final rule on swap and security-based swap transactions and on transactions with independent fiduciaries with financial expertise.

[37] See discussion above on what constitutes "independence" under the final rule in the case of provisions that require the plan to be represented by an independent plan fiduciary.

were, what made them similar to other service providers listed in the provision, and why there was an issue regarding their activities or communications giving rise to potential fiduciary investment advice status. For example, based on the descriptions in the comments, the Department agrees that the provision of clearing services by, and communications that ordinarily accompany the provision of clearing services from, a derivatives clearing organization or clearing agency, or a member of a derivatives clearing organization or clearing agency, as those terms are defined in section 1a of the Commodity Exchange Act and section 3(a) of the Securities Exchange Act in connection with clearing a commodity interest transaction as defined in 17 CFR 1.3(yy), including swaps and futures contracts, or in connection with clearing a security-based swap, would not appear to require or typically involve a clearing organization or clearing firm making investment recommendations as that term is defined in the final rule. Rather, it appears that clearing services can be provided in compliance with the Commodity Exchange Act and the Securities Exchange Act without such compliance, by itself, causing a clearing organization or clearing firm to be an investment advice fiduciary under the final rule. Moreover, to the extent issues arise with respect to such ''other similar service providers,'' the provision of the final rule regarding transactions with independent plan fiduciaries with financial expertise would be available.

This same commenter also questioned whether the provisions in the proposal were intended to change the conclusions of Advisory Opinion 2013–01A regarding the fiduciary and party in interest status of certain parties involved in the clearing process, such as clearing firms and clearinghouses. The conclusions in Advisory Opinion 2013–01A did not involve interpretations of the investment advice fiduciary provision in ERISA section 3(21)(A)(ii). Rather, they involved other elements of the fiduciary definition under section 3(21). Accordingly, the final rule does not change the conclusions expressed in the advisory opinion.

Some commenters argued that IRA owners should be able to engage in a swap and security-based swap transaction under appropriate circumstances, assuming the account owner is an ''eligible contract participant.'' The Department notes that IRAs and IRA owners would not appear to be ''special entities'' under the Dodd-Frank Act provisions and transactions with IRAs would not be subject to the business conduct standards that apply to cleared and uncleared swap and security-based swap transactions with employee benefit plans. Moreover, for the same reasons discussed elsewhere in this Notice that the Department declined to adopt a broad ''seller's'' exception for retail retirement investors, the Department does not believe extending the swap and security-based swap provisions to IRA investors is appropriate. Rather, as described below, the Department concluded that it was more appropriate to address this issue in the context of the ''independent plan fiduciary with financial expertise'' provision described elsewhere in this Notice.

Some commenters requested that the swap and security-based swap provision include transactions involving pooled investment funds, and other alternative investments, including specifically futures contracts. The Department does not believe it has an adequate basis for a wholesale expansion of the swaps and security-based swap provision to other classes of investments that are not subject to the business conduct standards in the Dodd-Frank Act regarding swaps and security-based swaps. Rather, the final rule's general provision relating to transactions with ''independent plan fiduciaries with financial expertise'' (paragraph (c)(1)) has been significantly adjusted and expanded from the so-called ''counterparty'' carve-out in the proposal. That provision in the final rule gives an alternative avenue for parties involved in futures, alternative investments, or other investment transactions to conduct the transaction in a way that would ensure they do not become investment advice fiduciaries under the final rule. With respect to pooled investment funds that hold plan assets, the same ''independent plan fiduciary'' provision is available for swap and security-based swap transactions involving pooled investment vehicles managed by independent fiduciaries.

(3) Employees of Plan Sponsors, Plans, or Plan Fiduciaries

Paragraph (c)(3) of the final rule provides that a person is not an investment advice fiduciary if, in his or her capacity as an employee of the plan sponsor of a plan, as an employee of an affiliate of such plan sponsor, as an employee of an employee benefit plan, as an employee of an employee organization, or as an employee of a plan fiduciary, the person provides advice to a plan fiduciary, or to an employee (other than in his or her capacity as a participant or beneficiary of a plan) or independent contractor of such plan sponsor, affiliate, or employee benefit plan, provided the person receives no fee or other compensation, direct or indirect, in connection with the advice beyond the employee's normal compensation for work performed for the employer.

This exclusion from the scope of the fiduciary investment advice definition addresses concerns raised by public comments seeking confirmation that the rule does not include as investment advice fiduciaries employees working in a company's payroll, accounting, human resources, and financial departments, who routinely develop reports and recommendations for the company and other named fiduciaries of the sponsors' plans. The exclusion was revised to make it clear that it covers employees even if they are not the persons ultimately communicating directly with the plan fiduciary (*e.g.,* employees in financial departments that prepare reports for the Chief Financial Officer who then communicates directly with a named fiduciary of the plan). The Department agrees that such personnel of the employer should not be treated as investment advice fiduciaries based on communications that are part of their normal employment duties if they receive no compensation for these advice-related functions above and beyond their normal salary.

Similarly, and as requested by commenters, the exclusion covers communications between employees, such as human resources department staff communicating information to other employees about the plan and distribution options in the plan subject to certain conditions designed to prevent the exclusion from covering employees who are in fact employed to provide investment recommendations to plan participants or otherwise becoming a possible loophole for financial services providers seeking to avoid fiduciary status under the rule. Specifically, the exclusion covers circumstances where an employee of the plan sponsor of a plan, or as an employee of an affiliate of such plan sponsor, provides advice to another employee of the plan sponsor in his or her capacity as a participant or beneficiary of the plan, provided the person's job responsibilities do not involve the provision of investment advice or investment recommendations, the person is not registered or licensed under federal or state securities or insurance laws, the advice they provide does not require the person to be registered or licensed under federal or state securities or insurance laws, and the person receives no fee or other compensation, direct or indirect, in connection with the advice beyond the employee's normal compensation for work performed for the employer. The Department established these conditions to address circumstances where an HR employee, for example, may inadvertently make an investment recommendation within the meaning of the final rule. It also is designed so that it does not cover situations designed to evade the standards and purposes of the final rule. For example, the Department wanted to ensure that the exclusion did not create a loophole through which a person could be detailed from an investment firm, or ''hired'' under a dual employment structure, as part of an arrangement designed to avoid fiduciary obligations in connection with investment advice to participants or insulate recommendations designed to benefit the investment firm. For the reasons discussed elsewhere in this Notice in connection with call center employees, the Department does not believe this exclusion should extend beyond employees of the plan sponsor and its affiliates.

E. 29 CFR 2510.3–21(d), (e), and (f)—Scope, Execution of Securities Transactions, and Applicability Under Internal Revenue Code

(1) Scope of Investment Advice Fiduciary Duty

Paragraph (d) confirms that a person who is a fiduciary with respect to the assets of a plan or IRA by reason of rendering investment advice defined in the general provisions of the final rule shall not be deemed to be a fiduciary regarding any assets of the plan or IRA with respect to which that person does not have or exercise any discretionary authority, control, or responsibility or with respect to which the person does not render or have authority to render investment advice defined by the final rule, provided that nothing in paragraph (d) exempts such person from the provisions of section 405(a) of the Act concerning liability for violations of fiduciary responsibility by other fiduciaries or excludes such person from the definition of party in interest under section 3(14)(B) of the Act or section 4975(e)(2) of the Code. This provision is unchanged from the current 1975 regulation and the 2015 Proposal. Although this is long-held guidance, there were a number of comments on this provision. Many commenters asked whether the Department could clarify whether parties may limit the scope and timeframe for a fiduciary relationship, including when the fiduciary relationship is terminated. Many commenters asked the Department to clarify the point in time during a transaction when investment advice takes place, such that the fiduciary standard is triggered. Some commenters argued that the parties to the advice arrangement should be able to define fiduciary relationships for themselves, including whether a fiduciary role is intended. Others suggested that there should be a time period during which an investor could reasonably rely upon the advice provided. Other commenters requested clarification as to whether there is an ongoing duty to monitor the advice once it was provided. Other commenters requested clarification on the interaction of the proposal with existing DOL guidance on fiduciary responsibility such as advisory opinions on fee neutrality or the use of independently designed computer models [38] and existing statutory exemptions and regulations thereunder.

The final rule defines the circumstances when a person is providing fiduciary investment advice. Paragraph (d) merely confirms longstanding guidance that, except for co-fiduciary liability under section 405(a) of the Act, being an investment advice fiduciary for certain assets of a plan or IRA does not make that person a fiduciary for all of the assets of the plan or IRA. In response to comments regarding the use of an agreement to define the fiduciary relationship, the Department notes that parties cannot by contract or disclaimer alter the application of the final rule as to whether fiduciary investment advice has occurred in the first instance or will occur during the course of a relationship. In keeping with past guidance, whether someone is a fiduciary for a particular activity is a functional test based on facts and circumstances. The final rule amends the factors to be considered under a functional test for the provision of fiduciary investment advice, but it does not alter the ''facts and circumstances'' nature of the test.

The Department notes that some questions involving temporal issues, such as when an advice recommendation becomes stale if not immediately acted upon, are addressed in the section below discussing the definition of advice for a fee or other compensation, direct or indirect. With respect to commenters' questions about the ongoing duty to monitor advice recommendations, the Department notes that, if the recommendations relate to the advisability of acquiring or exchanging securities or other investment property in a particular transaction, the final rule does not impose on the person an automatic fiduciary obligation to continue to monitor the investment or the advice recipient's activities to ensure the recommendations remain prudent and appropriate for the plan or IRA.[39] Instead, the obligation to monitor the investment on an ongoing basis would be a function of the reasonable expectations, understandings, arrangements, or agreements of the parties.[40]

As has been made clear by the Department, there are a number of ways to provide investment advice without engaging in transactions prohibited by ERISA and the Code because of the conflicts of interest they pose. For example, the adviser can structure the fee arrangement to avoid prohibited conflicts of interest as explained in advisory opinions issued by the Department or the adviser can comply with a statutory exemption such as that provided by section 408(b)(14) of the Act. There is nothing in the final rule that alters these advisory opinions. Additionally, the Department notes that many of the issues raised by commenters in this area were seeking guidance on existing advisory opinions or statutory exemptions and were not comments on the 2015 Proposal. The Department does not believe that this Notice is the appropriate vehicle to address such questions or issue new guidance on those advisory opinions or statutory exemptions. Rather, the Department directs those commenters to that the Advisory Opinion process under ERISA Procedure 76–1.

(2) Execution of Securities Transactions

Paragraph (e) of the final rule provides that a broker or dealer

[38] *See* Advisory Opinions 97–15A and 97–16A, May 22, 1997, and 2001–09A, December 9, 2001.

[39] Nor does the Best Interest Contract Exemption, if applicable, impose such an obligation.

[40] The preamble to the Best Interest Contract Exemption explains that ''when determining the extent of the monitoring to be provided, as disclosed in the contract pursuant to Section II(e) of the exemption, Financial Institutions should carefully consider whether certain investments can be prudently recommended to the individual Retirement Investor, in the first place, without a mechanism in place for the ongoing monitoring of the investment. This is particularly a concern with respect to investments that possess unusual complexity and risk, and that are likely to require further guidance to protect the investor's interests. Without an accompanying agreement to monitor certain recommended investments, or at least a recommendation that the Retirement Investor arrange for ongoing monitoring, the Adviser may be unable to satisfy the exemption's Best Interest obligation with respect to such investments. In addition, the Department expects that the added cost of monitoring investments should be considered by the Adviser and Financial Institution in determining whether certain investments are in the Retirement Investors' Best Interest.''

registered under the Securities Exchange Act of 1934 that executes transactions for the purchase of securities on behalf of a plan or IRA will not be a fiduciary with respect to an employee benefit plan or IRA solely because such person executes transactions for the purchase or sale of securities on behalf of such plan in accordance with the terms of paragraph (e). This provision is unchanged from the current 1975 regulation and the 2015 Proposal. There were only a few comments on this provision. One commenter asked that the provision be extended to include trade orders to foreign broker-dealers and that the provision extend to specifically referenced transactions in fixed income securities, options and currency that are not executed on an agency basis.

The Department has decided not to modify paragraph (e). In the proposal, the Department did not propose an exclusion for the activities requested. Further, this provision modifies all of the prongs of section 3(21)(A) of the Act, not merely section 3(21)(A)(ii) which is the subject of this final rule. Further, the Department believes that the exclusion under paragraph (c)(1) should cover, to a significant degree, the requested changes when the transactions are conducted with sophisticated fiduciaries.

(3) Application to Code Section 4975

Certain provisions of Title I of ERISA, 29 U.S.C. 1001–1108, such as those relating to participation, benefit accrual, and prohibited transactions, also appear in the Code. This parallel structure ensures that the relevant provisions apply to ERISA-covered employee benefit plans, whether or not they are subject to the section 4975 provisions in the Code, and to tax-qualified plans, including IRAs, regardless of whether they are subject to Title I of ERISA. With regard to prohibited transactions, the ERISA Title I provisions generally authorize recovery of losses from, and imposition of civil penalties on, the responsible plan fiduciaries, while the Code provisions impose excise taxes on persons engaging in the prohibited transactions. The definition of fiduciary is the same in section 4975(e)(3)(B) of the Code as the definition in section 3(21)(A)(ii) of ERISA, 29 U.S.C. 1002(21)(A)(ii). The Department's 1975 regulation defining fiduciary investment advice is virtually identical to the regulation that defines the term "fiduciary" under the Code. 26 CFR 54.4975–9(c) (1975).

To rationalize the administration and interpretation of the parallel provisions in ERISA and the Code, Reorganization Plan No. 4 of 1978 divided the interpretive and rulemaking authority for these provisions between the Secretaries of Labor and of the Treasury, so that, in general, the agency with responsibility for a given provision of Title I of ERISA would also have responsibility for the corresponding provision in the Code. Among the sections transferred to the Department of Labor were the prohibited transaction provisions and the definition of a fiduciary in both Title I of ERISA and in the Code. ERISA's prohibited transaction rules, 29 U.S.C. 1106–1108, apply to ERISA-covered plans, and the Code's corresponding prohibited transaction rules, 26 U.S.C. 4975(c), apply both to ERISA-covered pension plans that are tax-qualified pension plans, as well as other tax-advantaged arrangements, such as IRAs, that are not subject to the fiduciary responsibility and prohibited transaction rules in ERISA.[41]

A provision of the final rule states that the final rule applies to the parallel provision defining investment advice fiduciary under section 4975(e)(3) of the Internal Revenue Code. Thus, notwithstanding 26 CFR 54.4975–9, the effective and applicability dates provided for in this rule apply to the definition of investment advice fiduciary under both Section 4975(e)(3) of the Code and Section 3(21) of ERISA, and the Department's changes to 29 CFR 2510.3–21 supersede 26 CFR 54.4975–9 as of the effective and applicability dates of this final rule. See below for a discussion of public comments on the scope of the Department's regulatory authority.

F. 29 CFR 2510.3–21(g)—Definitions

(1) For a Fee or Other Compensation, Direct or Indirect

Paragraph (a)(1) of the proposal required that in order to be fiduciary advice, the advice must be in exchange for a fee or other compensation, whether direct or indirect. Paragraph (f)(6) of the proposal provided that fee or other compensation, direct or indirect, means any fee or compensation for the advice received by the person (or by an affiliate) from any source and any fee or compensation incident to the transaction in which the investment advice has been rendered or will be rendered. The proposal referenced the term fee or other compensation as including, for example, brokerage fees, mutual fund and insurance sales commissions.

[41] The Secretary of Labor also was transferred authority to grant administrative exemptions from the prohibited transaction provisions of the Code.

Some commenters expressed support for the definition arguing that it captured more of the indirect payments that pervade the current investment advice marketplace. Others criticized the definition as too broad and possibly sweeping in fees with no intrinsic connection to the advice or resulting transaction. Commenters asked that the Department state that a recommendation is not fiduciary advice until a transaction is entered into and fees have been received. Commenters also asked that the Department state that the advice must be acted upon within a reasonable time frame and that such a requirement be included in the rule. Those commenters expressed concern about possible fiduciary liability in such cases if the advice recipient acts on advice only after market conditions or other relevant facts have changed. Some commenters said the phrase "incident to the transaction" was ambiguous, especially in the rollover context where they argued that more than one "transaction" occurs during the rollover process. Other commenters expressed concerns that service providers, such as call center employees who receive a salary but are not compensated by an incremental fee based on actions taken by plan participants or IRA owners, would be considered investment advice fiduciaries if their communications included "investment recommendations" as defined in the rule. Several commenters focused on certain types of fees or compensation, with some asserting that revenue sharing, asset-based fees paid by mutual funds to their investment advisers, and profits banks earn on deposit and savings accounts should be excluded from the definition. Commenters asked whether the use of "in exchange for" was intended to change the Department's prior guidance under section 3(21) of the Act, which provided that any fee or compensation "incident" to the transaction was sufficient to establish fiduciary investment advice. Other questions involved issues of timing, such as whether advice that is provided in the hopes of obtaining business but that does not result in a transaction executed by the adviser or an affiliate should give rise to fiduciary status. According to the commenters, this may occur when the advice recipient walks away without engaging in a recommended transaction, but then follows the advice on his or her own and chooses some other way to execute it.

The Department already addressed many of these issues in the preamble to the 2015 Proposal.[42] For example, the Department said that the term includes (1) any fee or compensation for the advice received by the advice provider (or by an affiliate) from any source and (2) any fee or compensation incident to the transaction in which the investment advice has been rendered or will be rendered. The preamble gave examples that included commissions, fees charged on an ''omnibus'' basis (*e.g.,* compensation paid based on business placed or retained that includes plan or IRA business), and compensation received by affiliates. The preamble specifically noted that the definition included fees paid from a mutual fund to an investment adviser affiliate of the person giving advice. The preamble also expressly addressed call center employees who are paid only a salary and said that the Department did not think a general exception was appropriate for such call center employees if, in the performance of their jobs, they make specific investment recommendations to plan participants and IRA owners. Also, as is evident from the discussion in the preamble to the 2015 Proposal which expressly referenced any fee or compensation ''incident'' to the advice transaction, the Department clearly did not intend the proposal's use of the words ''in exchange for'' to limit our guidance under the 1975 rule on the scope of the term ''fee or other compensation.'' Thus, neither the proposal nor the final rule is intended to narrow the Department's view expressed in Advisory Opinion 83–60A, (Nov. 21, 1983) that a fee or other compensation, direct or indirect, includes all fees or compensation incident to the transaction in which investment advice to the plan has been or will be rendered.

To further emphasize these points, however, the Department has revised the text of the final rule. The final rule does not use the phrase ''in exchange for.'' Rather, consistent with the preamble to the 2015 Proposal, the final rule provides that ''fee or other compensation, direct or indirect'' for purposes of this section and section 3(21)(A)(ii) of the Act, 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 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 final rule also expressly provides that a fee or compensation is paid ''in connection with or as a result of'' advice if the fee or compensation would not have been paid but for the recommended transaction or advisory 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.

With respect to the timing issues presented by some commenters, in the Department's view, if a participant, beneficiary or IRA owner receives investment advice from an adviser, does not open an account with that adviser, but nevertheless acts on the advice through another channel and purchases a recommended investment that pays revenue sharing to the adviser or an affiliate, that revenue sharing would still be treated as paid to the adviser or an affiliate ''in connection with'' the advice for purposes of the final rule. As explained in more detail in the preamble to the Best Interest Contract Exemption, commenters expressed concern that this position could result in a prohibited transaction for which there was no relief because the adviser and financial institution would not be able to satisfy all of the conditions in the exemption. For example, they cited as an example an adviser who was affiliated with the mutual fund recommending an investment in that fund, which the investor followed by executing the transaction through a separate institution unaffiliated with the mutual fund. The Department has addressed this problem in the Best Interest Contract Exemption by providing a method of complying with the exemption in the event that the participant, beneficiary or IRA owner does not open an account with the adviser or otherwise conduct the recommended transaction through the adviser.

(2) Definition of Plan Includes IRAs and Other Non-ERISA Plans

As discussed above, the Department received extensive comments on whether the proposal should apply to other non-ERISA plans covered by Code section 4975, such as Health Savings Accounts (HSAs), Archer Medical Savings Accounts and Coverdell Education Savings Accounts. The Department notes that these accounts are given tax preferences, as are IRAs. Further, some of the accounts, such as HSAs, may have associated investment accounts that can be used as long term savings accounts for retiree health care expenses. HSA funds may be invested in investments approved for IRAs (*e.g.,* bank accounts, annuities, certificates of deposit, stocks, mutual funds, or bonds). The HSA trust or custodial agreement may restrict investments to certain types of permissible investments (*e.g.,* particular investment funds).[43] The Employee Benefit Research Institute (EBRI) estimates that as of December 31, 2014 there were 13.8 million HSAs holding $24.2 billion in assets. Approximately 6 percent of the HSAs had an associated investment account, of which 37 percent ended 2014 with a balance of $10,000 or more.[44] Based on tax preferences, EBRI observes that HSA owners may use the investment-account option as a means to increase savings for retirement, while others may be using it for shorter-term investing.[45] EBRI notes that it has been estimated that about 3 percent of HSA owners invest, and that HSA investments are likely to increase from an estimated $3 billion in 2015 to $40 billion in 2020.[46] These types of accounts also are expressly defined by Code section 4975(e)(1) as plans that are subject to the Code's prohibited transaction rules. Thus, although they generally hold fewer assets and may exist for shorter durations than IRAs, the owners of these accounts and the persons for whom these accounts were established are entitled to receive the same protections from conflicted investment advice as IRA owners. The Department does not agree with the commenters that the owners of these accounts are entitled to less protection than IRA investors. Accordingly, the final rule continues to include these ''plans'' in the scope of the final rule.

G. Scope of Department's Regulatory Authority

The Department received comments arguing that the proposal was inconsistent with the statutory text of ERISA, that the proposal exceeded the Department's regulatory authority under

[42] *See* 80 FR 21928, 21945 (Apr. 20, 2015).

[43] IRS Notice 2004–50, Q&A 65, 2004–33 I.R.B. 196 (8/16/2004).

[44] Paul Fronstin, ''Health Savings Account Balances, Contributions, Distributions, and Other Vital Statistics, 2014: Estimates from the EBRI HSA Database,'' EBRI Issue Brief, no. 416, (Employee Benefit Research Institute, July 2015) at *www.ebri.org/pdf/briefspdf/EBRI_IB_416.July15.HSAs.pdf.*

[45] EBRI Notes, August 2015, Vol. 36, No. 8, (*www.ebri.org/pdf/notespdf/EBRI_Notes_08_Aug15_HSAs-QLACs.pdf*).

[46] *http://www.devenir.com/research/2014-year-end-devenir-hsa-market-research-report/.*

ERISA, and that the Department should publish another proposal before moving to publish a final rule. One commenter argued that the proposed rule would make fiduciaries of broker-dealers whose relationships with customers do not have the hallmarks of a trust relationship. As discussed above, however, ERISA's statutory definition of fiduciary status broadly covers any person that renders investment advice to a plan or IRA for a fee, as broker-dealers frequently do. The final rule honors the broad sweep of the statutory text in a way that the 1975 rule does not.

As courts have recognized, ERISA attaches fiduciary status more broadly than trust law which generally reserves fiduciary status for express trustees. *See, e.g., Mertens* v. *Hewitt Associates,* 508 U.S. 248, 262 (1993) (distinguishing traditional trust law under which only the trustee had fiduciary duties from ERISA which defines "fiduciary" in functional terms); *Smith* v. *Provident Bank,* 170 F.3d 609, 613 (6th Cir. 1999) (definition of fiduciary is "intended to be broader than the common-law definition and does not turn on formal designations or labels"); *Beddall* v. *State Street Bank & Trust Co.,* 137 F.3d 12 (1st Cir. 1998) ("the statute also extends fiduciary liability to functional fiduciaries"); *Acosta* v. *Pacific Enterprises,* 950 F.2d 611, 618 (9th Cir. 1991) (fiduciary status is determined by "actions, not the official designation"); *Sladek* v. *Bell Systems Mgmt. Pension Plan,* 880 F.2d 972, 976 (7th Cir. 1989); *Donovan* v. *Mercer,* 747 F.2d 304, 305 (5th Cir. 1984); *Eaves* v. *Penn,* 587 F.2d 453, 458–59 (10th Cir. 1978).

Thus, the statute broadly provides that a person is a fiduciary under ERISA if the person "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 . . . ." The statute neither requires an express trust, nor limits fiduciary status to an ongoing advisory relationship. A plan may need specialized advice for a single, unusual and complex transaction, and the paid adviser may fully understand the plan's dependence on his or her professional judgment. As the preamble points out, the "regular basis" requirement would mean that the adviser is not a fiduciary with respect to his one-time advice, no matter what the parties' understanding, the significance of the advice to the retirement investor, or the language of the statutory definition, which included no "regular basis" requirement.

Nor is the Department bound by the Investment Advisers Act in defining a person's status as a fiduciary adviser under ERISA and the Code. The Investment Advisers Act specifically excludes from the definition of investment adviser "any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefore." 15 U.S.C. 80b–2(11). Nothing in ERISA, or its legislative history, gives any indication that Congress meant to limit fiduciary investment advisers under Title I of ERISA or the Code to persons who meet the Investment Advisers Act's definition of investment adviser, and commenters have cited no such indication.

Whether a securities broker will be a fiduciary under this regulation depends on the facts and circumstances. If the broker is only executing a purchase or sale at the client's request, then, as both the current rule and the final rule make clear, the broker is not a fiduciary.[47] Additionally, as under the proposal, the broker may also provide general education without becoming a fiduciary. In this way, the final rule is consistent with cases such as *Robinson* v. *Merrill Lynch, Pierce, Fenner & Smith,* 337 F. Supp. 107, 114 (N.D. Ala. 1971) (a broker is not a fiduciary if the broker is merely executing the plaintiff's orders on an open market), and *Lowe* v. *SEC,* 472 U.S. 181 (1985) (publishers of bona fide newspapers, news magazines or business or financial publications of general and regular circulation are not investment advisers under the Investment Advisers Act). It is also consistent with the current regime under which brokers can, and frequently do, act in a fiduciary capacity. *See, e.g., SE.C.* v *Pasternak,* 561 F. Supp. 2d 459, 499–500 (D.N.J. 2008) (following *McAdam* v. *Dean Witter Reynolds, Inc.,* 896 F.2d 750, 767 (3d Cir. 1990)). Accordingly, although the final rule would impose a higher duty of loyalty upon certain brokers when they are compensated in connection with investment actions they recommend, the rule is informed by the breadth of the statutory text and purposes and by those rules currently governing brokers and dealers.

The Department also disagrees with comments that argued that the Dodd-Frank Act somehow prevents the Department from defining the term "fiduciary investment advice." Section 913 of that Act directs the SEC to conduct a study on the standards of care applicable to brokers-dealers and investment advisers, and issue a report containing, among other things:

> an analysis of whether [sic] any identified legal or regulatory gaps, shortcomings, or overlap in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers.

Dodd-Frank Act, sec. 913(d)(1)(B).

Section 913 also authorizes, but does not require, the SEC to issue rules addressing standards of care for broker-dealers and investment advisers for providing personalized investment advice about securities to retail customers. 15 U.S.C. 80b–11(g)(1). Nothing in the Dodd-Frank Act indicates that Congress meant to preclude the Department's regulation of fiduciary investment advice under ERISA or its application of such a regulation to securities brokers or dealers. To the contrary, Dodd-Frank Act specifically directed the SEC to study the effectiveness of existing legal or regulatory standards of care under other federal and state authorities. Dodd-Frank Act, sec. 913(b)(1) and (c)(1). The SEC has also consistently recognized ERISA as an applicable authority in this area, noting "that advisers entering into performance fee arrangements with employee benefit plans covered by the Employee Retirement Income Security Act of 1974 ("ERISA") are subject to the fiduciary responsibility and prohibited transaction provisions of ERISA." SE.C. Investment Advisers Act Release No. 1732, (July 17, 1998), 63 FR 39022, 39024 (July 21, 1998).

Other comments have stated that that the Department should publish yet another proposal before moving to publish a final rule. The Department disagrees. As noted elsewhere, the 2015 Proposal benefitted from comments received on a proposal issued in 2010. The changes in this final rule reflect the Department's careful consideration of the extensive comments received on both the 2010 Proposal and the second 2015 Proposal. Moreover, the Department believes that such changes are consistent with reasonable expectations of the affected parties and, together with the prohibited transaction exemptions being finalized with this rule, strike an appropriate balance in addressing the need to modernize the fiduciary rule with the various

[47] Subsection (d) of the 1975 regulation, which is preserved in paragraph (e) of the final rule, continues to provide that a broker dealer is not a fiduciary solely by reason of executing specific orders. 29 CFR 2510.3–21(d).

stakeholder interests. As a result a third proposal and comment period is not necessary.

To the extent compliance and interpretive issues arise after publication of the final rule, the Department fully intends to provide advisers, plan sponsors and fiduciaries, and other affected parties with extensive compliance assistance and education, including guidance specifically tailored to small businesses as required under the Small Business Regulatory Enforcement Fairness Act, Pub. Law 104–121 section 212. The Department routinely provides such assistance following its issuance of highly technical or significant guidance. For example, the Department's compliance assistance Web page, at *www.dol.gov/ebsa/compliance_assistance.html,* provides a variety of tools, including compliance guides, tips, and fact sheets, to assist parties in satisfying their ERISA obligations. Recently, the Department added broad support for regulated parties on the Affordable Care Act regulations, at *www.dol.gov/ebsa/healthreform/.* The Department also will provide informal assistance to affected parties who wish to contact the Department with questions or concerns about the final rule. See ''For Further Information Contact,'' at the beginning of this Notice.

Some commenters argued that the Department does not have the power to regulate IRAs, and the broker-dealers who offer them. The Department disagrees. The Reorganization Plan No. 4 of 1978 specifically gives the Department the authority to define ''fiduciary'' under both ERISA and the Code.[48] Section 102(a) of the Reorganization Plan gives the Department ''all authority'' for ''regulations, rulings, opinions, and exemptions under section 4975 [of the Code]'' subject to certain exemptions not relevant here.[49] This includes the definition of ''fiduciary'' at Code section 4975(e)(3) which parallels ERISA section 3(21). In President Carter's message to Congress regarding the Reorganization Plan, he made explicitly clear that as a result of the plan, ''Labor will have statutory authority for fiduciary obligations. . . . Labor will be responsible for overseeing fiduciary conduct under these provisions.'' [50]

Some commenters argued that because Congress has amended ERISA without changing the definition of ''fiduciary,'' Congress has implicitly endorsed the five-part test. The Department disagrees. ERISA is an extensive, complex statute that Congress has amended many times since its original enactment in 1974. It does not make sense to say that whenever Congress amended any part of ERISA, it was indicating its approval of all the Secretary's regulations and interpretations. On none of these occasions did Congress amend any part of the fiduciary definition in section 3(21) of ERISA.[51] Courts have upheld agency changes to long-standing regulations as long as ''the new policy is permissible under the statute, . . . there are good reasons for it, and . . . the agency believes it to be better.'' [52] Given the evolving retirement savings market—which Congress could not have imagined when it enacted ERISA and which created a significant regulatory gap that runs counter to the congressional purposes underlying ERISA—the Department has concluded that there are good reasons for this change, and that the amended definition is better.

H. Administrative Prohibited Transaction Exemptions

In addition to the final rule in this Notice, the Department is also finalizing elsewhere in this edition of the **Federal Register**, certain administrative class exemptions from the prohibited transaction provisions of ERISA (29 U.S.C. 1106), and the Code (26 U.S.C. 4975(c)(1)) as well as proposed amendments to previously adopted exemptions. The exemptions and amendments would allow, subject to appropriate safeguards, certain broker-dealers, insurance agents and others that act as investment advice fiduciaries to nevertheless continue to receive a variety of forms of compensation that would otherwise violate prohibited transaction rules and trigger excise taxes. The exemptions would supplement statutory exemptions at 29 U.S.C. 1108 and 26 U.S.C. 4975(d), and previously adopted class exemptions.

Investment advice fiduciaries to plans and plan participants must meet ERISA's standards of prudence and loyalty to their plan customers. Such fiduciaries also face excise taxes, remedies, and other sanctions for engaging in certain transactions, such as self-dealing with plan assets or receiving payments from third parties in connection with plan transactions, unless the transactions are permitted by an exemption from ERISA's and the Code's prohibited transaction rules. IRA fiduciaries do not have the same general fiduciary obligations of prudence and loyalty under the statute, but they too must adhere to the prohibited transaction rules or they must pay an excise tax. The prohibited transaction rules help ensure that investment advice provided to plan participants and IRA owners is not driven by the adviser's financial self-interest.

The new exemptions adopted today are the Best Interest Contract Exemption and the Class Exemption for Principal Transactions in Certain Assets between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (the Principal Transactions Exemption). The Best Interest Contract Exemption is specifically designed to address the conflicts of interest associated with the wide variety of payments advisers receive in connection with retail transactions involving plans and IRAs. The Principal Transactions Exemption permits investment advice fiduciaries to sell or purchase certain debt securities and other investments out of their own inventories to or from plans and IRAs. These exemptions require, among other things, that investment advice fiduciaries adhere to certain Impartial Conduct Standards, which are fundamental obligations of fair dealing and fiduciary conduct, and include obligations to act in the customer's best interest, avoid misleading statements, and receive no more than reasonable compensation.

At the same time that the Department has granted these new exemptions, it has also amended existing exemptions to ensure uniform application of the Impartial Conduct Standards.[53] Taken together, the new exemptions and amendments to existing exemptions ensure that plan and IRA investors are consistently protected by Impartial Conduct Standards, regardless of the particular exemption upon which the adviser relies.

The amendments also revoke certain existing exemptions, which provided little or no protections to IRA and non-plan participants, in favor of more uniform application of the Best Interest Contract Exemption in the market for

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[48] Reorganization Plan No. 4 of 1978 (5 U.S.C. App. (2000)).

[49] Id. at section 102.

[50] Reorganization Plan, Message of the President.

[51] *See, e.g., Public Citizen* v. *Dep't of Health and Human Servs.,* 332 F.3d 654, 668 (2003) (the ratification doctrine has limited application when Congress has not re-enacted the entire statute at issue or significantly amended the relevant provision).

[52] *FCC* v. *Fox Television Stations, Inc.,* 556 U.S. 502, 515 (2009) ; *see also Home Care Ass'n of America* v. *Weil,* 799 F.3d 1084 (D.C. Cir. 2015), petition for cert. filed Nov. 24, 2015 (15–683); *National Ass'n of Home Builders* v. *EPA,* 682 F.3d 1032, 1036–39 (D.C. Cir. 2012)

[53] The amended exemptions, published elsewhere in this **Federal Register**, include Prohibited Transaction Exemption (PTE) 75–1, Parts II–V; PTE 77–4; PTE 80–83; PTE 83–1: PTE 84–24; and PTE 86–128.

retail investments.[54] With limited exceptions, it is the Department's intent that advice fiduciaries in the retail investment market rely on statutory exemptions or the Best Interest Contract Exemption to the extent that they receive conflicted forms of compensation that would otherwise be prohibited. The new and amended exemptions reflect the Department's view that retirement investors should be protected by a more consistent application of fundamental fiduciary standards across a wide range of investment products and advice relationships, and that retail investors, in particular, should be protected by the stringent protections set forth in the Best Interest Contract Exemption. When fiduciaries have conflicts of interest, they will uniformly be expected to adhere to fiduciary norms and to make recommendations that are in their customer's best interests.

Several commenters asked whether a fiduciary investment adviser would need to utilize the Best Interest Contract Exemption or other prohibited transaction exemptions if the only compensation the adviser receives is a fixed percentage of the value of assets under management. Whether a particular relationship or compensation structure would result in an adviser having an interest that may affect the exercise of its best judgment as a fiduciary when providing a recommendation, in violation of the self-dealing provisions of prohibited transaction rules under section 406(b) of ERISA, depends on the surrounding facts and circumstances. The Department believes that, by itself, the ongoing receipt of compensation calculated as a fixed percentage of the value of a customer's assets under management, where such values are determined by readily available independent sources or independent valuations, typically would not raise prohibited transaction concerns for the adviser. Under these circumstances, the amount of compensation received depends solely on the value of the investments in a client account, and ordinarily the interests of the adviser in making prudent investment recommendations, which could have an effect on compensation received, are consistent with the investor's interests in growing and protecting account investments.

However, the Department notes that a recommendation to a plan participant to take a full or partial distribution from a plan to invest in recommended assets that will generate a fee for the adviser that he would not otherwise receive implicates the prohibited transaction rules, even if the fee going forward is based on a fixed percent of assets under management. In that circumstance, the adviser should use the Best Interest Contract Exemption or other applicable prohibited transaction exemption. Prohibited transaction rules would similarly be implicated by a recommendation to switch from a commission-based account to an account that charges a fixed percent of assets under management. Further, the Department notes that other remunerations (*e.g.,* commissions or revenue sharing), beyond the fixed assets under management fee, received by the adviser or affiliates as a result of investments made pursuant to recommendations or instances of the self-valuation of the assets upon which the fixed management fee was based would potentially raise prohibited transaction issues and therefore require use of the Best Interest Contract Exemption or other prohibited transaction exemptions.[55]

I. Effective Date; Applicability Date

The proposal stated that the final rule and amended and new prohibited transaction exemptions would be effective 60 days after publication in the **Federal Register** and the requirements of the final rule and exemptions would generally become applicable eight months after publication of a final rule and related administrative exemptions.

Commenters asked the Department to provide sufficient time for orderly and efficient adjustments to, for example, recordkeeping systems; internal compliance, monitoring, education, and training programs; affected service provider contracts; compensation arrangements; and other business practices as necessary to make the transition to the new expanded definition of investment advice fiduciary. The commenters also asked that the Department make it clear that the final rule does not apply in connection with advice provided before the effective date of the final rule. Many commenters expressed concern with the provision in the proposal that the final rule and class exemptions would be effective 60 days after their publication in the **Federal Register**, and said the proposed eight month applicability date was wholly inadequate due to the time and budget requirements necessary to make required changes. Some commenters suggested that the effective and applicability dates should be extended to as much as 18 to 36 months (and some suggested even longer, *e.g.,* five years) following publication of the final rule to allow service providers sufficient time to make changes necessary to comply with the new rule and exemptions. Many other commenters asked that the Department provide a grandfather or similar rule for existing contracts or arrangements or a temporary exemption permitting all currently permissible transactions to continue for a certain period of time. As part of these concerns, a few commenters highlighted possible challenges with enforcement, asking that the Department state that good faith and reasonably diligent efforts to comply with the rule and related exemptions would be sufficient for compliance, and one commenter requested a stay on enforcement of the rule for 36 months. Other commenters who supported the rule thought that the effective and applicability dates in the proposal were reasonable and asked that the final rule go into effect promptly in order to reduce ongoing harms to savers.

After careful consideration of the public comments, the Department has determined that it is important for the final rule to become effective on the earliest possible date. The Congressional Review Act provides that significant final rules can be effective 60 days after

[54] The revoked exemptions include PTE 75–1, Parts I(b) and (c); PTE 75–1, Part II(2); and parts of PTE 84–2 and PTE 86–128.

[55] Although compensation based on a fixed percentage of the value of assets under management generally does not require a prohibited transaction exemption, certain practices raise violations that would not be eligible for the relief granted in the Best Interest Contract Exemption. In its "Report on Conflicts of Interest" (Oct. 2013), p. 29, FINRA suggests a number of circumstances in which advisers may recommend inappropriate commission- or fee-based accounts as means of promoting the adviser's compensation at the expense of the customer (*e.g.,* recommending a fee-based account to an investor with low trading activity and no need for ongoing monitoring or advice; or first recommending a mutual fund with a front-end sales load, and shortly thereafter, recommending that the customer move the shares into an advisory account subject to asset-based fees). Fee selection and reverse churning continue to be an examination priority for the SEC in 2016. *See www.sec.gov/about/offices/ocie/national-examination-program-priorities-2016.pdf.* Such conduct designed to enhance the adviser's compensation at the Retirement Investor's expense would violate the prohibition on self-dealing in ERISA section 406(b)(1) and Code section 4975(c)(1)(E), and fall short of meeting the Impartial Conduct Standards required for reliance on the Best Interest Contract Exemption and other exemptions. The Department also notes that charging commissions or receiving revenue sharing in addition to an asset management fee may present other compliance issues. See, for example, In the Matter of Wunderlich Securities, Inc., available at *www.sec.gov/litigation/admin/2011/34-64558.pdf,* where the SEC found that clients were overcharged in a "wrap fee" investment advisory program because they contracted to pay one bundled or "wrap" fee for advisory, execution, clearing, and custodial services, but were charged commissions and other transactional fees that were contrary to the fees disclosed in the clients' written advisory agreements.

publication in the **Federal Register**. The final rule, accordingly, is effective June 7, 2016. Making the rule effective at the earliest possible date will provide certainty to plans, plan fiduciaries, plan participants and beneficiaries, IRAs, and IRA owners that the new protections afforded by the final rule are now officially part of the law and regulations governing their investment advice providers. Similarly, the financial services providers and other affected service providers will also have certainty that the rule is final and not subject to further amendment or modification without additional public notice and comment. The Department expects that this effective date will remove uncertainty as an obstacle to regulated firms allocating capital and other resources toward transition and longer term compliance adjustments to systems and business practices.

The Department has also determined that, in light of the importance of the final rule's consumer protections and the significance of the continuing monetary harm to retirement investors without the rule's changes, that an applicability date of one year after publication of the final rule in the **Federal Register** is adequate time for plans and their affected financial services and other service providers to adjust to the basic change from non-fiduciary to fiduciary status. The Department read the public comments as more generally requesting transition relief in connection with the conditions in the new and amended prohibited transaction exemptions. The Department agrees that is the appropriate place for transition provisions. Those transition provisions are explained in the final prohibited transaction exemptions being published with this final rule. Further, as noted above, consistent with EBSA's longstanding commitment to providing compliance assistance to employers, plan sponsors, plan fiduciaries, other employee benefit plan officials and service providers in understanding and complying with the requirements of ERISA, the Department intends to provide affected parties with significant assistance and support during the transition period and thereafter with the aim of helping to ensure the important consumer protections and other benefits of the final rule and final exemptions are implemented in an efficient and effective manner.

J. Regulatory Impact Analysis; Executive Order 12866

This action is a significant regulatory action and was therefore submitted to the Office of Management and Budget (OMB) for review. The Department prepared an analysis of the potential costs and benefits associated with this action. This analysis is contained in the document, *Fiduciary Investment Advice Final Rule* (2016). A copy of the analysis is available in the rulemaking docket (EBSA–2010–0050) on *www.regulations.gov* and on EBSA's Web site at *www.dol.gov/ebsa,* and the analysis is briefly summarized in the Executive Summary section of this preamble, above.

K. Regulatory Flexibility Analysis

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) imposes certain requirements with respect to Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act (5 U.S.C. 551 *et seq.*) and which are likely to have a significant economic impact on a substantial number of small entities. Unless the head of an agency certifies that a final rule is not likely to have a significant economic impact on a substantial number of small entities, section 604 of the RFA requires that the agency present a final regulatory flexibility analysis (FRFA) describing the rule's impact on small entities and explaining how the agency made its decisions with respect to the application of the rule to small entities.

The Secretary has determined that this final rule will have a significant economic impact on a substantial number of small entities. The Secretary has separately published a Regulatory Impact Analysis (RIA) which contains the complete economic analysis for this rulemaking including the Department's FRFA for this rule and the related prohibited transaction exemptions also published this issue of the **Federal Register**. This section of this preamble sets forth a summary of the FRFA. The RIA is available at *www.dol.gov/ebsa.*

As noted in section 6.1 of the RIA, the Department has determined that regulatory action is needed to mitigate conflicts of interest in connection with investment advice to retirement investors. The regulation is intended to improve plan and IRA investing to the benefit of retirement security. In response to the proposed rulemaking, organizations representing small businesses submitted comments expressing particular concern with three issues: The carve-out for investment education, the best interest contract exemption, and the carve-out for persons acting in the capacity of counterparties to plan fiduciaries with financial expertise. Section 2 of the RIA contains an extensive discussion of these concerns and the Department's response.

As discussed in section 6.2 of the RIA, the Small Business Administration (SBA) defines a small business in the Financial Investments and Related Activities Sector as a business with up to $38.5 million in annual receipts. In response to a comment received from the SBA's Office of Advocacy on our Initial Regulatory Flexibility Analysis, the Department contacted the SBA, and received from them a dataset containing data on the number of firms by North American Industry Classification System (NAICS) codes, including the number of firms in given revenue categories. This dataset allows the estimation of the number of firms with a given NAICS code that fall below the $38.5 million threshold and would therefore be considered small entities by the SBA. However, this dataset alone does not provide a sufficient basis for the Department to estimate the number of small entities affected by the rule. Not all firms within a given NAICS code would be affected by this rule, because being an ERISA fiduciary relies on a functional test and is not based on industry status as defined by a NAICS code. Further, not all firms within a given NAICS code work with ERISA-covered plans and IRAs.

Over 90 percent of broker-dealers, registered investment advisers, insurance companies, agents, and consultants are small businesses according to the SBA size standards (132 CFR 121.201). Applying the ratio of entities that meet the SBA size standards to the number of affected entities, based on the methodology described at greater length in the RIA, the Department estimates that the number of small entities affected by this rule is 2,414 BDs, 16,524 registered investment advisers, 395 insurers, and 3,358 other ERISA service providers.

For purposes of the RFA, the Department continues to consider an employee benefit plan with fewer than 100 participants to be a small entity. Further, while some large employers may have small plans, in general small employers maintain most small plans. The definition of small entity considered appropriate for this purpose differs, however, from a definition of small business that is based on size standards promulgated by the SBA. These small pension plans will benefit from the rule, because as a result of the rule, they will receive non-conflicted advice from their fiduciary service providers. The 2013 Form 5500 filings show nearly 595,000 ERISA covered retirement plans with less than 100 participants.

Section 6.5 of the RIA summarizes the projected reporting, recordkeeping, and other compliance costs of the rule, which are discussed in detail in section 5 of the RIA. Among other things, the Department concludes that it is likely that some small service providers may find that the increased costs associated with ERISA fiduciary status outweigh the benefits of continuing to service the ERISA plan market or the IRA market. The Department does not believe that this outcome will be widespread or that it will result in a diminution of the amount or quality of advice available to small or other retirement savers, because other firms are likely to fill the void and provide services the ERISA plan and IRA market. It is also possible that the economic impact of the rule on small entities would not be as significant as it would be for large entities, because anecdotal evidence indicates that small entities do not have as many business arrangements that give rise to conflicts of interest. Therefore, they would not be confronted with the same costs to restructure transactions that would be faced by large entities.

Section 5.3.1 of the RIA includes a discussion of the changes to the proposed rule and exemptions that are intended to reduce the costs affecting both small and large business. These include elimination of data collection and annual disclosure requirements in the Best Interest Contract Exemption, and changes to the implementation of the contract requirement in the exemption. Section 7 of the RIA discusses significant regulatory alternatives considered by the Department and the reasons why they were rejected.

L. Paperwork Reduction Act

In accordance with the requirements of the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506(c)(2)), the Department's amendment to its 1975 rule that defines when a person who provides investment advice to an employee benefit plan or IRA becomes a fiduciary, solicited comments on the information collections included therein. The Department also submitted an information collection request (ICR) to OMB in accordance with 44 U.S.C. 3507(d), contemporaneously with the publication of the proposed regulation, for OMB's review. The Department received two comments from one commenter that specifically addressed the paperwork burden analysis of the information collections. Additionally comments were submitted which contained information relevant to the information collection costs and administrative burdens attendant to the proposal. The Department took into account such public comments in connection with making changes to the final rule, analyzing the economic impact of the proposal, and developing the revised paperwork burden analysis summarized below.

In connection with publication of the Department's amendment to its 1975 rule that defines when a person who provides investment advice to an employee benefit plan or IRA becomes a fiduciary, the Department is submitting an ICR to OMB requesting approval of a new collection of information under OMB Control Number 1210–0155. The Department will notify the public when OMB approves the ICR.

A copy of the ICR may be obtained by contacting the PRA addressee shown below or at *http://www.RegInfo.gov.* PRA ADDRESSEE: G. Christopher Cosby, Office of Policy and Research, U.S. Department of Labor, Employee Benefits Security Administration, 200 Constitution Avenue NW., Room N–5718, Washington, DC 20210. Telephone: (202) 693–8410; Fax: (202) 219–4745. These are not toll-free numbers.

As discussed in detail above, paragraph (b)(2)(i) of the final rule provides that a person is not an investment advice fiduciary by reason of certain communications with plan fiduciaries of participant-directed individual account employee benefit plans described in section 3(3) of ERISA regarding platforms of investment vehicles from which plan participants or beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. A condition of paragraph (b)(2)(i) is that the person discloses in writing to the plan fiduciary that the person is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity.

Paragraph (b)(2)(iv)(C) and (D) of the regulation make clear that furnishing and providing certain specified investment educational information and materials (including certain investment allocation models and interactive plan materials) to a plan, plan fiduciary, participant, beneficiary, or IRA owner would not constitute the rendering of investment advice within the meaning of the final rule if certain conditions are met. The investment education provision includes conditions that require asset allocation models or interactive materials to include certain explanations and that they be accompanied by a statement with certain specified information.

Paragraph (c)(1) of the final rule provides that a person shall not be deemed to be an investment advice fiduciary within the meaning of the final rule by reason of advice to certain independent fiduciaries of a plan or IRA in connection with an arm's length sale, purchase, loan, exchange, or other transaction involving the investment of securities or other property if, before entering into the transaction, the independent fiduciary represents to the person that the fiduciary is exercising independent judgment in evaluating any recommendation, and the person fairly informs the independent plan fiduciary that the person is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity and fairly informs the independent plan fiduciary of the existence and nature of the person's financial interests in the transaction.

Paragraph (c)(2) of the final rule provides that, in the case of certain swap transactions required to be cleared under provisions of the Dodd-Frank Act, certain counterparties, clearing members and clearing organizations are not deemed to be investment advice fiduciaries within the meaning of the final rule. A condition in the provision is that the plan fiduciary involved in the swap transaction, before entering into the transaction, represents that the fiduciary understands that the counterparty, clearing member or clearing organization are not undertaking to provide impartial investment advice and that the plan fiduciary is exercising independent judgment in evaluating any recommendations.

The disclosures needed to satisfy the platform provider, investment education, independent plan fiduciary, and swap transaction provisions of the final rule are information collection requests (ICRs) subject to the Paperwork Reduction Act. The Department has made the following assumptions in order to establish a reasonable estimate of the paperwork burden associated with these ICRs:

• Approximately 2,000 service providers will produce the platform provider disclosures; [56]

[56] One commenter requested additional transparency regarding the source of this estimate. According to 2013 Form 5500 Schedule C filings, approximately 2,000 service providers provided recordkeeping services to plans. The Department believes that considerable overlap exists between the recordkeeping market and the platform provider market and between the large plan service provider market and the small plan service provider market. Therefore, the Department has chosen to use recordkeepers reported on the Schedule C as a proxy for platform providers due to data availability constraints.

• Approximately 23,500 financial institutions and service providers will add the investment education disclosure to their investment education materials;[57]

• Approximately 36,000 independent plan fiduciaries with financial expertise would receive the independent plan fiduciary with financial expertise disclosure;[58]

• Service providers producing the platform provider disclosure already maintain contracts with their customers as a regular and customary business practice and the materials costs arising from inserting the platform provider disclosure into the existing contracts would be negligible;

• Materials costs arising from inserting the required investment education disclosure into existing models and interactive materials would be negligible;

• In transactions with independent plan fiduciaries covered by the provision in the final rule, the independent fiduciary would receive substantially all of the disclosures electronically via means already used in their normal course of business and the costs arising from electronic distribution would be negligible;

• Persons relying on these provisions in the final rule would use existing in-house resources to prepare the disclosures; and

• The tasks associated with the ICRs would be performed by clerical personnel at an hourly rate of $55.21 and legal professionals at an hourly rate of $133.61.[59]

In response to a recommendation made during testimony at the Department's August 2015 public hearing on the proposed rule, the Department tasked several attorneys with drafting sample legal documents in an attempt to determine the hour burden associated with complying with the ICRs. Commenters did not provide time or cost estimates needed to draft these disclosures; the legal burden estimates in this analysis, therefore, use the data generated by the Department to estimate the time required to create sample disclosures.

The Department estimates that it would require ten minutes of legal professional time to draft the disclosure needed under the platform provider provision; a statement that the person is not providing impartial investment advice or acting in a fiduciary capacity. Therefore, the platform provider disclosure would result in approximately 300 hours of legal time at an equivalent cost of approximately $45,000.

The Department estimates that it would require one hour of legal professional time to draft the disclosure needed under the investment education provision. Therefore, this disclosure would result in approximately 23,500 hours of legal time at an equivalent cost of approximately $3.1 million.

The Department estimates that it would require 25 minutes of legal professional time and 30 minutes of clerical time to produce the disclosure needed under the provision regarding transactions with independent plan fiduciaries. Therefore, the Department estimates that this disclosure would result in approximately 15,000 hours of legal time at an equivalent cost of approximately $2.0 million. It would also result in approximately 18,000 hours of clerical time at an equivalent cost of approximately $994,000. In total, the burden associated with producing the disclosure is approximately 33,000 hours at an equivalent cost of $3.0 million.

Plan fiduciaries covered by the swap transactions provision must already make the required representation to the counterparty under the Dodd-Frank Act provisions governing cleared swap transactions. This rule adds a requirement that the representation be made to the clearing member and financial institution involved in the transaction. The Department believes that the incremental burden of this additional requirement would be de minimis. Plan fiduciaries would be required to add a few words to the representations required under the Dodd-Frank Act provisions reflecting the additional recipients of the representation. Due to the sophisticated nature of the entities engaging in swap transactions, the Department believes that all of these representations are transmitted electronically; therefore, the incremental burden of transmitting this representation to two additional parties is de minimis. Further, keeping records that the representation had been received is a usual and customary business practice. Accordingly, the

[57] One commenter questioned the basis for the Department's assumption regarding the number of financial institutions likely to provide investment education disclosures. According to the "2015 Investment Management Compliance Testing Survey", Investment Adviser Association, cited in the regulatory impact analysis for the accompanying rule, 63 percent of Registered Investment Advisers service ERISA-covered plans and IRAs. The Department conservatively interprets this to mean that all of the 113 large Registered Investment Advisers, 63 percent of the 3,021 medium Registered Investment Advisers (1,903), and 63 percent of the 24,475 small Registered Investment Advisers (RIAs) (15,419) work with ERISA-covered plans and IRAs. The Department assumes that all of the 42 large broker-dealers, and similar shares of the 233 medium broker-dealers (147) and the 3,682 small broker-dealers (2,320) work with ERISA-covered plans and IRAs. According to SEC and FINRA data, cited in the regulatory impact analysis, 18 percent of broker-dealers are also registered as RIAs. Removing these firms from the RIA counts produces counts of 105 large RIAs, 1,877 medium RIAs, and 15,001 small RIAs that work with ERISA-covered plans and IRAs and are not also registered as broker-dealers. SNL Financial data show that 398 life insurance companies reported receiving either individual or group annuity considerations in 2014. The Department has used these data as the count of insurance companies working in the ERISA-covered plan and IRA markets. Finally, 2013 Form 5500 data show 3,375 service providers to ERISA-covered plans that are not also broker-dealers, Registered Investment Advisers, or insurance companies. Therefore, the Department estimates that approximately 23,265 broker-dealers, RIAs, insurance companies, and service providers work with ERISA-covered plans and IRAs. The Department has rounded up to 23,500 to account for any other financial institutions that may provide covered investment education.

[58] According to the "2015 Investment Management Compliance Testing Survey," Investment Adviser Association, cited in the regulatory impact analysis for the accompanying rule, 63 percent of Registered Investment Advisers (RIAs) service ERISA-covered plans and IRAs. The Department conservatively interprets this to mean that all of the 113 large RIAs, 63 percent of the 3,021 medium RIAs (1,903), and 63 percent of the 24,475 small RIAs (15,419) work with ERISA-covered plans and IRAs. The Department assumes that all of the 42 large broker-dealers, and similar shares of the 233 medium broker-dealers (147) and the 3,682 small broker-dealers (2,320) work with ERISA-covered plans and IRAs. According to SEC and FINRA data, cited in the regulatory impact analysis, 18 percent of broker-dealers are also registered as RIAs. Removing these firms from the RIA counts produces counts of 105 large RIAs, 1,877 medium RIAs, and 15,001 small RIAs that work with ERISA-covered plans and IRAs and are not also registered as broker-dealers. SNL Financial data show that 398 life insurance companies reported receiving either individual or group annuity considerations in 2014. The Department has used these data as the count of insurance companies working in the ERISA-covered plan and IRA markets. Finally, 2013 Form 5500 data show 3,375 service providers to ERISA-covered plans that are not also broker-dealers, Registered Investment Advisers, or insurance companies. Therefore, the Department estimates that approximately 23,265 broker-dealers, RIAs, insurance companies, and service providers work with ERISA-covered plans and IRAs. Additionally, the Department is using plans with assets of $50 million or more as a proxy for other persons who managed $50 million or more in plan assets. According to 2013 Form 5500 filings, 12,446 plans had assets of $50 million or more. These categories total 35,711. The Department rounded up to 36,000 to account for other entities that might produce the disclosure.

[59] For a description of the Department's methodology for calculating wage rates, see *www.dol.gov/ebsa/pdf/labor-cost-inputs-used-in-ebsa-opr-ria-and-pra-burden-calculations-march-2016.pdf.* The Department's methodology for calculating the overhead cost input of its wage rates was adjusted from the proposed regulation to the final regulation. In the proposed regulation, the Department based its overhead cost estimates on longstanding internal EBSA calculations for the cost of overhead. In response to a public comment stating that the overhead cost estimates were too low and without any supporting evidence, the Department incorporated published US Census Bureau survey data on overhead costs into its wage rate estimates.

Department has not associated any cost or burden with this ICR.

In total, the hour burden for information collections in this rule is approximately 57,000 hours at an equivalent cost of $6.2 million.

Because the Department assumes that all disclosures would either be distributed electronically or incorporated into existing materials, the Department has not associated any cost burden with these ICRs.

These paperwork burden estimates are summarized as follows:

Type of Review: New collection.

Agency: Employee Benefits Security Administration, Department of Labor.

Title: Conflict of Interest Final Rule, Fiduciary Exception Disclosure Requirements.

OMB Control Number: 1210—0155.

Affected Public: Business or other for profit.

Estimated Number of Respondents: 38,000.

Estimated Number of Annual Responses: 61,500.

Frequency of Response: When engaging in excepted transaction.

Estimated Total Annual Burden Hours: 56,833 hours.

Estimated Total Annual Burden Cost: $0.

M. Congressional Review Act

The final rule is subject to the Congressional Review Act provisions of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801, *et seq.*) and, will be transmitted to Congress and the Comptroller General for review. The final rule is a ''major rule'' as that term is defined in 5 U.S.C. 804, because it is likely to result in an annual effect on the economy of $100 million or more.

N. Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104–4) requires each Federal agency to prepare a written statement assessing the effects of any Federal mandate in a proposed or final agency rule that may result in an expenditure of $100 million or more (adjusted annually for inflation with the base year 1995) in any one year by State, local, and tribal governments, in the aggregate, or by the private sector. Such a mandate is deemed to be a ''significant regulatory action.'' The final rule is expected to have such an impact on the private sector, and the Department hereby provides such an assessment.

The Department is issuing the final rule under ERISA section 3(21)(A)(ii) (29 U.S.C. 1002(21)(a)(ii)).[60] The Department is charged with interpreting the ERISA and Code provisions that attach fiduciary status to anyone who is paid to provide investment advice to plan or IRA investors. The final rule updates and supersedes the 1975 rule[61] that currently interprets these statutory provisions.

The Department assessed the anticipated benefits and costs of the final rule pursuant to Executive Order 12866 in the Regulatory Impact Analysis for the final rule and concluded that its benefits would justify its costs. The Department's complete Regulatory Impact Analysis is available at *www.dol.gov/ebsa.* To summarize, the final rule's material benefits and costs generally would be confined to the private sector, where plans and IRA investors would, in the Department's estimation, reap both social welfare gains and transfers from the financial industry. The Department itself would benefit from increased efficiency in its enforcement activity. The public and overall U.S. economy would benefit from increased compliance with ERISA and the Code and increased confidence in advisers, as well as from more efficient allocation of investment capital. Together these welfare gains and transfers justify the associated costs.

The final rule is not expected to have any material economic impacts on State, local or tribal governments, or on health, safety, or the natural environment. In fact, the North American Securities Administrators Association submitted a comment in support of the Department's 2015 Proposal that did not suggest a material economic impact on state securities regulators. The National Association of Insurance Commissioners also submitted a comment that recognized that oversight of the retirement plans marketplace is a shared regulatory responsibility, and indicated a shared commitment to protect, educate and empower consumers as they make important decisions to provide for their retirement security. They pointed out that it is important that the approaches regulators take within their respective regulatory frameworks are consistent and compatible as much as possible, but did not suggest the rule would require an expenditure of $100 million or more by state insurance regulators. Similarly, comments from the National Conference of Insurance Legislators and the National Association of Governors suggested further dialogue with the NAIC, insurance legislators, and other state officials to ensure the federal and state approaches to consumer protection in this area are consistent and compatible, but did not identify a monetary impact on state or local governments resulting from the rule. As noted elsewhere in this Notice, the Department's obligation and overriding objective in developing regulations implementing ERISA (and the relevant prohibited transaction provisions in the Code) is to achieve the consumer protection objectives of ERISA and the Code. The Department believes the final rule reflects that obligation and objective while also reflecting that care was taken to craft the rule so it does not require state banking, insurance, or securities regulators to take steps that would impose additional costs on them or conflict with applicable state statutory or regulatory requirements. In fact, the Department noted that ERISA section 514 expressly saves state regulation of insurance, banking, and securities from ERISA's express preemption provision and has added a new paragraph (i) to the final rule to acknowledge that the regulation is not intended to change the scope or effect of ERISA section 514, including the savings clause in ERISA section 514(b)(2)(A) for state regulation of insurance, banking, or securities. The Department also, in response to state regulator suggestions, agreed that it would be appropriate for the final rule to include an express provision acknowledging the savings clause in ERISA section 514(b)(2)(A) for state insurance, banking, or securities laws to emphasize the fact that those state regulators all have important roles in the administration and enforcement of standards for retirement plans and products within their jurisdiction.

O. Federalism Statement

Executive Order 13132 (August 4, 1999) outlines fundamental principles of federalism, and requires the adherence to specific criteria by Federal agencies in the process of formulating and implementing policies that have substantial direct effects on the States, the relationship between the national government and States, or on the distribution of power and responsibilities among the various levels of government. As discussed elsewhere in this Notice, the Department does not believe this final rule has federalism implications because it has no substantial direct effect on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the

[60] Under section 102 of the Reorganization Plan No. 4 of 1978, the authority of the Secretary of the Treasury to interpret section 4975 of the Code has been transferred, with exceptions not relevant here, to the Secretary of Labor.

[61] 29 CFR 2510.3–21(c).

various levels of government. Section 514 of ERISA provides, with certain exceptions specifically enumerated, that the provisions of Titles I and IV of ERISA supersede any and all laws of the States as they relate to any employee benefit plan covered under ERISA. As explained elsewhere in this Notice, the Department does not intend this regulation to change the scope or effect of ERISA section 514, including the savings clause in ERISA section 514(b)(2)(A) for state regulation of securities, banking, or insurance laws. The final rule now includes an express provision to that effect in a new paragraph (i). The requirements implemented in the final rule do not alter the fundamental reporting and disclosure requirements of the statute with respect to employee benefit plans, and as such have no implications for the States or the relationship or distribution of power between the national government and the States.

Statutory Authority

This regulation is issued pursuant to the authority in section 505 of ERISA (Pub. L. 93–406, 88 Stat. 894; 29 U.S.C. 1135) and section 102 of Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 237, and under Secretary of Labor's Order No. 1–2011, 77 FR 1088 (Jan. 9, 2012).

List of Subjects in 29 CFR Parts 2509 and 2510

Employee benefit plans, Employee Retirement Income Security Act, Pensions, Plan assets.

For the reasons set forth in the preamble, the Department is amending parts 2509 and 2510 of subchapters A and B of Chapter XXV of Title 29 of the Code of Federal Regulations as follows:

Subchapter A—General

PART 2509—INTERPRETIVE BULLETINS RELATING TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

■ 1. The authority citation for part 2509 continues to read as follows:

Authority: 29 U.S.C. 1135. Secretary of Labor's Order 1–2011, 77 FR 1088 (Jan. 9, 2012). Sections 2509.75–10 and 2509.75–2 issued under 29 U.S.C. 1052, 1053, 1054. Sec. 2509.75–5 also issued under 29 U.S.C. 1002. Sec. 2509.95–1 also issued under sec. 625, Pub. L. 109–280, 120 Stat. 780.

§ 2509.96–1 [Removed]

■ 2. Remove § 2509.96–1.

Subchapter B—Definitions and Coverage under the Employee Retirement Income Security Act of 1974

PART 2510—DEFINITIONS OF TERMS USED IN SUBCHAPTERS C, D, E, F, AND G OF THIS CHAPTER

■ 3. The authority citation for part 2510 is revised to read as follows:

Authority: 29 U.S.C. 1002(2), 1002(21), 1002(37), 1002(38), 1002(40), 1031, and 1135; Secretary of Labor's Order 1–2011, 77 FR 1088; Secs. 2510.3–21, 2510.3–101 and 2510.3–102 also issued under Sec. 102 of Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 237. Section 2510.3–38 also issued under Pub. L. 105–72, Sec. 1(b), 111 Stat. 1457 (1997).

■ 4. Revise § 2510.3–21 to read as follows:

§ 2510.3–21 Definition of "Fiduciary."

(a) *Investment advice.* For purposes of section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 (Act) and section 4975(e)(3)(B) of the Internal Revenue Code (Code), except as provided in paragraph (c) of this section, a person shall be deemed to be rendering investment advice with respect to moneys or other property of a plan or IRA described in paragraph (g)(6) of this section if—

(1) 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, selection of other persons to provide investment advice or investment management services, selection of investment account arrangements (*e.g.,* brokerage versus advisory); 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

(2) With respect to the investment advice described in paragraph (a)(1) of this section, 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 the Act or the Code;

(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.

(b)(1) For purposes of this section, "recommendation" means 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. The determination of whether a "recommendation" has been made is an objective rather than subjective inquiry. In addition, 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 particular advice recipient 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. Furthermore, 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.

(2) The provision of services or the furnishing or making available of information and materials in conformance with paragraphs (b)(2)(i) through (iv) of this section is not a "recommendation" for purposes of this section. Determinations as to whether any activity not described in this paragraph (b)(2) constitutes a recommendation must be made by reference to the criteria set forth in paragraph (b)(1) of this section.

(i) *Platform providers.* Marketing or making available to a plan fiduciary of a plan, without regard to the individualized needs of the plan, its participants, or beneficiaries a platform or similar mechanism from which a plan fiduciary may select or monitor investment alternatives, including qualified default investment alternatives, into which plan participants or beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts, provided the plan fiduciary is independent of the person who markets or makes available the platform or similar mechanism, and the person discloses in writing to the plan fiduciary that the person is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity. A plan participant or beneficiary or relative of either shall not be considered a plan fiduciary for purposes of this paragraph.

(ii) *Selection and monitoring assistance.* In connection with the activities described in paragraph (b)(2)(i) of this section with respect to a plan,

(A) Identifying investment alternatives that meet objective criteria specified by the plan fiduciary (*e.g.,* stated parameters concerning expense ratios, size of fund, type of asset, or credit quality), provided that the person identifying the investment alternatives discloses in writing whether the person has a financial interest in any of the identified investment alternatives, and if so the precise nature of such interest;

(B) In response to a request for information, request for proposal, or similar solicitation by or on behalf of the plan, identifying a limited or sample set of investment alternatives based on only the size of the employer or plan, the current investment alternatives designated under the plan, or both, provided that the response is in writing and discloses whether the person identifying the limited or sample set of investment alternatives has a financial interest in any of the alternatives, and if so the precise nature of such interest; or

(C) Providing objective financial data and comparisons with independent benchmarks to the plan fiduciary.

(iii) *General Communications.* Furnishing or making available to a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner general communications 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, research or news reports prepared for general distribution, general marketing materials, general market data, including data on market performance, market indices, or trading volumes, price quotes, performance reports, or prospectuses.

(iv) *Investment Education.* Furnishing or making available any of the following categories of investment-related information and materials described in paragraphs (b)(2)(iv)(A) through (D) of this section to a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner 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, except as noted in paragraphs (b)(2)(iv)(C)(*4*) and (b)(2)(iv)(D)(*6*) of this section.

(A) *Plan information.* Information and materials that, without reference to the appropriateness of any individual investment alternative or any individual benefit distribution option for the plan or IRA, or a particular plan participant or beneficiary or IRA owner, describe the terms or operation of the plan or IRA, inform a plan fiduciary, plan participant, beneficiary, or IRA owner about the benefits of plan or IRA participation, the benefits of increasing plan or IRA contributions, the impact of preretirement withdrawals on retirement income, retirement income needs, varying forms of distributions, including rollovers, annuitization and other forms of lifetime income payment options (*e.g.,* immediate annuity, deferred annuity, or incremental purchase of deferred annuity), advantages, disadvantages and risks of different forms of distributions, or describe product features, investor rights and obligations, fee and expense information, applicable trading restrictions, investment objectives and philosophies, risk and return characteristics, historical return information, or related prospectuses of investment alternatives available under the plan or IRA.

(B) *General financial, investment, and retirement information.* Information and materials on financial, investment, and retirement matters that do not address specific investment products, specific plan or IRA investment alternatives or distribution options available to the plan or IRA or to plan participants, beneficiaries, and IRA owners, or specific investment alternatives or services offered outside the plan or IRA, and inform the plan fiduciary, plan participant or beneficiary, or IRA owner about:

(*1*) General financial and investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment;

(*2*) Historic differences in rates of return between different asset classes (*e.g.,* equities, bonds, or cash) based on standard market indices;

(*3*) Effects of fees and expenses on rates of return;

(*4*) Effects of inflation;

(*5*) Estimating future retirement income needs;

(*6*) Determining investment time horizons;

(*7*) Assessing risk tolerance;

(*8*) Retirement-related risks (*e.g.,* longevity risks, market/interest rates, inflation, health care and other expenses); and

(*9*) General methods and strategies for managing assets in retirement (*e.g.,* systematic withdrawal payments, annuitization, guaranteed minimum withdrawal benefits), including those offered outside the plan or IRA.

(C) *Asset allocation models.* Information and materials (*e.g.,* pie charts, graphs, or case studies) that provide a plan fiduciary, plan participant or beneficiary, or IRA owner with models of asset allocation portfolios of hypothetical individuals with different time horizons (which may extend beyond an individual's retirement date) and risk profiles, where—

(*1*) Such models are based on generally accepted investment theories that take into account the historic returns of different asset classes (*e.g.,* equities, bonds, or cash) over defined periods of time;

(*2*) All material facts and assumptions on which such models are based (*e.g.,* retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, and rates of return) accompany the models;

(*3*) The asset allocation models are accompanied by a statement indicating that, in applying particular asset allocation models to their individual situations, plan participants, beneficiaries, or IRA owners should consider their other assets, income, and investments (*e.g.,* equity in a home, Social Security benefits, individual retirement plan investments, savings accounts, and interests in other qualified and non-qualified plans) in addition to their interests in the plan or IRA, to the extent those items are not taken into account in the model or estimate; and

(*4*) The models do not include or identify any specific investment product or investment alternative available under the plan or IRA, except that solely with respect to a plan, asset allocation models may identify a specific investment alternative available under the plan if it is a designated investment alternative within the meaning of 29 CFR 2550.404a–5(h)(4) under the plan subject to oversight by a plan fiduciary independent from the person who developed or markets the investment alternative and the model:

(*i*) Identifies all the other designated investment alternatives available under the plan that have similar risk and return characteristics, if any; and

(*ii*) is accompanied by a statement indicating that those other designated investment alternatives have similar risk and return characteristics and identifying where information on those investment alternatives may be obtained, including information described in paragraph (b)(2)(iv)(A) of this section and, if applicable, paragraph (d) of 29 CFR 2550.404a–5.

(D) *Interactive investment materials.* Questionnaires, worksheets, software, and similar materials that provide a plan fiduciary, plan participant or beneficiary, or IRA owner the means to: Estimate future retirement income needs and assess the impact of different asset allocations on retirement income; evaluate distribution options, products, or vehicles by providing information under paragraphs (b)(2)(iv)(A) and (B) of this section; or estimate a retirement income stream that could be generated by an actual or hypothetical account balance, where—

(*1*) Such materials are based on generally accepted investment theories that take into account the historic returns of different asset classes (*e.g.,* equities, bonds, or cash) over defined periods of time;

(*2*) There is an objective correlation between the asset allocations generated by the materials and the information and data supplied by the plan participant, beneficiary or IRA owner;

(*3*) There is an objective correlation between the income stream generated by the materials and the information and data supplied by the plan participant, beneficiary, or IRA owner;

(*4*) All material facts and assumptions (*e.g.,* retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, rates of return and other features, and rates specific to income annuities or systematic withdrawal plans) that may affect a plan participant's, beneficiary's, or IRA owner's assessment of the different asset allocations or different income streams accompany the materials or are specified by the plan participant, beneficiary, or IRA owner;

(*5*) The materials either take into account other assets, income and investments (*e.g.,* equity in a home, Social Security benefits, individual retirement plan investments, savings accounts, and interests in other qualified and non-qualified plans) or are accompanied by a statement indicating that, in applying particular asset allocations to their individual situations, or in assessing the adequacy of an estimated income stream, plan participants, beneficiaries, or IRA owners should consider their other assets, income, and investments in addition to their interests in the plan or IRA; and

(*6*) The materials do not include or identify any specific investment alternative or distribution option available under the plan or IRA, unless such alternative or option is specified by the plan participant, beneficiary, or IRA owner, or it is a designated investment alternative within the meaning of 29 CFR 2550.404a–5(h)(4) under a plan subject to oversight by a plan fiduciary independent from the person who developed or markets the investment alternative and the materials:

(*i*) Identify all the other designated investment alternatives available under the plan that have similar risk and return characteristics, if any; and

(*ii*) Are accompanied by a statement indicating that those other designated investment alternatives have similar risk and return characteristics and identifying where information on those investment alternatives may be obtained; including information described in paragraph (b)(2)(iv)(A) of this section and, if applicable, paragraph (d) of 29 CFR 2550.404a–5;

(c) Except for persons who represent or acknowledge that they are acting as a fiduciary within the meaning of the Act or the Code, a person shall not be deemed to be a fiduciary within the meaning of section 3(21)(A)(ii) of the Act or section 4975(e)(3)(B) of the Code solely because of the activities set forth in paragraphs (c)(1), (2), and (3) of this section.

(1) *Transactions with independent fiduciaries with financial expertise*—The provision of any advice by a person (including the provision of asset allocation models or other financial analysis tools) to a fiduciary of the plan or IRA (including a fiduciary to an investment contract, product, or entity that holds plan assets as determined pursuant to sections 3(42) and 401 of the Act and 29 CFR 2510.3–101) who is independent of the person providing the advice 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 person providing the advice satisfies the requirements of this paragraph (c)(1).

(i) The person knows or reasonably believes that the independent fiduciary of the plan or IRA is:

(A) A bank as defined in section 202 of the Investment Advisers Act of 1940 or similar institution that is regulated and supervised and subject to periodic examination by a State or Federal agency;

(B) 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;

(C) An investment adviser registered under the Investment Advisers Act of 1940 or, if not registered an as investment adviser under the Investment Advisers Act by reason of paragraph (1) of section 203A of such Act, is registered as an investment adviser under the laws of the State (referred to in such paragraph (1)) in which it maintains its principal office and place of business;

(D) A broker-dealer registered under the Securities Exchange Act of 1934; or

(E) Any independent fiduciary that holds, or has under management or control, total assets of at least $50 million (the person may rely on written representations from the plan or independent fiduciary to satisfy this paragraph (c)(1)(i));

(ii) The person 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 (the person may rely on written representations from the plan or independent fiduciary to satisfy this paragraph (c)(1)(ii));

(iii) The person 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;

(iv) The person knows or reasonably believes that the independent fiduciary of the plan or IRA is a fiduciary under ERISA or the Code, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction (the person may rely on written representations from the plan or independent fiduciary to satisfy this paragraph (c)(1)(iv)); and

(v) The person 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.

(2) *Swap and security-based swap transactions.* The provision of any advice to an employee benefit plan (as described in section 3(3) of the Act) by a person who is a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, or a swap clearing firm in connection with a swap or security-based swap, as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a) and section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) if—

(i) The employee benefit plan is represented by a fiduciary under ERISA independent of the person;

(ii) In the case of a swap dealer or security-based swap dealer, the person is not acting as an advisor to the employee benefit plan (within the meaning of section 4s(h) of the Commodity Exchange Act or section 15F(h) of the Securities Exchange Act of 1934) in connection with the transaction;

(iii) The person does not receive a fee or other compensation directly from the plan or plan fiduciary for the provision of investment advice (as opposed to other services) in connection with the transaction; and

(iv) In advance of providing any recommendations with respect to the transaction, or series of transactions, the person obtains a written representation from the independent fiduciary that the independent fiduciary understands 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 that the independent fiduciary is exercising independent judgment in evaluating the recommendation.

(3) *Employees.* (i) In his or her capacity as an employee of the plan sponsor of a plan, as an employee of an affiliate of such plan sponsor, as an employee of an employee benefit plan, as an employee of an employee organization, or as an employee of a plan fiduciary, the person provides advice to a plan fiduciary, or to an employee (other than in his or her capacity as a participant or beneficiary of an employee benefit plan) or independent contractor of such plan sponsor, affiliate, or employee benefit plan, provided the person receives no fee or other compensation, direct or indirect, in connection with the advice beyond the employee's normal compensation for work performed for the employer; or

(ii) In his or her capacity as an employee of the plan sponsor of a plan, or as an employee of an affiliate of such plan sponsor, the person provides advice to another employee of the plan sponsor in his or her capacity as a participant or beneficiary of the plan, provided the person's job responsibilities do not involve the provision of investment advice or investment recommendations, the person is not registered or licensed under federal or state securities or insurance law, the advice he or she provides does not require the person to be registered or licensed under federal or state securities or insurance laws, and the person receives no fee or other compensation, direct or indirect, in connection with the advice beyond the employee's normal compensation for work performed for the employer.

(d) *Scope of fiduciary duty—investment advice.* A person who is a fiduciary with respect to an plan or IRA by reason of rendering investment advice (as defined in paragraph (a) of this section) for a fee or other compensation, direct or indirect, with respect to any securities or other investment property of such plan or IRA, or having any authority or responsibility to do so, shall not be deemed to be a fiduciary regarding any assets of the plan or IRA with respect to which such person does not have any discretionary authority, discretionary control or discretionary responsibility, does not exercise any authority or control, does not render investment advice (as described in paragraph (a)(1) of this section) for a fee or other compensation, and does not have any authority or responsibility to render such investment advice, provided that nothing in this paragraph shall be deemed to:

(1) Exempt such person from the provisions of section 405(a) of the Act concerning liability for fiduciary breaches by other fiduciaries with respect to any assets of the plan; or

(2) Exclude such person from the definition of the term "party in interest" (as set forth in section 3(14)(B) of the Act) or "disqualified person" (as set forth in section 4975(e)(2) of the Code) with respect to any assets of the employee benefit plan or IRA.

(e) *Execution of securities transactions.* (1) A person who is a broker or dealer registered under the Securities Exchange Act of 1934, a reporting dealer who makes primary markets in securities of the United States Government or of an agency of the United States Government and reports daily to the Federal Reserve Bank of New York its positions with respect to such securities and borrowings thereon, or a bank supervised by the United States or a State, shall not be deemed to be a fiduciary, within the meaning of section 3(21)(A) of the Act or section 4975(e)(3)(B) of the Code, with respect to a plan or IRA solely because such person executes transactions for the purchase or sale of securities on behalf of such plan in the ordinary course of its business as a broker, dealer, or bank, pursuant to instructions of a fiduciary with respect to such plan or IRA, if:

(i) Neither the fiduciary nor any affiliate of such fiduciary is such broker, dealer, or bank; and

(ii) The instructions specify:

(A) The security to be purchased or sold;

(B) A price range within which such security is to be purchased or sold, or, if such security is issued by an open-end investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1, *et seq.*), a price which is determined in accordance with Rule 22c1 under the Investment Company Act of 1940 (17 CFR 270.22c1);

(C) A time span during which such security may be purchased or sold (not to exceed five business days); and

(D) The minimum or maximum quantity of such security which may be purchased or sold within such price range, or, in the case of a security issued by an open-end investment company registered under the Investment Company Act of 1940, the minimum or maximum quantity of such security which may be purchased or sold, or the value of such security in dollar amount which may be purchased or sold, at the price referred to in paragraph (e)(1)(ii)(B) of this section.

(2) A person who is a broker-dealer, reporting dealer, or bank which is a fiduciary with respect to a plan or IRA

solely by reason of the possession or exercise of discretionary authority or discretionary control in the management of the plan or IRA, or the management or disposition of plan or IRA assets in connection with the execution of a transaction or transactions for the purchase or sale of securities on behalf of such plan or IRA which fails to comply with the provisions of paragraph (e)(1) of this section, shall not be deemed to be a fiduciary regarding any assets of the plan or IRA with respect to which such broker-dealer, reporting dealer or bank does not have any discretionary authority, discretionary control or discretionary responsibility, does not exercise any authority or control, does not render investment advice (as defined in paragraph (a) of this section) for a fee or other compensation, and does not have any authority or responsibility to render such investment advice, provided that nothing in this paragraph shall be deemed to:

(i) Exempt such broker-dealer, reporting dealer, or bank from the provisions of section 405(a) of the Act concerning liability for fiduciary breaches by other fiduciaries with respect to any assets of the plan; or

(ii) Exclude such broker-dealer, reporting dealer, or bank from the definition of the term ''party in interest'' (as set forth in section 3(14)(B) of the Act) or ''disqualified person'' (as set forth in section 4975(e)(2) of the Code) with respect to any assets of the plan or IRA.

(f) *Internal Revenue Code.* Section 4975(e)(3) of the Code contains provisions parallel to section 3(21)(A) of the Act which define the term ''fiduciary'' for purposes of the prohibited transaction provisions in Code section 4975. Effective December 31, 1978, section 102 of the Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 237 transferred the authority of the Secretary of the Treasury to promulgate regulations of the type published herein to the Secretary of Labor. All references herein to section 3(21)(A) of the Act should be read to include reference to the parallel provisions of section 4975(e)(3) of the Code. Furthermore, the provisions of this section shall apply for purposes of the application of Code section 4975 with respect to any plan, including any IRA, described in Code section 4975(e)(1).

(g) *Definitions.* For purposes of this section—

(1) The term ''affiliate'' means any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with such person; any officer, director, partner, employee, or relative (as defined in paragraph (g)(8) of this section) of such person; and any corporation or partnership of which such person is an officer, director, or partner.

(2) The term ''control,'' for purposes of paragraph (g)(1) of this section, means the power to exercise a controlling influence over the management or policies of a person other than an individual.

(3) The term ''fee or other compensation, direct or indirect'' means, for purposes of this section and section 3(21)(A)(ii) of the Act, 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.

(4) The term ''investment property'' does not include health insurance policies, disability insurance policies, term life insurance policies, and other property to the extent the policies or property do not contain an investment component.

(5) The term ''IRA owner'' means, with respect to an IRA, either the person who is the owner of the IRA or the person for whose benefit the IRA was established.

(6)(i) The term ''plan'' means any employee benefit plan described in section 3(3) of the Act and any plan described in section 4975(e)(1)(A) of the Code, and

(ii) The term ''IRA'' means any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

(7) The term ''plan fiduciary'' means a person described in section (3)(21)(A) of the Act and 4975(e)(3) of the Code. For purposes of this section, a participant or beneficiary of the plan or a relative of either is not a ''plan fiduciary'' with respect to the plan, and the IRA owner or a relative is not a ''plan fiduciary'' with respect to the IRA.

(8) The term ''relative'' means a person described in section 3(15) of the Act and section 4975(e)(6) of the Code or a brother, a sister, or a spouse of a brother or sister.

(9) The term ''plan participant'' or ''participant'' means, for a plan described in section 3(3) of the Act, a person described in section 3(7) of the Act.

(h) *Effective and applicability dates*—(1) *Effective date.* This section is effective on June 7, 2016.

(2) *Applicability date.* Paragraphs (a), (b), (c), (d), (f), and (g) of this section apply April 10, 2017.

(3) Until the applicability date under this paragraph (h), the prior regulation under the Act and the Code (as it appeared in the July 1, 2015 edition of 29 CFR part 2510 and the April 1, 2015 edition of 26 CFR part 54) applies.

(i) *Continued applicability of State law regulating insurance, banking, or securities.* Nothing in this part shall be construed to affect or modify the provisions of section 514 of Title I of the Act, including the savings clause in section 514(b)(2)(A) for state laws that regulate insurance, banking, or securities.

■ 5. Effective June 7, 2016 to April 10, 2017, § 2510.3–21 is further amended by adding paragraph (j) to read as follows:

§ 2510.3–21 Definition of ''Fiduciary.''

* * * * *

(j) *Temporarily applicable provisions.* (1) During the period between June 7, 2016 and April 10, 2017, this paragraph (j) shall apply.

(i) A person shall be deemed to be rendering ''investment advice'' to an employee benefit plan, within the meaning of section 3(21)(A)(ii) of the Act, section 4975(e)(3)(B) of the Code and this paragraph (j), only if:

(A) Such person renders advice to the plan as to the value of securities or other property, or makes recommendation as to the advisability of investing in, purchasing, or selling securities or other property; and

(B) Such person either directly or indirectly (*e.g.,* through or together with any affiliate)—

(*1*) Has discretionary authority or control, whether or not pursuant to agreement, arrangement or understanding, with respect to purchasing or selling securities or other property for the plan; or

(*2*) Renders any advice described in paragraph (j)(1)(i) of this section on a regular basis to the plan 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, that such services will serve as a primary basis for investment decisions with respect to plan assets, and that such person will render individualized investment advice to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.

(2) *Affiliate and control.* (i) For purposes of paragraph (j) of this section, an ''affiliate'' of a person shall include:

(A) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with such person;

(B) Any officer, director, partner, employee or relative (as defined in section 3(15) of the Act) of such person; and

(C) Any corporation or partnership of which such person is an officer, director or partner.

(ii) For purposes of this paragraph (j), the term ''control'' means the power to exercise a controlling influence over the management or policies of a person other than an individual.

(3) *Expiration date.* This paragraph (j) expires on April 10, 2017.

Signed at Washington, DC, this 1st day of April, 2016.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

[FR Doc. 2016–07924 Filed 4–6–16; 11:15 am]

BILLING CODE 4510–29–P

DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

[Application No. D–11712]

ZRIN 1210–ZA25

Best Interest Contract Exemption

AGENCY: Employee Benefits Security Administration (EBSA), U.S. Department of Labor.

ACTION: Adoption of Class Exemption.

SUMMARY: This document contains an exemption from certain prohibited transactions provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (the Code). The provisions at issue generally prohibit fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs) from engaging in self-dealing and receiving compensation from third parties in connection with transactions involving the plans and IRAs. The exemption allows entities such as registered investment advisers, broker-dealers and insurance companies, and their agents and representatives, that are ERISA or Code fiduciaries by reason of the provision of investment advice, to receive compensation that may otherwise give rise to prohibited transactions as a result of their advice to plan participants and beneficiaries, IRA owners and certain plan fiduciaries (including small plan sponsors). The exemption is subject to protective conditions to safeguard the interests of the plans, participants and beneficiaries and IRA owners. The exemption affects participants and beneficiaries of plans, IRA owners and fiduciaries with respect to such plans and IRAs.

DATES: *Issuance date:* This exemption is issued June 7, 2016.

Applicability date: This exemption is applicable to transactions occurring on or after April 10, 2017. See Section K of this preamble, *Applicability Date and Transition Rules,* for further information.

FOR FURTHER INFORMATION CONTACT: Brian Shiker or Susan Wilker, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor, (202) 693–8824 (this is not a toll-free number).

SUPPLEMENTARY INFORMATION:

Executive Summary

Purpose of This Regulatory Action

The Department grants this exemption in connection with its publication, elsewhere in this issue of the **Federal Register**, of a final regulation defining who is a ''fiduciary'' of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries (Regulation). The Regulation also applies to the definition of a ''fiduciary'' of a plan (including an IRA) under the Code. The Regulation amends a prior regulation, dating to 1975, specifying when a person is a ''fiduciary'' under ERISA and the Code by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. The Regulation takes into account the advent of 401(k) 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 existing regulation was issued. In light of the extensive changes in retirement investment practices and relationships, the Regulation updates 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.

This Best Interest Contract Exemption is designed to promote the provision of investment advice that is in the best interest of retail investors such as plan participants and beneficiaries, IRA owners, and certain plan fiduciaries, including small plan sponsors. ERISA and the Code 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 types of fees and compensation common in the retail market, 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. To facilitate continued provision of advice to such retail investors under conditions designed to safeguard the interests of these investors, the exemption allows investment advice fiduciaries, including investment advisers registered under the Investment Advisers Act of 1940 or state law, 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 Code.

Rather than create a set of highly prescriptive transaction-specific exemptions, which has been the Department's usual approach, the exemption flexibly accommodates a wide range of compensation practices, while minimizing the harmful impact of conflicts of interest on the quality of advice. As a condition of receiving compensation that would otherwise be prohibited, individual Advisers and the Financial Institutions that employ or otherwise retain them must adhere to conditions designed to mitigate the harmful impact of conflicts of interest. By taking a standards-based approach, the exemption permits firms to continue to rely on many common compensation

reasonably available at their customary location for examination during normal business hours by:

(A) An authorized employee or representative of the Department of Labor or the Internal Revenue Service,

(B) Any fiduciary of a plan that engaged in a transaction pursuant to this exemption, or any authorized employee or representative of such fiduciary;

(C) Any contributing employer and any employee organization whose members are covered by a plan described in paragraph (e)(1)(B), or any authorized employee or representative of these entities; or

(D) Any participant or beneficiary of a plan described in paragraph (e)(1)(B), IRA owner or the authorized representative of such participant, beneficiary or owner.

(2) None of the persons described in paragraph (e)(1)(B)–(D) of this exemption are authorized to examine records regarding a recommended transaction involving another investor, or privileged trade secrets or privileged commercial or financial information, of the broker-dealer engaging in the covered transaction, or information identifying other individuals.

(3) Should the broker-dealer engaging in the covered transaction refuse to disclose information on the basis that the information is exempt from disclosure, the broker-dealer must, by the close of the thirtieth (30th) day following the request, provide a written notice advising the requestor of the reasons for the refusal and that the Department may request such information.

(4) Failure to maintain the required records necessary to determine whether the conditions of this exemption have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions.

For purposes of this exemption, the terms ''party in interest,'' ''disqualified person'' and ''fiduciary'' shall include such party in interest, disqualified person, or fiduciary, and any affiliates thereof, and the term ''affiliate'' shall be defined in the same manner as that term is defined in 29 CFR 2510.3–21 and 26 CFR 54.4975–9. Also for the purposes of this exemption, the term ''IRA'' means any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

Signed at Washington, DC, this 1st day of April, 2016.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

[FR Doc. 2016–07927 Filed 4–6–16; 11:15 am]

BILLING CODE 4510–29–P

DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

ZRIN 1210–ZA25

[Application Number D–11850]

Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 84–24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters

AGENCY: Employee Benefits Security Administration (EBSA), Department of Labor.

ACTION: Adoption of amendment to and partial revocation of PTE 84–24.

SUMMARY: This document amends and partially revokes Prohibited Transaction Exemption (PTE) 84–24, an exemption from certain prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986 (the Code). The ERISA and Code provisions at issue generally prohibit fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs) from engaging in self-dealing in connection with transactions involving these plans and IRAs. Non-fiduciary service providers also may not enter into certain transactions with plans and IRAs without an exemption. The amended exemption allows fiduciaries and other service providers to receive compensation when plans and IRAs purchase insurance contracts, ''Fixed Rate Annuity Contracts,'' as defined in the exemption, securities of investment companies registered under the Investment Company Act of 1940, as well as certain related transactions. The amendments increase the safeguards of the exemption. This document also contains the revocation of the exemption as it applies to plan and IRA purchases of annuity contracts that do not satisfy the definition of a Fixed Rate Annuity Contract, and the revocation of the exemption as it applies to IRA purchases of investment company securities. The amendments and revocations affect participants and beneficiaries of plans, IRA owners, and certain fiduciaries and service providers of plans and IRAs.

DATES: *Issuance date:* This amendment and partial revocation is issued June 7, 2016.

Applicability date: This amendment and partial revocation is applicable to transactions occurring on or after April 10, 2017. For further information, see *Applicability Date,* below.

FOR FURTHER INFORMATION CONTACT: Brian Shiker or Brian Mica, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor, 200 Constitution Avenue NW., Suite 400, Washington, DC 20210, (202) 693–8824 (not a toll-free number).

SUPPLEMENTARY INFORMATION: The Department is amending PTE 84–24 [1] on its own motion, pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637 (October 27, 2011)).

Executive Summary

Purpose of Regulatory Action

The Department grants this amendment to PTE 84–24 in connection with its publication today, elsewhere in this issue of the **Federal Register**, of a final regulation defining who is a ''fiduciary'' of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries (Regulation). The Regulation also applies to the definition of a ''fiduciary'' of a plan (including an IRA) under the Code. The Regulation amends a prior regulation, dating to 1975, specifying when a person is a ''fiduciary'' under ERISA and the Code by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. The Regulation takes into account the advent of 401(k) 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 existing regulation was issued. In light of the extensive changes in retirement investment practices and relationships, the Regulation updates existing rules to distinguish more appropriately between the sorts of advice relationships that should be

[1] PTE 84–24, 49 FR 13208 (Apr. 3, 1984), as corrected, 49 FR 24819 (June 15, 1984), as amended, 71 FR 5887 (Feb. 3, 2006).

treated as fiduciary in nature and those that should not.

PTE 84–24 is an exemption originally granted in 1977, and amended several times over the years. It historically provided relief for certain parties to receive commissions when plans and IRAs purchased recommended insurance and annuity contracts and investment company securities (*e.g.,* mutual fund shares). In connection with the adoption of the Regulation, PTE 84–24 is amended to increase the safeguards of the exemption and partially revoked in light of alternative exemptive relief finalized today. As amended, the exemption generally permits certain investment advice fiduciaries and other service providers to receive commissions in connection with the purchase of insurance contracts and Fixed Rate Annuity Contracts by plans and IRAs, as well as the purchase of investment company securities by plans. A Fixed Rate Annuity Contract is a fixed annuity contract issued by an insurance company that is either an immediate annuity contract or a deferred annuity contract that (i) satisfies applicable state standard nonforfeiture laws at the time of issue, or (ii) in the case of a group fixed annuity, guarantees return of principal net of reasonable compensation and provides a guaranteed declared minimum interest rate in accordance with the rates specified in the standard nonforfeiture laws in that state that are applicable to individual annuities; in either case, the benefits of which do not vary, in part or in whole, based on the investment experience of a separate account or accounts maintained by the insurer or the investment experience of an index or investment model. A Fixed Rate Annuity Contract does not include a variable annuity or an indexed annuity or similar annuity. Relief for compensation received in connection with purchases of annuity contracts that are not Fixed Rate Annuity Contracts by plans and IRAs, and compensation received in connection with purchases of investment company securities by IRAs, is revoked.

This amendment to and partial revocation of PTE 84–24 is part of the Department's regulatory initiative to mitigate the effects of harmful conflicts of interest associated with fiduciary investment advice. In the absence of an exemption, ERISA and the Code generally prohibit fiduciaries from using their authority to affect or increase their own compensation. A new exemption for receipt of compensation by fiduciaries that provide investment advice to IRAs, plan participants and beneficiaries, and certain plan fiduciaries, is adopted elsewhere in this issue of the **Federal Register**, in the ''Best Interest Contract Exemption.'' That exemption provides relief for a broader range of transactions and compensation practices, including transactions involving annuity contracts that are not Fixed Rate Annuity Contracts, such as variable and indexed annuities. The Best Interest Contract Exemption contains important safeguards which address the conflicts of interest associated with investment recommendations in the more complex financial marketplace that has developed since PTE 84–24 was granted.

ERISA section 408(a) specifically authorizes the Secretary of Labor to grant and amend administrative exemptions from ERISA's prohibited transaction provisions.[2] Regulations at 29 CFR 2570.30 to 2570.52 describe the procedures for applying for an administrative exemption. In amending this exemption, the Department has determined that the amended exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners.

Summary of the Major Provisions

PTE 84–24, as amended, provides an exemption for certain prohibited transactions that occur when investment advice fiduciaries and other service providers receive compensation for their recommendation that plans or IRAs purchase ''Fixed Rate Annuity Contracts'' as defined in the exemption, and insurance contracts. IRAs are defined in the exemption to include other plans described in Code section 4975(e)(1)(B)–(F), such as Archer MSAs, Health Savings Accounts (HSAs), and Coverdell education savings accounts. Relief is also provided for certain prohibited transactions that occur when investment advice fiduciaries and other service providers receive compensation as a result of recommendations that plans purchase investment company securities. The exemption permits insurance agents, insurance brokers, pension consultants and investment company principal underwriters that are parties in interest or fiduciaries with respect to plans or IRAs, as applicable, to effect these purchases and receive a commission on them. The exemption is also available for the prohibited transaction that occurs when an insurance company selling a Fixed Rate Annuity Contract or insurance contract is a party in interest or disqualified person with respect to the plan or IRA.

As amended, the exemption requires fiduciaries engaging in these transactions to adhere to certain ''Impartial Conduct Standards,'' including acting in the best interest of the plans and IRAs when providing advice. The amendment also more specifically defines the types of payments that are permitted under the exemption and revises the disclosure and recordkeeping requirements of the exemption.

Executive Order 12866 and 13563 Statement

Under Executive Orders 12866 and 13563, the Department must determine whether a regulatory action is ''significant'' and therefore subject to the requirements of the Executive Orders and subject to review by the Office of Management and Budget (OMB). Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing and streamlining rules, and of promoting flexibility. It also requires federal agencies to develop a plan under which the agencies will periodically review their existing significant regulations to make the agencies' regulatory programs more effective or less burdensome in achieving their regulatory objectives.

Under Executive Order 12866, ''significant'' regulatory actions are subject to the requirements of the Executive Order and review by the Office of Management and Budget (OMB). Section 3(f) of Executive Order

[2] Code section 4975(c)(2) authorizes the Secretary of the Treasury to grant exemptions from the parallel prohibited transaction provisions of the Code. Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)) (''Reorganization Plan'') generally transferred the authority of the Secretary of the Treasury to grant administrative exemptions under Code section 4975 to the Secretary of Labor. Specifically, section 102(a) of the Reorganization Plan provides the DOL with ''all authority'' for ''regulations, rulings, opinions, and exemptions under section 4975 [of the Code]'' subject to certain exceptions not relevant here. Reorganization Plan section 102. In President Carter's message to Congress regarding the Reorganization Plan, he made explicitly clear that as a result of the plan, ''Labor will have statutory authority for fiduciary obligations. . . . Labor will be responsible for overseeing fiduciary conduct under these provisions.'' Reorganization Plan, Message of the President. This amended exemption provides relief from the indicated prohibited transaction provisions of both ERISA and the Code.

12866, defines a "significant regulatory action" as an action that is likely to result in a rule (1) having an annual effect on the economy of $100 million or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as "economically significant" regulatory actions); (2) creating serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order. Pursuant to the terms of the Executive Order, OMB has determined that this action is "significant" within the meaning of Section 3(f)(4) of the Executive Order. Accordingly, the Department has undertaken an assessment of the costs and benefits of the proposal, and OMB has reviewed this regulatory action. The Department's complete Regulatory Impact Analysis is available at *www.dol.gov/ebsa.*

Background

Regulation Defining a Fiduciary

As explained more fully in the preamble to the Regulation, ERISA is a comprehensive statute designed to protect the interests of plan participants and beneficiaries, the integrity of employee benefit plans, and the security of retirement, health, and other critical benefits. The broad public interest in ERISA-covered plans is reflected in its imposition of fiduciary responsibilities on parties engaging in important plan activities, as well as in the tax-favored status of plan assets and investments. One of the chief ways in which ERISA protects employee benefit plans is by requiring that plan fiduciaries comply with fundamental obligations rooted in the law of trusts. In particular, plan fiduciaries must manage plan assets prudently and with undivided loyalty to the plans and their participants and beneficiaries.[3] In addition, they must refrain from engaging in "prohibited transactions," which ERISA does not permit because of the dangers posed by the fiduciaries' conflicts of interest with respect to the transactions.[4] When fiduciaries violate ERISA's fiduciary duties or the prohibited transaction rules, they may be held personally liable for the breach.[5] In addition, violations of the prohibited transaction rules are subject to excise taxes under the Code.

The Code also has rules regarding fiduciary conduct with respect to tax-favored accounts that are not generally covered by ERISA, such as IRAs. In particular, fiduciaries of these arrangements, including IRAs, are subject to the prohibited transaction rules, and, when they violate the rules, to the imposition of an excise tax enforced by the Internal Revenue Service (IRS). Unlike participants in plans covered by Title I of ERISA, IRA owners do not have a statutory right to bring suit against fiduciaries for violation of the prohibited transaction rules.

Under this statutory framework, the determination of who is a "fiduciary" is of central importance. Many of ERISA's and the Code's protections, duties, and liabilities hinge on fiduciary status. In relevant part, section 3(21)(A) of ERISA and section 4975(e)(3) of the Code provide that a person is a fiduciary with respect to a plan or IRA to the extent he or she (i) exercises any discretionary authority or discretionary control with respect to management of such plan or IRA, or exercises any authority or control with respect to management or disposition of its assets; (ii) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan or IRA, or has any authority or responsibility to do so; or (iii) has any discretionary authority or discretionary responsibility in the administration of such plan or IRA.

The statutory definition deliberately casts a wide net in assigning fiduciary responsibility with respect to plan and IRA assets. Thus, "any authority or control" over plan or IRA assets is sufficient to confer fiduciary status, and any persons who render "investment advice for a fee or other compensation, direct or indirect" are fiduciaries, regardless of whether they have direct control over the plan's or IRA's assets and regardless of their status as an investment adviser or broker under the federal securities laws. The statutory definition and associated responsibilities were enacted to ensure that plans, plan participants, and IRA owners can depend on persons who provide investment advice for a fee to provide recommendations that are untainted by conflicts of interest. In the absence of fiduciary status, persons who provide investment advice are neither subject to ERISA's fundamental fiduciary standards, nor accountable under ERISA or the Code for imprudent, disloyal, or biased advice.

In 1975, the Department issued a regulation, at 29 CFR 2510.3–21(c), defining the circumstances under which a person is treated as providing "investment advice" to an employee benefit plan within the meaning of section ERISA 3(21)(A)(ii) (the "1975 regulation").[6] The 1975 regulation narrowed the scope of the statutory definition of fiduciary investment advice by creating a five-part test for fiduciary advice. Under the 1975 regulation, for advice to constitute "investment advice," an adviser[7] must—(1) render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property (2) on a regular basis (3) pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary that (4) the advice will serve as a primary basis for investment decisions with respect to plan assets, and that (5) the advice will be individualized based on the particular needs of the plan. The regulation provided that an adviser is a fiduciary with respect to any particular instance of advice only if he or she meets each and every element of the five-part test with respect to the particular advice recipient or plan at issue.

The market for retirement advice has changed dramatically since the Department first promulgated the 1975 regulation. Individuals, rather than large employers and professional money managers, have become increasingly responsible for managing retirement assets as IRAs and participant-directed plans, such as 401(k) plans, have supplanted defined benefit pensions. At the same time, the variety and complexity of financial products have increased, widening the information gap between advisers and their clients. Plan fiduciaries, plan participants and IRA investors must often rely on experts for advice, but are unable to assess the quality of the expert's advice or effectively guard against the adviser's

[3] ERISA section 404(a).

[4] ERISA section 406. ERISA also prohibits certain transactions between a plan and a "party in interest."

[5] ERISA section 409; *see also* ERISA section 405.

[6] The Department of the Treasury issued a virtually identical regulation, at 26 CFR 54.4975–9(c), which interprets Code section 4975(e)(3).

[7] When using the term "adviser," the Department does not intend to refer only to investment advisers registered under the Investment Advisers Act of 1940 or under state law, but rather to any person rendering fiduciary investment advice under the Regulation. For example, as used herein, the term adviser can be an individual who is, among other things, a representative of a registered investment adviser, a bank or similar financial institution, an insurance company, or a broker-dealer.

conflicts of interest. This challenge is especially true of retail investors who typically do not have financial expertise and can ill-afford lower returns to their retirement savings caused by conflicts. The IRA accounts of these investors often account for all or the lion's share of their assets, and can represent all of savings earned for a lifetime of work. Losses and reduced returns can be devastating to the investors who depend upon such savings for support in their old age. As baby boomers retire, they are increasingly moving money from ERISA-covered plans, where their employer has both the incentive and the fiduciary duty to facilitate sound investment choices, to IRAs where both good and bad investment choices are myriad and advice that is conflicted is commonplace. These rollovers are expected to approach $2.4 trillion cumulatively from 2016 through 2020.[8] These trends were not apparent when the Department promulgated the 1975 rule. At that time, 401(k) plans did not yet exist and IRAs had only just been authorized.

As the marketplace for financial services has developed in the years since 1975, the five-part test has now come to undermine, rather than promote, the statutes' text and purposes. The narrowness of the 1975 regulation has allowed advisers, brokers, consultants and valuation firms to play a central role in shaping plan and IRA investments, without ensuring the accountability that Congress intended for persons having such influence and responsibility. Even when plan sponsors, participants, beneficiaries, and IRA owners clearly relied on paid advisers for impartial guidance, the 1975 regulation has allowed many advisers to avoid fiduciary status and disregard basic fiduciary obligations of care and prohibitions on disloyal and conflicted transactions. As a consequence, these advisers have been able to steer customers to investments based on their own self-interest (*e.g.,* products that generate higher fees for the adviser even if there are identical lower-fee products available), give imprudent advice, and engage in transactions that would otherwise be prohibited by ERISA and the Code without fear of accountability under either ERISA or the Code.

In the Department's amendments to the regulation defining fiduciary advice within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) (the "Regulation"), which are also published in this issue of the **Federal Register**, the Department is replacing the existing regulation with one that more appropriately distinguishes between the sorts of advice relationships that should be treated as fiduciary in nature and those that should not, in light of the legal framework and financial marketplace in which IRAs and plans currently operate.[9]

The Regulation describes the types of advice that constitute "investment advice" with respect to plan and IRA assets for purposes of the definition of a fiduciary at ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B). The Regulation covers ERISA-covered plans, IRAs, and other plans not covered by Title I of ERISA, such as Keogh plans, and HSAs described in section 223(d) of the Code.

As amended, the Regulation provides that a person renders investment advice with respect to assets of a plan or IRA if, among other things, the person provides, directly to a plan, a plan fiduciary, a plan participant or beneficiary, IRA or IRA owner, one of the following types of advice, for a fee or other compensation, whether 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; and

(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, selection of other persons to provide investment advice or investment management services, types of investment account arrangements (brokerage versus advisory), 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.

In addition, in order to be treated as a fiduciary, such person, either directly or indirectly (*e.g.,* through or together with any affiliate), must: Represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code with respect to the advice described; represent or acknowledge that it is acting as a fiduciary within the meaning of the ERISA or the Code; render 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 direct 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. The Regulation also provides that as a threshold matter in order to be fiduciary advice, the communication must be a "recommendation" as defined therein. The Regulation, as a matter of clarification, provides that a variety of other communications do not constitute "recommendations," including non-fiduciary investment education; general communications; and specified communications by platform providers. These communications which do not rise to the level of "recommendations" under the regulation are discussed more fully in the preamble to the final Regulation.

The Regulation also specifies certain circumstances where the Department has determined that a person will not be treated as an investment advice fiduciary even though the person's activities technically may satisfy the definition of investment advice. For example, the Regulation contains a provision excluding recommendations to independent fiduciaries with financial expertise that are acting on behalf of plans or IRAs in arm's length transactions, if certain conditions are met. The independent fiduciary must be a bank, insurance carrier qualified to do business in more than one state, investment adviser registered under the Investment Advisers Act of 1940 or by a state, broker-dealer registered under the Securities Exchange Act of 1934 (Exchange Act), or any other independent fiduciary that holds, or has under management or control, assets of at least $50 million, and: (1) The person making the recommendation must know or reasonably believe 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 (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition); (2) the person

[8] Cerulli Associates, "Retirement Markets 2015."

[9] The Department initially proposed an amendment to its regulation defining a fiduciary within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) on October 22, 2010, at 75 FR 65263. It subsequently announced its intention to withdraw the proposal and propose a new rule, consistent with the President's Executive Orders 12866 and 13563, in order to give the public a full opportunity to evaluate and comment on the new proposal and updated economic analysis. The first proposed amendment to the rule was withdrawn on April 20, 2015, *see* 80 FR 21927.

must fairly inform 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 must fairly inform the independent fiduciary of the existence and nature of the person's financial interests in the transaction; (3) the person must know or reasonably believe that the independent fiduciary of the plan or IRA is a fiduciary under ERISA or the Code, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition); and (4) the person cannot 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.

Similarly, the Regulation provides that the provision of any advice to an employee benefit plan (as described in ERISA section 3(3)) by a person who is a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, or a swap clearing firm in connection with a swap or security-based swap, as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a) and section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is not investment advice if certain conditions are met. Finally, the Regulation describes certain communications by employees of a plan sponsor, plan, or plan fiduciary that would not cause the employee to be an investment advice fiduciary if certain conditions are met.

Prohibited Transactions

ERISA section 406(a)(1)(A)–(D) and Code section 4975(c)(1)(A)–(D) prohibit certain transactions between plans or IRAs and "parties in interest," as defined in ERISA section 3(14), or "disqualified persons," as defined in Code section 4975(e)(2). Fiduciaries and other service providers are parties in interest and disqualified persons under ERISA and the Code. As a result, they are prohibited from engaging in (1) the sale, exchange or leasing of property with a plan or IRA, (2) the lending of money or other extension of credit to a plan or IRA, (3) the furnishing of goods, services or facilities to a plan or IRA and (4) the transfer to or use by or for the benefit of a party in interest of plan assets.

ERISA section 406(b) and Code section 4975(c)(1)(E) and (F) are aimed at fiduciaries only. These provisions generally prohibit a fiduciary from dealing with the income or assets of a plan or IRA in his or her own interest or his or her own account and from receiving payments from third parties in connection with transactions involving the plan or IRA. Parallel regulations issued by the Departments of Labor and the Treasury explain that these provisions impose on fiduciaries of plans and IRAs a duty not to act on conflicts of interest that may affect the fiduciary's best judgment on behalf of the plan or IRA. Under these provisions, a fiduciary may not cause a plan or IRA to pay an additional fee to such fiduciary, or to a person in which such fiduciary has an interest that may affect the exercise of the fiduciary's best judgment.

The receipt of a commission on the sale of an insurance or annuity contract or investment company securities by a fiduciary that recommended the investment violates the prohibited transaction provisions of ERISA section 406(b) and Code section 4975(c)(1)(E) and (F). In addition, the effecting of the sale by a fiduciary or service provider is a service, potentially in violation of ERISA section 406(a)(1)(C) and Code section 4975(c)(1)(C). Finally, the purchase of an insurance or annuity contract by a plan or IRA from an insurance company that is a fiduciary, service provider or other party in interest or disqualified person, violates ERISA section 406(a)(1)(A) and (D) and Code section 4975(c)(1)(A) and (D).

Prohibited Transaction Exemption 84–24

As the prohibited transaction provisions demonstrate, ERISA and the Code strongly disfavor conflicts of interest. In appropriate cases, however, the statutes provide exemptions from their broad prohibitions on conflicts of interest. In addition, the Secretary of Labor has discretionary authority to grant administrative exemptions under ERISA and the Code on an individual or class basis, but only if the Secretary first finds that the exemptions are (1) administratively feasible, (2) in the interests of plans and their participants and beneficiaries and IRA owners, and (3) protective of the rights of the participants and beneficiaries of such plans and IRA owners. Accordingly, while fiduciary advisers may always give advice without need of an exemption if they avoid the sorts of conflicts of interest that result in prohibited transactions, when they choose to give advice in which they have a financial interest, they must rely upon an exemption.

Pursuant to its exemption authority, the Department has previously granted several conditional administrative class exemptions that are available to fiduciary advisers in defined circumstances. PTE 84–24 historically provided an exemption from the prohibited transaction provisions of ERISA and the Code for insurance agents, insurance brokers, pension consultants, insurance companies and investment company principal underwriters to engage in certain transactions involving insurance and annuity contracts, and investment company securities. Prior to this amendment, PTE 84–24 provided relief to these parties in connection with transactions involving ERISA-covered plans, Keogh plans, as well as IRAs and other plans described in Code section 4975, such as Archer MSAs, HSAs and Coverdell education savings accounts.[10]

Specifically, PTE 84–24 permitted insurance agents, insurance brokers and pension consultants to receive, directly or indirectly, a commission for selling insurance or annuity contracts to plans and IRAs. The exemption also permitted the purchase by plans and IRAs of insurance and annuity contracts from insurance companies that are parties in interest or disqualified persons. The term "insurance and annuity contract" included a variable annuity contract.[11]

With respect to transactions involving investment company securities, PTE 84–24 also permitted the investment company's principal underwriter to receive commissions in connection with a plan's or IRA's purchase of investment company securities. The term "principal underwriter" is defined in the same manner as it is defined in the Investment Company Act of 1940. Section 2(a)(29) of the Investment Company Act of 1940[12] provides that a

> 'Principal underwriter' of or for any investment company other than a closed-end company, or of any security issued by such a company, means any underwriter who as principal purchases from such company, or pursuant to contract has the right (whether absolute or conditional) from time to time to purchase from such company, any such security for distribution, or who as agent for such company sells or has the right to sell any such security to a dealer or to the public or both, but does not include a dealer who purchases from such company through a principal underwriter acting as agent for such company.

[10] *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).

[11] *See* PTE 77–9, 42 FR 32395 (June 24, 1977) (predecessor to PTE 84–24).

[12] 15 U.S.C. 80a–2(a)(29).

As the Department stated in a 1980 Advisory Opinion,[13] the exemption is limited, in this regard, to principal underwriters acting in their ordinary course of business as principal underwriters, and does not extend more generally to all broker-dealers.[14]

In connection with the proposed Regulation, the Department proposed an amendment to PTE 84–24 that included several important changes. First, the Department proposed to increase the safeguards of the exemption by requiring fiduciaries that rely on the exemption to adhere to "Impartial Conduct Standards," including acting in the best interest of the plans and IRAs when providing advice, and by more precisely defining the types of payments that are permitted under the exemption. Second, on a going forward basis, the Department proposed to revoke relief for insurance agents, insurance brokers and pension consultants to receive a commission in connection with the purchase by IRAs of variable annuity contracts and other annuity contracts that are securities under federal securities laws, and for investment company principal underwriters to receive a commission in connection with the purchase by IRAs of investment company securities.

This amended exemption follows a lengthy public notice and comment process, which gave interested persons an extensive opportunity to comment on the proposed Regulation and the related exemption proposals, including the proposed amendment to and partial revocation of PTE 84–24. The proposals initially provided for 75-day comment periods, ending on July 6, 2015, but the Department extended the comment periods to July 21, 2015. The Department then also held four days of public hearings on the new regulatory package, including the proposed exemptions, in Washington, DC from August 10 to 13, 2015, at which over 75 speakers testified. The transcript of the hearing was made available on September 8, 2015, and the Department provided additional opportunity for interested persons to comment on the proposals or hearing transcript until September 24, 2015. A total of over 3,000 comment letters were received on the new proposals. There were also over 300,000 submissions made as part of 30 separate petitions submitted on the proposals. These comments and petitions came from consumer groups, plan sponsors, financial services companies, academics, elected government officials, trade and industry associations, and others, both in support and in opposition to the rule and related exemption proposals.[15] The Department has reviewed all comments, and after careful consideration of the comments, has decided to grant this amendment to and partial revocation of PTE 84–24, as described below.

Description of the Amendment and Partial Revocation of PTE 84–24

The final amendment to PTE 84–24 preserves the availability of the exemption for the receipt of commissions by insurance agents, insurance brokers and pension consultants, in connection with the recommendation that plans or IRAs purchase insurance contracts and certain types of annuity contracts defined in the exemption as "Fixed Rate Annuity Contracts." A Fixed Rate Annuity Contract is a fixed annuity contract issued by an insurance company that is either an immediate annuity contract or a deferred annuity contract that (i) satisfies applicable state standard nonforfeiture laws at the time of issue, or (ii) in the case of a group fixed annuity, guarantees return of principal net of reasonable compensation and provides a guaranteed declared minimum interest rate in accordance with the rates specified in the standard nonforfeiture laws in that state that are applicable to individual annuities; in either case, the benefits of which do not vary, in part or in whole, based on the investment experience of a separate account or accounts maintained by the insurer or the investment experience of an index or investment model. A Fixed Rate Annuity Contract does not include a variable annuity, or an indexed annuity or similar annuity.

The Department's approach to the definition of Fixed Rate Annuity Contract is generally based on satisfaction of applicable state standard nonforfeiture laws at the time of issue. If the applicable law does not have a standard nonforfeiture provision, the definition may be satisfied by compliance with the National Association of Insurance Commissioners (NAIC) Model Standard Nonforfeiture Law. However, for group fixed annuities, which the Department understands are not typically covered by standard nonforfeiture laws, the definition requires the annuity to meet comparable standards. Therefore, the group fixed annuity must guarantee return of principal net of reasonable compensation and provide a guaranteed declared minimum interest rate in accordance with the rates specified in the standard nonforfeiture laws in that state that are applicable to individual annuities (or the NAIC Model Standard Nonforfeiture Law if there is no applicable state standard nonforfeiture law).

By defining a Fixed Rate Annuity Contract in this manner, the Department intends to cover within PTE 84–24 fixed annuities that currently are referred to as immediate annuities, traditional annuities, declared rate annuities or fixed rate annuities (including deferred income annuities). These annuities provide payments that are the subject of insurance companies' contractual guarantees and that are predictable. Permitting such annuities to be recommended under the terms of PTE 84–24 will promote access to these annuity contracts which have important lifetime income guarantees and terms that are more understandable to consumers. As noted by commenters, lifetime income products are increasingly critical for retirement savers due to the shift away from defined benefit plans. The Department notes that the fact that an annuity contract allows for the payment of dividends, allows the insurance company in its discretion to credit a rate higher than the minimum guarantee, or provides for a cost-of-living adjustment does not in and of itself remove an annuity contract from the definition of a Fixed Rate Annuity Contract under the exemption.

On the other hand, the exemption does not cover variable annuities, indexed annuities or similar annuities, in which contract values vary, in whole or in part, based on the investment experience of a separate account or accounts maintained by the insurer or the investment experience of an index or investment model. In this regard, the exemption also does not cover any annuity registered as a security under federal securities laws. These investments typically require the customer to shoulder significant investment risk and do not offer the

[13] Advisory Opinion 80–30A (May 21, 1980).

[14] PTE 84–24 also provides relief for: (1) The purchase, with plan assets, of an insurance or annuity contract from an insurance company which is a fiduciary or a service provider (or both) with respect to the plan solely by reason of the sponsorship of a master or prototype plan, and (2) the purchase, with plan assets, of investment company securities from, or the sale of such securities to, an investment company or investment company principal underwriter, when such investment company or its principal underwriter or investment adviser is a fiduciary or a service provider (or both) with respect to the plan solely by reason of: The sponsorship of a master or prototype plan or the provision of nondiscretionary trust services to the plan; or both.

[15] As used throughout this preamble, the term "comment" refers to information provided through these various sources, including written comments, petitions and witnesses at the public hearing.

same predictability of payments as Fixed Rate Annuity Contracts. The Department determined that these annuities, which are often quite complex and subject to significant conflicts of interest at the point of sale, should be sold under the more stringent conditions of the Best Interest Contract Exemption. The Best Interest Contract Exemption contains important safeguards which address the conflicts of interest associated with investment recommendations in the more complex financial marketplace that has developed since PTE 84–24 was granted. While it is the Department's general intent that new types of annuity products introduced after the finalization of this amendment should be sold under the conditions of the Best Interest Contract Exemption, the Department, as needed, will provide additional guidance or interpretations regarding whether a particular annuity contract, available now or in the future, satisfies the definition of Fixed Rate Annuity Contract for purposes of PTE 84–24.

The amendment adopts the proposal's approach to the receipt of commissions by investment company principal underwriters. The exemption remains available for these transactions involving ERISA plans and Keogh plans, but not for IRAs and other plans described in Code section 4975(e)(1)(B)-(D), including Archer MSAs, HSAs and Coverdell education savings accounts.

As amended, the exemption requires fiduciaries engaging in these transactions to adhere to certain "Impartial Conduct Standards," including acting in the best interest of the plans and IRAs when providing advice. The amendment also more specifically defines the types of payments that are permitted under the exemption and revises the disclosure and recordkeeping requirements of the exemption.

The Department amended and revoked PTE 84–24 in these ways only in conjunction with the grant of a new exemption, the Best Interest Contract Exemption, adopted elsewhere in this issue of the **Federal Register**, that is applicable to advice to certain "retirement investors"—generally retail investors such as plan participants and beneficiaries, IRA owners, and certain plan fiduciaries. The Best Interest Contract Exemption provides broad relief for investment advice fiduciaries to recommend all investments, subject to protective conditions, including that the recommendation be in the best interest of the retirement investor. The exemption applies to all annuities, including Fixed Rate Annuity Contracts as well as variable annuity contracts and indexed annuity contracts. Likewise, broader relief is available in the Best Interest Contract Exemption for transactions involving investment company securities involving both plans and IRAs that are retirement investors. As discussed in more detail below, the conditions of the Best Interest Contract Exemption more appropriately address these conflicted arrangements.

In addition, the Regulation adopted today permits investment professionals—including insurance agents, insurance brokers, pension consultants, and mutual fund principal underwriters—to avoid fiduciary status when they engage in arm's length transactions with plans or IRAs that are independently represented by a fiduciary with financial expertise. Such independent fiduciaries generally include banks, insurance carriers, registered investment advisers, broker-dealers and other fiduciaries with $50 million or more in assets under management or control. This provision in the Regulation complements the limitations in the Best Interest Contract Exemption and is available for transactions involving all insurance and annuity contracts and investment company securities.[16]

A number of commenters objected generally to changes to PTE 84–24 on the basis that the original exemption, in combination with other regulatory safeguards under insurance law or securities law, provides sufficient protections to plans and IRAs. Commenters said there is no demonstrated harm to these consumers under the existing approach.

The Department does not agree. The extensive changes in the retirement plan landscape and the associated investment market in recent decades undermine the continued adequacy of the original approach in PTE 84–24. In the years since the exemption was originally granted in 1977,[17] the growth of 401(k) plans and IRAs has increasingly placed responsibility for critical investment decisions on individual investors rather than professional plan asset managers. Moreover, at the same time as individual investors have increasingly become responsible for managing their own investments, the complexity of investment products and range of conflicted compensation structures have likewise increased. As a result, it is appropriate to revisit and revise the exemption to better reflect the realities of the current marketplace.

Therefore, while the exemption remains available for insurance contracts and Fixed Rate Annuity Contracts, it is revoked for annuity contracts that do not satisfy the definition of Fixed Rate Annuity contracts. Accordingly, the exemption specifically excludes recommendations of variable annuities, indexed annuities and similar annuities. Given the complexity, investment risks, and conflicted sales practices associated with these products, the Department has determined that recommendations to purchase such annuities should be subject to the greater protections of the Best Interest Contract Exemption.

Both the Securities and Exchange Commission (SEC) staff and the Financial Industry Regulatory Authority (FINRA)[18] have issued publications specifically addressing variable annuities and indexed annuities. In its Investor Alert "Variable Annuities: Beyond the Hard Sell," which focused on deferred variable annuities, FINRA stated:

> The marketing efforts used by some variable annuity sellers deserve scrutiny—especially when seniors are the targeted investors. Sales pitches for these products might attempt to scare or confuse investors. One scare tactic used with seniors is to claim that a variable annuity will protect them from lawsuits or seizures of their assets. Many such claims are not based on facts, but nevertheless help land a sale. While variable annuities can be appropriate as an investment under the right circumstances, as an investor, you should be aware of their restrictive features, understand that substantial taxes and charges may apply if you withdraw your money early, and guard against fear-inducing sales tactics.

The FINRA alert further stated:

> Investing in a variable annuity within a tax-deferred account, such as an individual retirement account (IRA) may not be a good idea. Since IRAs are already tax-advantaged, a variable annuity will provide no additional tax savings. It will, however, increase the

[16] Parties satisfying this provision of the Regulation are not fiduciaries subject to the provisions of ERISA section 406(b) and Code section 4975(c)(1)(E) and (F) but they may still be subject to the prohibited transactions restrictions of ERISA section 406(a) and Code section 4975(c)(1)(A)–(D) for transactions involving parties in interest and disqualified persons. To the extent relief from those provisions is necessary for non-fiduciaries entering into insurance and annuity contract transactions, the Best Interest Contract Exemption provides such relief in a supplemental exemption in Section VI of the exemption, even for parties that are not retirement investors.

[17] *See* PTE 77–9, 42 FR 32395 (June 24, 1977) (predecessor to PTE 84–24).

[18] FINRA is registered with the Securities and Exchange Commission (SEC) as a national securities association and is a self-regulatory organization, as those terms are defined in the Exchange Act, which operates under SEC oversight.

expense of the IRA, while generating fees and commissions for the broker or salesperson.[19]

With respect to indexed annuities, a FINRA Investor Alert, ''Equity-Indexed Annuities: A Complex Choice,'' stated:

Sales of equity-indexed annuities (EIAs) . . . have grown considerably in recent years. Although one insurance company at one time included the word 'simple' in the name of its product, EIAs are anything but easy to understand. One of the most confusing features of an EIA is the method used to calculate the gain in the index to which the annuity is linked. To make matters worse, there is not one, but several different indexing methods. Because of the variety and complexity of the methods used to credit interest, investors will find it difficult to compare one EIA to another.''[20]

Similarly, in its 2011 ''Investor Bulletin: Indexed Annuities,'' the SEC staff stated:

You can lose money buying an indexed annuity. If you need to cancel your annuity early, you may have to pay a significant surrender charge and tax penalties. A surrender charge may result in a loss of principal, so that an investor may receive less than his original purchase payments. Thus, even with a specified minimum value from the insurance company, it can take several years for an investment in an indexed annuity to 'break even.'[21]

The SEC staff further noted:

It is important to note that indexed annuity contracts commonly allow the insurance company to change the participation rate, cap, and/or margin/spread/asset or administrative fee on a periodic—such as annual—basis. Such changes could adversely affect your return.[22]

Finally, a commenter noted that the North American Securities Administrators Association has issued the following statement on equity indexed annuities:

Equity indexed annuities are extremely complex investment products that have often been used as instruments of fraud and abuse. For years, they have taken an especially heavy toll on our nation's most vulnerable investors, our senior citizens for whom they are clearly unsuitable.[23]

In the Department's view, the increasing complexity and conflicted payment structures associated with these annuity products have heightened the conflicts of interest experienced by investment advice providers that recommend them. These are complex products requiring careful consideration of their terms and risks. Assessing the prudence of a particular indexed annuity requires an understanding of surrender terms and charges; interest rate caps; the particular market index or indexes to which the annuity is linked; the scope of any downside risk; associated administrative and other charges; the insurer's authority to revise terms and charges over the life of the investment; and the specific methodology used to compute the index-linked interest rate and any optional benefits that may be offered, such as living benefits and death benefits. In operation, the index-linked interest rate can be affected by participation rates; spread, margin or asset fees; interest rate caps; the particular method for determining the change in the relevant index over the annuity's period (annual, high water mark, or point-to-point); and the method for calculating interest earned during the annuity's term (*e.g.,* simple or compounded interest). Investors can all too easily overestimate the value of these contracts, misunderstand the linkage between the contract and index performance, underestimate the costs of the contract, and overestimate the scope of their protection from downside risk (or wrongly believe they have no risk of loss). As a result, retirement investors are acutely dependent on sound advice that is untainted by the conflicts of interest posed by advisers' incentives to secure the annuity purchase, which can be quite substantial.

These developments have undermined the protections of PTE 84–24 as applied to variable and indexed annuities purchased by plans and IRAs. As stated in the accompanying Regulatory Impact Analysis, conflicts of interest in the marketplace for retail investments result in billions of dollars of underperformance to investors saving for retirement. Both categories of annuities, variable and indexed annuities, are susceptible to abuse, and all retirement investors—plans and IRAs alike—would benefit from a requirement that advisers adhere to enforceable standards of fiduciary conduct and fair dealing. The Department has therefore concluded that variable annuities, indexed annuities and similar annuities are properly recommended to both plans and IRAs under the conditions of the Best Interest Contract Exemption.

The Best Interest Contract Exemption's important protections include fiduciary advisers' enforceable contractual commitment to adhere to the Impartial Conduct Standards, such as giving best interest advice; financial institutions' express written acknowledgment of their fiduciary status; and full disclosure of conflicts of interest, compensation practices, and financial arrangements with third parties. As part of the Best Interest Contract Exemption's protections, financial institutions must also adopt and adhere to stringent anti-conflict policies and procedures aimed at ensuring advice that is in the best interest of the retirement investor and avoiding misaligned financial incentives. These protective conditions serve as strong counterweights to the conflicts of interest associated with complex investment products, such as variable and indexed annuities.

However, the Department is not fully revoking PTE 84–24. In this final amendment, the scope of the exemption as applicable to insurance transactions has been narrowed to focus on ''Fixed Rate Annuity Contracts,'' which are defined as fixed annuity contracts issued by an insurance company that are either immediate annuity contracts or deferred annuity contracts that (i) satisfy applicable state standard nonforfeiture laws at the time of issue, or (ii) in the case of a group fixed annuity, guarantee return of principal net of reasonable compensation and provide a guaranteed declared minimum interest rate in accordance with the rates specified in the standard nonforfeiture laws in that state that are applicable to individual annuities; in either case, the benefits of which do not vary, in part or in whole, based on the investment experience of a separate account or accounts maintained by the insurer or the investment experience of an index or investment model. A Fixed Rate Annuity Contract does not include

[19] ''Variable Annuities: Beyond the Hard Sell,'' *available at http://www.finra.org/sites/default/files/InvestorDocument/p125846.pdf.* FINRA also has special suitability rules for certain investment products, including variable annuities. *See* FINRA Rule 2330 (imposing heightened suitability, disclosure, supervision and training obligations regarding variable annuities); *see also* FINRA rule 2360 (options) and FINRA rule 2370 (securities futures). *See also* SEC Office of Investor Education and Advocacy Investor Publication ''Variable Annuities: What You Should Know'' *available at http://www.sec.gov/investor/pubs/varannty.htm.* ''[I]f you are investing in a variable annuity through a tax-advantaged retirement plan (such as a 401(k) plan or IRA), you will get no additional tax advantage from the variable annuity. Under these circumstances, consider buying a variable annuity only if it makes sense because of the annuity's other features, such as lifetime income payments and death benefit protection. The tax rules that apply to variable annuities can be complicated—before investing, you may want to consult a tax adviser about the tax consequences to you of investing in a variable annuity.''

[20] ''Equity-Indexed Annuities: A Complex Choice'' *available at https://www.finra.org/investors/alerts/equity-indexed-annuities_a-complex-choice.*

[21] SEC Office of Investor Education and Advocacy Investor Bulletin: Indexed Annuities, *available at https://www.sec.gov/investor/alerts/secindexedannuities.pdf.*

[22] Id.

[23] *See* NASAA Statement on SEC Equity-Indexed Annuity Rule (December 17, 2008) *available at http://www.nasaa.org/5611/statement-on-sec-equity-indexed-annuity-rule/.*

a variable annuity or an indexed annuity or similar annuity. Accordingly, PTE 84–24 effectively provides a more streamlined exemption for less complex annuity products that provide guaranteed lifetime income.

Additionally, the Department revokes the exemption for covered mutual fund transactions involving IRAs (as defined in the exemption). The amended exemption incorporates the Impartial Conduct Standards, and applies to narrow categories of payments. The Department finds that the conditions of the amended exemption are appropriate in connection with the narrow scope of relief provided in the amended exemption.

The specific changes to PTE 84–24, and comments received on the proposed amendment and revocation, are discussed below.

Scope of the Amended Exemption

Section I(b) of the exemption, as amended, provides relief for six transactions if the conditions of the exemption are satisfied. The exemption provides relief from the application of ERISA section 406(a)(1)(A) though (D) and 406(b) and the taxes imposed by Code section 4975(a) and (b) by reason of Code section 4975(c)(1)(A) through (F). The six transactions are:

(1) The receipt, directly or indirectly, by an insurance agent or broker or a pension consultant of an Insurance Commission and related employee benefits, from an insurance company in connection with the purchase, with assets of a Plan or Individual Retirement Account (IRA),[24] including through a rollover or distribution, of an insurance contract or Fixed Rate Annuity Contract. A Fixed Rate Annuity Contract is a fixed annuity contract issued by an insurance company that is either an immediate annuity contract or a deferred annuity contract that (i) satisfies applicable state standard nonforfeiture laws at the time of issue, or (ii) in the case of a group fixed annuity, guarantees return of principal net of reasonable compensation and provides a guaranteed declared minimum interest rate in accordance with the rates specified in the standard nonforfeiture laws in that state that are applicable to individual annuities; in either case, the benefits of which do not vary, in part or in whole, based on the investment experience of a separate account or accounts maintained by the insurer or the investment experience of an index or investment model. A Fixed Rate Annuity Contract does not include a variable annuity or an indexed annuity or similar annuity.

(2) The receipt of a Mutual Fund Commission by a Principal Underwriter for an investment company registered under the Investment Company Act of 1940 (an investment company) in connection with the purchase, with Plan assets, including through a rollover or distribution, of securities issued by an investment company.

(3)(i) The effecting by an insurance agent or broker, or pension consultant of a transaction for the purchase, with assets of a Plan or IRA, including through a rollover or distribution, of a Fixed Rate Annuity Contract or insurance contract, or (ii) the effecting by a Principal Underwriter of a transaction for the purchase, with assets of a Plan, including through a rollover or distribution, of securities issued by an investment company.

(4) The purchase, with assets of a Plan or IRA, including through a rollover or distribution, of a Fixed Rate Annuity Contract or insurance contract from an insurance company, and the receipt of compensation or other consideration by the insurance company.

(5) The purchase, with assets of a Plan, of a Fixed Rate Annuity Contract or insurance contract from an insurance company which is a fiduciary or a service provider (or both) with respect to the Plan solely by reason of the sponsorship of a Master or Prototype Plan.

(6) The purchase, with assets of a Plan, of securities issued by an investment company from, or the sale of such securities to, an investment company or an investment company Principal Underwriter, when the investment company, Principal Underwriter, or the investment company investment adviser is a fiduciary or a service provider (or both) with respect to the Plan solely by reason of: (A) The sponsorship of a Master or Prototype Plan; or (B) the provision of Nondiscretionary Trust Services to the Plan; or (C) both (A) and (B).

The amended exemption is, therefore, limited to plan and IRA transactions involving Fixed Rate Annuity Contracts and insurance contracts. The exemption's transactions regarding investment company securities are limited to transactions involving plans. Transactions involving advice with respect to annuities that do not meet the definition of Fixed Rate Annuity Contract (*i.e.,* variable annuities, indexed annuities, and similar annuities) and investment company transactions involving IRAs must occur under the conditions of another exemption, such as the Best Interest Contract Exemption, to the extent the transactions are otherwise prohibited. Section I(c) makes these issues of scope clear.[25]

The Department also made certain additional revisions to the description of the covered transactions, as a result of commenters' input. Although the Department intended that the exemption, as amended, cover transactions resulting from a rollover or distribution, some commenters expressed concern about the exemption's applicability in that context, and the text now specifically states that the exemption applies in the context of a rollover or distribution. In addition, in Section I(b)(1), the final exemption explicitly provides that, in addition to Insurance Commissions, the payment of related employee benefits is covered under the exemption. This revision was made in response to comments, discussed in greater detail below, regarding certain types of payments commonly paid to insurance company statutory employees that commenters believed may raise prohibited transactions issues.[26] Finally, in Section I(a)(4), the Department expressly revised the scope of covered transactions regarding Fixed Rate Annuity Contracts and insurance contracts to specify that the relief under the exemption extends to the receipt of compensation or other consideration by the insurance company involved in the transaction, in addition to the commission received by the insurance agent, insurance broker, or pension consultant.[27]

[24] For purposes of this amendment, the terms "Individual Retirement Account" or "IRA" mean any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and an HSA described in section 223(d) of the Code.

[25] The Department notes that the provisions of the exemption for "insurance contracts" refer to an insurance contract that is not an annuity; accordingly, it is not possible to rely on the exemption for a variable annuity contract transaction, for example, under the theory that a variable annuity contract falls within the provisions for insurance contracts as opposed to annuity contracts.

[26] Some commenters asked whether the exemption covered salary, bonuses, overtime pay, and employee benefits provided to common law employees. Based on the information provided in the comments, the Department was unable to determine why the commenters believed salary, overtime pay and benefits provided to common law employees constitute prohibited transactions for which relief is necessary. With respect to bonus payments that raise prohibited transaction issues, without additional information, the Department is unable to evaluate how the conditions of this amended exemption would apply to such payments. The Department will provide additional guidance if commenters wish to provide additional information and analysis related to any of these payments to common law employees. Additionally, to the extent the conditions are met, the Department notes that the Best Interest Contract Exemption is not limited to any particular form of compensation and therefore would provide relief for such payments.

[27] Regarding the scope of the exemption, one commenter requested that the Department clarify whether the Department's Advisory Opinion 2000–15 allows fiduciaries providing investment advice for a fee to utilize PTE 84–24. The advisory opinion concerned the application of PTE 84–24 to transactions involving IRAs offered by TIAA–CREF. The opinion did not disallow investment advice fiduciaries from using PTE 84–24, but rather expressed the Department's longstanding view that the types of payments available under PTE 84–24 are limited to commissions, as opposed to other types of fees for investment advice. Thus the

Continued

Comments on these issues of scope are discussed below. Although the majority of commenters on the proposed revocation focused on the amendment's application to insurance and annuity contracts, some also addressed the proposed revocation of relief for investment company transactions.

a. Insurance and Annuity Products

In the proposed amendment, the Department proposed to revoke relief for transactions involving IRAs and variable annuities and other annuity contracts that are securities under federal securities laws. As an initial matter, some commenters raised a concern about terminology, noting that all annuity products are securities, but some are "exempt" securities under section 3(a) of the Securities Act of 1933. For purposes of this preamble discussion, the Department has adopted that the "exempt" terminology.

The proposed amendment to PTE 84–24 stated that the proposed Best Interest Contract Exemption was designed for IRA owners and other investors that rely on fiduciary investment advisers in the retail marketplace, and expressed the view that some of the transactions involving IRAs that were permitted under PTE 84–24 should instead occur under the conditions of the Best Interest Contract Exemption, specifically, transactions involving variable annuity contracts and other annuity contracts that are non-exempt securities under federal securities laws, and investment company securities.

The proposed amendment further proposed that transactions involving insurance and annuity contracts that are exempt securities could continue to occur under PTE 84–24, with the added protections of the Impartial Conduct Standards. In taking this approach, the proposal noted that that the Department was not certain that the conditions of the proposed Best Interest Contract Exemption, including some of the disclosure requirements, would be readily applicable to insurance and annuity contracts that are exempt securities, or that the distribution methods and channels of such insurance products would fit within the exemption's framework.

The proposal, therefore, distinguished between transactions that involve insurance products that are exempt securities and those that are non-exempt securities. This distinction was based on the view that annuity contracts that are non-exempt securities and investment company securities are distributed through the same channels as many other investments covered by the Best Interest Contract Exemption, and such investment products have similar disclosure requirements under existing regulations. Accordingly, the conditions of the proposed Best Interest Contract Exemption were viewed as appropriately tailored for such transactions.

The Department considered the contractual enforcement mechanism proposed in the Best Interest Contract Exemption as especially relevant to IRA owners, who do not have a mechanism to enforce the prohibited transactions provisions of ERISA and the Code. However, other conditions of the proposed Best Interest Contract Exemption were equally protective of both plans and IRAs, including the requirement that financial institutions relying on the exemption adopt anti-conflict policies and procedures designed to ensure that advisers satisfy the Impartial Conduct Standards.

The Department sought comment on the distinction drawn in the proposed amendment to PTE 84–24 between exempt and non-exempt securities. In particular, the proposal asked whether revoking relief for non-exempt securities transactions involving IRAs but leaving in place relief for IRA transactions involving insurance products that are exempt securities struck the appropriate balance, and whether that approach would be sufficiently protective of the interests of the IRAs. The Department also sought comment in the proposed Best Interest Contract Exemption on a number of issues related to the workability of that exemption (particularly, the disclosure requirements) for exempt insurance and annuity products. A number of comments on the two proposals addressed this issue of scope.

Some commenters, expressing concern about the risks associated with variable annuities, commended the Department for proposing that variable annuities should be recommended under the conditions of the Best Interest Contract Exemption rather than PTE 84–24. Generally, the commenters argued that due to the complexity, illiquidity and commission and fee structure of variable annuities and similar products, investors should be provided the additional protections of the Best Interest Contract Exemption for transactions involving these investments.

In this regard, commenters argued that variable annuities and investment company securities are similar to the other assets listed in the definition of assets in the proposed Best Interest Contract Exemption in that their value may fluctuate on a daily basis and, as such, variable annuities and investment company securities should be treated consistently with other investments in securities. The comments stated that the Best Interest Contract Exemption would offer protection and a means of redress for investors due to the conflicts of interest created by the commission and fee structure of variable annuities.

In addition to comments on variable annuities, some commenters argued that due to their complexity, fee structure, inherent conflicts of interest, as well as lack of regulation under the securities laws, indexed annuities similarly require heightened regulation. Consistent with this position, commenters argued that indexed annuities should be treated the same as variable annuities under the Department's exemptions. Additionally, one commenter noted that the compensation structure for indexed annuities is similar to that of variable annuities, raising comparable concerns regarding conflicts of interest. As a result, commenters said that recommendations of such products by fiduciaries should be subject to the same protective conditions as those proposed for variable annuities under the Best Interest Contract Exemption.

The Department understands that like Fixed Rate Annuity Contracts, indexed annuities are generally not regulated as registered securities under federal securities laws. Although the SEC issued a rule in 2008 that would have treated certain indexed annuities as securities, the rule was vacated by court order [28] and the SEC subsequently withdrew the rule.[29] As several commenters noted, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), Title IX, section 989J calls for certain annuity contracts to be considered exempt securities by the SEC if the conditions of that section are met. In addition, the SEC Web site's Investor Information section states "An indexed annuity may or may not be a security;

opinion stated, "[i]t is the Department's view that PTE 84–24 would not provide relief for any prohibited transaction that may arise in connection with the receipt of any fees or other compensation separate and apart from the commission paid to a principal underwriter upon a plan's purchase of recommended securities. Thus, PTE 84–24 does not exempt any prohibited transaction arising out of transactions involving fees paid to a fiduciary service provider with respect to an advice program which provides specific/individualized asset allocation recommendations to participants based on their responses to questionnaires."

[28] *Am. Equity Life Ins. Co.* v. *SEC,* 613 F.3d 166, 179 (D.C. Cir. 2010).

[29] 75 FR 64642 (Oct. 20, 2010).

however, most indexed annuities are not registered with the SEC." [30]

Despite the fact that the proposed amendment to PTE 84–24 focused on the distinction between exempt and non-exempt securities under federal securities law, some commenters asserted that indexed annuities should also be covered under the Best Interest Contract Exemption in order to enhance retirement investor protection in an area lacking sufficient protections for investors in tax qualified accounts. A commenter argued that IRA owners need greater protections when investing in indexed annuities precisely because such products are not regulated as securities and therefore do not fall within FINRA's jurisdiction.

A few commenters cited statements by the SEC staff, FINRA and the North American Securities Administrators Association, regarding indexed annuities. The statements, quoted at length above, touch upon the risks, complexity and sales tactics associated with these products. In particular, the SEC staff pointed to the possibility of significant surrender charges, and the fact that the insurance company may be permitted to change the terms of the annuity on an annual basis, adversely affecting the return. As noted, the FINRA Investor Alert, "Equity-Indexed Annuities: A Complex Choice," states that equity-indexed annuities "are anything but easy to understand." [31] One commenter asserted that many advisers, in addition to their clients, do not fully understand indexed annuities.

In this regard, a commenter further argued that there is no difference between the conflicted compensation arrangements of variable annuity contracts and indexed annuity contracts and asserted that typically compensation paid to advisers for sales of indexed annuities is higher than other products, creating an incentive to sell indexed annuities. The commenter noted that requiring indexed annuity transactions to occur under the Best Interest Contract Exemption would result in firms developing policies and procedures that would protect retirement investors from compensation practices that encourage recommendations not in the investor's best interest. The commenter argued that the lack of regulation of indexed annuities under the securities laws supports the argument for applying expanded safeguards under the Best Interest Contract Exemption for recommendations involving these products.

The industry generally opposed the approach taken in the proposal to revoke the relief historically provided by PTE 84–24 for variable annuities and other annuities that are non-exempt securities under federal securities laws. They wrote that the insurance industry should be able to rely on PTE 84–24 for all insurance products, rather than bifurcating relief between two exemptions. A number of commenters asserted that variable annuity contracts were more closely aligned with insurance products than with securities, and that variable annuities were not just a "package" of mutual funds. Commenters argued that, like fixed annuities, variable annuities provide retirement income guarantees and insurance guarantees that distinguish the annuities from other investments that lack such guarantee, and therefore fixed and variable annuities should be treated the same under the Department's exemptions. One commenter stated that federal securities laws recognize that variable annuities are different from mutual funds and the laws accommodate these differences. These commenters disputed the suggestion that the distinction between annuities that are exempt securities and non-exempt securities merited different treatment in the exemptions.

In this regard, some industry commenters focused on indexed annuities, in particular. These commenters asserted that fixed indexed annuities and fixed annuities are identical insurance products except for the method of calculating interest credited to the contract. They said that indexed annuities are treated the same as other fixed annuities under state insurance law and federal securities law, and stated that indexed annuities can offer the same income, insurance and contractual guarantees as fixed annuities. Moreover, some commenters noted that significant investment risk is borne by the insurer and there is no risk of principal loss, assuming that the investor does not incur surrender charges.[32] According to some commenters, indexed annuities are no more complex than other fixed annuities, and there are no different conflicts of interest created with their sales, as compared to fixed annuities.

Commenters also emphasized the benefit, for compliance purposes, of having one exemption for all insurance products, including variable annuities and indexed annuities. These commenters highlighted the importance of lifetime income options, and the ways the Department, the Treasury Department and the IRS have worked to make annuities more accessible to retirement investors. Many of these commenters took the position that the Department's proposed approach would undermine these efforts by hindering access to lifetime income products by plans and IRAs.

Commenters said that some aspects of the proposed Best Interest Contract Exemption would exacerbate this problem. In particular, they expressed uncertainty as to the extent to which the Best Interest Contract Exemption permitted commission-based compensation for fiduciary advisers. By comparison, it was maintained, PTE 84–24 clearly referenced the receipt of a commission. There were also concerns about the disclosure requirements and certain other requirements as applicable to the insurance industry. Commenters said the burden of complying with the Best Interest Contract Exemption would cause some in the insurance industry to leave the market. Many commenters took the position that existing regulation of these products is sufficient.

After consideration of all of the comments, the Department has made revisions to both PTE 84–24 and the final Best Interest Contract Exemption as applicable to annuity contracts. Under this final amendment to PTE 84–24, the scope of covered annuity transactions is limited to plan and IRA transactions involving Fixed Rate Annuity Contracts. Accordingly, PTE 84–24 now provides a streamlined exemption for relatively straightforward guaranteed lifetime income products such as immediate and deferred income annuities, while leaving coverage of variable annuity contracts, indexed annuity contracts, and similar annuity contracts, to the Best Interest Contract Exemption. Based upon its significant concerns about the complexity, risk, and conflicts of interest associated with recommendations of variable annuity contracts, indexed annuity contracts and similar contracts, the final exemption treats these transactions the

[30] *https://www.sec.gov/answers/annuity.htm.*

[31] "Equity-Indexed Annuities: A Complex Choice" *available at https://www.finra.org/investors/alerts/equity-indexed-annuities_a-complex-choice.*

[32] However, as the SEC staff noted in its 2011 "Investor Bulletin: Indexed Annuities": "You can lose money buying an indexed annuity. If you need to cancel your annuity early, you may have to pay a significant surrender charge and tax penalties. A surrender charge may result in a loss of principal, so that an investor may receive less than his original purchase payments. Thus, even with a specified minimum value from the insurance company, it can take several years for an investment in an indexed annuity to 'break even.'"

same way whether the investor is a plan or IRA.[33]

At the same time, the Department revised the Best Interest Contract Exemption in ways that accommodate fiduciary recommendations for both plans and IRAs to purchase variable annuities and indexed annuities. The final Best Interest Contract Exemption contains more streamlined disclosure conditions that are applicable to a wide variety of products. The pre-transaction disclosure does not require a projection of the total cost of the recommended investment, which commenters indicated would be difficult to provide in the insurance context. The final exemption does not include the proposed data collection requirement, which also posed problems for insurance products, according to commenters. Further, the language of the final exemption was adjusted to address industry concerns in other places and the preamble provides interpretations to address the particular questions and concerns raised by the insurance industry. For example, the preamble of the Best Interest Contract Exemption makes clear that commissions are permitted under the exemption and that annuity commissions do not necessarily violate the Impartial Conduct Standards. In addition, the ''reasonable compensation'' standard adopted in the final exemption addresses comments from the insurance industry. Section IV of that exemption additionally provides specific guidance on the satisfaction of the Best Interest standard by proprietary product providers. Commenters stressed a desire for one exemption covering all insurance and annuity products; the final Best Interest Contract Exemption does just that, while ensuring a greater level of protection to vulnerable retirement investors.

In light of the ways in which these products have developed, and the concerns articulated by other regulators and the commenters regarding the complexity, risks, and enhanced conflicts of interest associated with them, the Department determined that the conditions of PTE 84–24 are insufficiently protective to safeguard the interests of plans and IRAs investing in these products. The Best Interest Contract Exemption's conditions, such as a contractual commitment to adhere to the Impartial Conduct Standards when transacting with IRA owners, the required adoption of and adherence to anti-conflict policies and procedures, and the required disclosures of conflicts of interest, are necessary to address dangerous conflicts present in transactions involving these products. Moreover, this final amendment and partial revocation of PTE 84–24 creates a uniform approach for plans and IRAs under which indexed annuities and variable annuities can be recommended only under the same protective conditions as other investments covered in the Best Interest Contract Exemption and avoids creating a regulatory incentive to preferentially recommend indexed annuities. As a final issue of scope, one commenter stated the Department should add an exclusion to the Regulation that would apply to the recommendation of a Qualified Longevity Annuity Contract as described in Treasury Regulation sections 1.401(a)(9) and 1.408, provided the disclosure requirements found in Treasury Regulation section 1.408–6 are satisfied and any disclosure requirements under applicable state insurance law are met. As an alternative, the commenter recommended that the Department should exclude recommendations on Qualified Longevity Annuity Contracts from PTE 84–24's Impartial Conduct Standards and the recordkeeping requirements.

The Department considered this request but declined to single out Qualified Longevity Annuity Contracts for unique treatment under PTE 84–24. Regardless of the merit of any particular investment in such an annuity, the Department is mindful that the exemption permits investment advice fiduciaries to make recommendations and receive compensation pursuant to conflicted arrangements. The conditions of PTE 84–24, as amended, are streamlined to promote access to such lifetime income products, but the Impartial Conduct Standards and recordkeeping requirements are critical conditions aimed at ensuring that all retirement investors receive basic fiduciary protections, regardless of the particular product the adviser chooses to recommend. The mere fact that a recommended investment is a Qualified Longevity Annuity Contract does not guarantee that the recommendation is prudent, unbiased, or in the customer's best interest. An important goal of this regulatory project is to ensure that all retirement investors receive advice that adheres to these basic standards of prudence, loyalty, honesty, and reasonable compensation.

For the reader's convenience, the chart attached as Appendix I describes some of the basic features and attributes of the different categories of annuities discussed above.

b. Investment Company Transactions

The proposed amendment and partial revocation also applied to investment company transactions historically covered under the exemption. Under the proposed amendment, receipt of compensation by investment company principal underwriters in connection with IRA transactions involving investment company securities would no longer be permitted under PTE 84–24.[34] These transactions are, however, covered under the Best Interest Contract Exemption as applicable to ''retirement investors.''

A few commenters addressed this aspect of the proposal. The commenters indicated the exemption had long been used by broker-dealers for mutual fund transactions and questioned the basis for the revocation of such relief. In this regard, relief under the exemption was historically limited by the Department to investment company principal underwriters ''in the ordinary course of [their] business'' as principal underwriters.[35] The Department never intended for the exemption to provide relief for broker-dealers that are not principal underwriters. The Best Interest Contract Exemption is specifically designed to address recommendations by such broker-dealers and contains appropriate safeguards for these transactions involving IRAs, as discussed in detail in the preamble to the Best Interest Contract Exemption.

One commenter requested that the Department extend relief under the exemption to include Mutual Fund Commissions paid to principal underwriters and their agents. The Department has not revised the exemption in this respect because the

[33] One commenter suggested the Department create a streamlined exemption for a class of fixed annuity that pays a contractually guaranteed rate of interest, has a surrender charge period of no more than seven years and restricts the commission structure to trail payments only. The Department considered this approach when amending the scope of PTE 84–24, but the suggested approach did not address all the Department's concerns with the conflicts of interest associated with annuities. In particular, as discussed herein, the Department determined that indexed annuities—which could fit within the parameters established by the commenter—have characteristics that warrant the particular protections of the Best Interest Contract Exemption.

[34] For purposes of this amendment, the terms ''Individual Retirement Account'' or ''IRA'' mean any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and an HSA described in section 223(d) of the Code.

[35] *See* Advisory Opinion 80–30A. As noted above, the term ''principal underwriter'' is defined in the same manner as it is defined in section 2(a)(29) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(29)).

exemption already permits the principal underwriter to share the commissions with its agents and employees.[36] Accordingly, no amendment was necessary.

One commenter suggested that "sophisticated" IRA owners should not be subject to the exemption's amendments, but instead should be able to use the exemption under the same conditions applicable to plans. The commenter suggested the Department could rely on the federal securities laws, specifically the accredited investor rules, which the commenter said are commonly used and understood and identify investors who may be financially sophisticated. In response, the Department notes that, as amended, the exemption's conditions do apply equally to plans and IRAs in the context of Fixed Rate Annuity Contracts. With respect to investment company transactions, the Department declines to provide a special rule based on the accredited investor rules or similar criteria. As explained above, the Regulation describes circumstances under which a person will not be a fiduciary when he or she engages in a transaction with an independent plan or IRA fiduciary with financial expertise. This approach in the Regulation does not extend to individual IRA owners or plan participants and beneficiaries. Individuals with large account balances may have reached that point through years of hard work, careful savings, the rollover of an account balance from a defined benefit plan, or from an inheritance. None of these paths necessarily correlate with financial expertise or sophistication, or suggest a reduced need for stringent fiduciary protections. Although relief is no longer available under this exemption for investment company securities transactions with IRA owners, individual plan participants or beneficiaries, the Best Interest Contract Exemption is available for such transactions. The Best Interest Contract Exemption was designed for IRA owners and other investors that rely on fiduciary investment advisers in the retail marketplace.

One commenter indicated that the exemptions uniformly failed to provide relief for non-proprietary mutual fund transactions sold to plans on an agency basis. The Department does not agree with this comment. The existing exemption, PTE 86–128 [37] (also amended today), permits non-proprietary mutual fund sales to plans on an agency basis. Further, the Best Interest Contract Exemption explicitly covers such advice with respect to retail investors, and the Regulation defining fiduciary advice creates a carve-out from fiduciary coverage for arm's length transactions between sophisticated counterparties engaged in such transactions. To the extent that commenters asked to expand the scope of PTE 84–24 to other investments, the Department responds that the Best Interest Contract Exemption and its specifically tailored and protective conditions is available for such expanded relief. To the extent firms do not wish to comply with the conditions in that exemption, they may provide advice under circumstances that are free from the sorts of conflicts of interest that trigger the prohibited transaction rules.

Impartial Conduct Standards

A new Section II of the exemption requires that insurance agents, insurance brokers, pension consultants, insurance companies and investment company principal underwriters that are fiduciaries engaging in the exempted transactions comply with fundamental Impartial Conduct Standards.

Generally stated, the Impartial Conduct Standards require that when insurance agents, insurance brokers, pension consultants, insurance companies or investment company principal underwriters provide fiduciary investment advice, they act in the plan's or IRA's Best Interest, and not make misleading statements to the plan or IRA about recommended transactions. As defined in the exemption, the insurance agent or broker, pension consultant, insurance company or investment company principal underwriter act in the Best Interest of a plan or IRA when they act "with 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 Plan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate or other party."

It is important to note that, unlike some of the other exemptions finalized today in this issue of the **Federal Register**, there is no requirement under this exemption that parties contractually commit to the Impartial Conduct Standards. Also unlike some of the other exemptions finalized or amended today, the Impartial Conduct Standards in PTE 84–24 do not include a requirement that the compensation received by the fiduciary and affiliates be reasonable. Such a requirement already exists under Section III(c) of the exemption, and is therefore unnecessary in Section II. As discussed below, Section III(c) aligns the conditions of this exemption with the standards finalized in the other exemptions including the Best Interest Contract Exemption.[38]

The Impartial Conduct Standards represent fundamental obligations of fair dealing and fiduciary conduct. The concepts of prudence and undivided loyalty are deeply rooted in ERISA and the common law of agency and trusts.[39] These longstanding concepts of law and equity were developed in significant part to deal with the issues that arise when agents and persons in a position of trust have conflicting loyalties, and accordingly, are well-suited to the problems posed by conflicted investment advice. The requirement that the adviser act "without regard to" the adviser's own financial interests or the interests of persons other than the retirement investor is a concise expression of ERISA's duty of loyalty as expressed in section 404(a)(1)(A) of ERISA and applied in the context of advice. It is consistent with the formulation stated in common law, and it is consistent with the language used by Congress in Section 913(g)(1) of the Dodd-Frank Act,[40] and cited in the Staff of the U.S. Securities and Exchange Commission "Study on Investment Advisers and Broker-Dealers, as required under the Dodd-Frank Act" (Jan. 2011) (SEC staff Dodd-Frank

[36] See Letter to John A. Cardon, et al., (October 31, 1977) (discussing payment of a portion of the commission to an employee of the principal underwriter).

[37] Exemption for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers, 51 FR 41686 (November 18, 1986), as amended, 67 FR 64137 (October 17, 2002).

[38] There is also no requirement in the other exemptions finalized today to contractually warrant compliance with applicable federal and state laws, as was proposed. However, significant violations of applicable federal or state law could also amount to violations of the Impartial Conduct Standards, such as the Best Interest standard, in which case, this exemption, as amended, would be unavailable for transactions occurring in connection with such violations.

[39] See generally ERISA sections 404(a), 408(b)(2); Restatement (Third) of Trusts section 78 (2007), and Restatement (Third) of Agency section 8.01.

[40] Section 913(g) governs "Standard of Conduct" and subsection (1) provides that "The Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice."

Study).[41] The Department notes, however, that the standard is not intended to outlaw investment advice fiduciaries' provision of advice from investment menus that are restricted on the basis of proprietary products or revenue sharing. Finally, the "reasonable compensation" obligation is a feature of ERISA and the Code under current law that has long applied to financial services providers, whether fiduciaries or not.

The Department received many comments on the proposed Impartial Conduct Standards. A number of commenters focused on the Department's authority to impose the Impartial Conduct Standards as conditions of this exemption. Commenters' arguments regarding the Impartial Conduct Standards as applicable to IRAs and non-ERISA plans were based generally on the fact that the standards, as noted above, are consistent with longstanding principles of prudence and loyalty set forth in ERISA section 404, but which have no counterpart in the Code. Commenters took the position that because Congress did not choose to impose the standards of prudence and loyalty on fiduciaries with respect to IRAs and non-ERISA plans, the Department exceeded its authority in proposing similar standards as a condition of relief in a prohibited transaction exemption.

With respect to ERISA plans, commenters stated that Congress' separation of the duties of prudence and loyalty (in ERISA section 404) from the prohibited transaction provisions (in ERISA section 406), showed an intent that the two should remain separate. Commenters additionally questioned why the conduct standards were necessary for ERISA plans, when such plans already have an enforceable right to fiduciary conduct that is both prudent and loyal. Commenters asserted that imposing the Impartial Conduct Standards as conditions of the exemption created strict liability for prudence violations.

Some commenters additionally took the position that Congress, in the Dodd-Frank Act, gave the SEC the authority to establish standards for broker-dealers and investment advisers and therefore, the Department did not have the authority to act in that area. The Department disagrees that the exemption exceeds its authority. The Department has clear authority under ERISA section 408(a) and the Reorganization Plan[42] to grant administrative exemptions from the prohibited transaction provisions of both ERISA and the Code. Congress gave the Department broad discretion to grant or deny exemptions and to craft conditions for those exemptions, subject only to the overarching requirement that the exemption be administratively feasible, in the interests of plans, plan participants and beneficiaries and IRA owners, and protective of their rights.[43] Nothing in ERISA or the Code suggests that, in exercising its express discretion to fashion appropriate conditions, the Department is forbidden to borrow from time-honored trust-law standards and principles developed by the courts to ensure proper fiduciary conduct.

The Impartial Conduct Standards represent, in the Department's view, baseline standards of fundamental fair dealing that must be present when fiduciaries make conflicted investment recommendations to retirement investors. After careful consideration, the Department determined that relief should be provided to investment advice fiduciaries receiving conflicted compensation only if such fiduciaries provided advice in accordance with the Impartial Conduct Standards—*i.e.,* if they provided prudent advice without regard to the interests of such fiduciaries and their affiliates and related entities, in exchange for reasonable compensation and without misleading investors.

These Impartial Conduct Standards are necessary to ensure that advisers' recommendations reflect the best interest of their retirement investor customers, rather than the conflicting financial interests of the advisers and their financial institutions. As a result, advisers and financial institutions bear the burden of showing compliance with the exemption and face liability for engaging in a non-exempt prohibited transaction if they fail to provide advice that is prudent or otherwise in violation of the standards. The Department does not view this as a flaw in the exemption, as commenters suggested, but rather as a significant deterrent to violations of important conditions under an exemption that accommodates a wide variety of potentially dangerous compensation practices. The Department similarly disagrees that Congress' directive to the SEC in the Dodd-Frank Act limits its authority to establish appropriate and protective conditions in the context of a prohibited transaction exemption. Section 913 of that Act directs the SEC to conduct a study on the standards of care applicable to brokers-dealers and investment advisers, and issue a report containing, among other things:

> an analysis of whether [sic] any identified legal or regulatory gaps, shortcomings, or overlap in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers.[44]

Section 913 authorizes, but does not require, the SEC to issue rules addressing standards of care for broker-dealers and investment advisers for providing personalized investment advice about securities to retail customers.[45] Nothing in the Dodd-Frank Act indicates that Congress meant to preclude the Department's regulation of fiduciary investment advice under ERISA or its application of such a regulation to securities brokers or dealers. To the contrary, Dodd-Frank in directing the SEC study specifically directed the SEC to consider the effectiveness of existing legal and regulatory standard of care under other federal and state authorities. Dodd-Frank Act, sec. 913(b)(1) and (c)(1). The Dodd-Frank Act did not take away the Department's responsibility with respect to the definition of fiduciary under ERISA and in the Code; nor did it qualify the Department's authority to issue exemptions that are administratively feasible, in the interests of plans, participants and beneficiaries, and IRA owners, and protective of the rights of participants and beneficiaries of the plans and IRA owners.

Some commenters suggested that it would be unnecessary to impose the Impartial Conduct Standards on advisers with respect to ERISA plans because fiduciaries to these Plans already are required to adhere to these obligations under the provisions of the statute. The Department considered this comment but has determined not to eliminate the conduct standards as conditions of the exemption for ERISA plans. One of the Department's goals is to ensure equal footing for all retirement investors. The SEC staff Dodd-Frank Study found that investors were frequently confused by the differing standards of care applicable to broker-dealers and registered investment advisers. The Department hopes to

[41] SEC Staff Study on Investment Advisers and Broker-Dealers, January 2011, available at *https://www.sec.gov/news/studies/2011/913studyfinal.pdf,* pp.109–110.

[42] *See* fn. 2, *supra,* discussing of Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)).

[43] *See* ERISA section 408(a) and Code section 4975(c)(2).

[44] Dodd-Frank Act, sec. 913(d)(2)(B).

[45] 15 U.S.C. 80b–11(g)(1).

minimize such confusion in the market for retirement advice by holding investment advice fiduciaries to similar standards, regardless of whether they are giving the advice to an ERISA plan, IRA, or a non-ERISA plan.

Moreover, inclusion of the standards in the exemption's conditions adds an important additional safeguard for ERISA and IRA investors alike because the party engaging in a prohibited transaction has the burden of showing compliance with an applicable exemption, when violations are alleged.[46] In the Department's view, this burden-shifting is appropriate because of the dangers posed by conflicts of interest, as reflected in the Department's Regulatory Impact Analysis and because of the difficulties plans and IRA investors have in effectively policing such violations.[47]

A few commenters also expressed concern that the requirements of this exemption, as proposed, would interfere with state insurance regulatory programs. In particular, one commenter asserted that the Impartial Conduct Standards could usurp state insurance regulations. The Department does not agree with these comments. In addition to consulting with state insurance regulators and the NAIC as part of this project, the Department has also reviewed NAIC model laws and regulations and state reactions to those models in order to ensure the requirements of this exemption work cohesively with the requirements currently in place. The Department has crafted the exemption so that it will work with, and complement, state insurance regulations. In addition, the Department confirms that it is not its intent to preempt or supersede state insurance law and enforcement, and that state insurance laws remain subject to the ERISA section 514(b)(2)(A) savings clause.

Several commenters also raised questions about the role of the McCarran-Ferguson Act[48] and the Department's authority to regulate insurance products. The McCarran-Ferguson Act states that federal laws do not preempt state laws to the extent they relate to or are enacted for the purpose of regulating the business of insurance; it does not, however, prohibit federal regulation of insurance.[49] The Department has designed the exemption to work with and complement state insurance laws, not to invalidate, impair, or preempt state insurance laws.[50] Specifically, the Supreme Court has made it clear that ''the McCarran-Ferguson Act does not surrender regulation exclusively to the States so as to preclude the applicable of ERISA to an insurer's actions.''[51]

Other commenters generally asserted that some of the exemption's terms were too vague and would result in the exemption failing to meet the ''administratively feasible'' requirement under ERISA section 408(a) and Code section 4975(c)(2). The Department disagrees with these commenters' suggestion that ERISA section 408(a) and Code section 4975(c)(2) fail to be satisfied by the exemption's principles-based approach or that the exemption's standards are unduly vague. It is worth repeating that the Impartial Conduct Standards are building on concepts that are longstanding and familiar in ERISA and the common law of trusts and agency. Far from requiring adherence to novel standards with no antecedents, these conditions primarily require adherence to fundamental obligations of fair dealing and fiduciary conduct. In addition, the exemption and this preamble includes a section, below, designed to provide specific interpretations and responses to issues raised in connection with the Impartial Conduct Standards.

In this regard, some commenters focused their comments on the Impartial Conduct Standards in the proposed Best Interest Contract Exemption and other proposals, as opposed to the proposed amendment to PTE 84–24. The Department determined it was important that the provisions of the exemptions, including the Impartial Conduct Standards, be uniform and compatible across exemptions. For this reason, the Department considered all comments made on any of the exemption proposals on a consolidated basis, and made corresponding changes across the projects. For ease of use, this preamble includes the same general discussion of comments as in the Best Interest Contract Exemption, despite the fact that some comments discussed below were not made directly with respect to this exemption.

a. Best Interest Standard

Under Section II(a), the insurance agent or broker, pension consultant, insurance company or investment company principal underwriter must comply with a Best Interest standard when providing investment advice to the plan or IRA. The exemption provides that these parties act in the best interest of the plan or IRA when they:

> 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 [p]lan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate or other party.

The Best Interest standard set forth in the amended exemption is based on longstanding concepts derived from ERISA and the law of trusts. It is meant to express the concept, set forth in ERISA section 404, that a fiduciary is required to act ''solely in the interest of the participants . . . 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 a like character and with like aims.'' Similarly, both ERISA section 404(a)(1)(A) and the trust-law duty of loyalty require fiduciaries to put the interests of trust beneficiaries first, without regard to the fiduciaries' own self-interest. Under this standard, for example, an investment advice fiduciary, in choosing between two investments, could not select an investment because it is better for the investment advice fiduciary's bottom line even though it is a worse choice for the plan or IRA.[52]

[46] *See e.g., Fish* v. *GreatBanc Trust Company,* 749 F.3d 671 (7th Cir. 2014).

[47] As a practical matter, one way for financial institutions to ensure that they can meet this burden is by implementing strong anti-conflict policies and procedures, and by refraining from creating incentives to violate the Impartial Conduct Standards. Although this exemption does not require that financial institutions make any warranty to their customers about the adoption of such policies and procedures, the Department expects that financial institutions that take the Impartial Conduct Standards seriously will adopt such practices.

[48] 15 U.S.C. 1011 *et seq.* (1945).

[49] *See John Hancock Mut. Life Ins. Co.* v. *Harris Trust & Sav. Bank,* 510 U.S. 86, 97–101 (1993) (holding that ''ERISA leaves room for complementary or dual federal or state regulation, and calls for federal supremacy when the two regimes cannot be harmonized or accommodated'').

[50] *See BancOklahoma Mortg. Corp.* v. *Capital Title Co., Inc.,* 194 F.3d 1089 (10th Cir. 1999) (stating that McCarran-Ferguson Act bars the application of a federal statute only if (1) the federal statute does not specifically relate to the business of insurance; (2) a state statute has been enacted for the purpose of regulating the business of insurance; and (3) the federal statute would invalidate, impair, or supersede the state statute); *Prescott Architects, Inc.* v. *Lexington Ins. Co.,* 638 F. Supp. 2d 1317 (N.D. Fla. 2009); *see also U.S.* v. *Rhode Island Insurers' Insolvency Fund,* 80 F.3d 616 (1st Cir. 1996).

[51] *John Hancock,* 510 U.S. at 98.

[52] The standard does not prevent investment advice fiduciaries relying on the exemption from restricting their recommended investments to proprietary products or products that generate

Continued

A wide range of commenters indicated support for a broad "best interest" standard. Some comments indicated that the Best Interest standard is consistent with the way advisers provide investment advice to clients today. However, a number of these commenters expressed misgivings as to the definition used in the proposed exemption, in particular, the "without regard to" formulation. The commenters indicated uncertainty as to the meaning of the phrase, including: whether it permitted the investment advice fiduciary to be paid; whether it permitted investment advice on proprietary products; and whether it effectively precluded recommending annuities if they generate higher commissions than mutual funds.

Other commenters asked that the exemption use a different definition of best interest, or simply use the exact language from ERISA's section 404 duty of loyalty. Others suggested definitional approaches that would require that the investment advice fiduciary "not subordinate" their customers' interests to their own interests, or that the investment advice fiduciary "put their customers' interests ahead of their own interests," or similar constructs.

FINRA suggested that the federal securities laws should form the foundation of the Best Interest standard. Specifically, FINRA urged that the best interest definition in the exemption incorporate the "suitability" standard applicable to investment advisers and broker-dealers under federal securities laws. According to FINRA, this would facilitate customer enforcement of the Best Interest standard by providing adjudicators with a well-established basis on which to find a violation.

Other commenters found the Best Interest standard to be an appropriate statement of the obligations of a fiduciary investment advice provider and believed it would provide concrete protections against conflicted recommendations. These commenters asked the Department to maintain the best interest definition as proposed. One commenter wrote that the term "best interest" is commonly used in connection with a fiduciary's duty of loyalty and cautioned the Department against creating an exemption that failed to include the duty of loyalty. Others urged the Department to avoid definitional changes that would reduce current protections to plans and IRAs. Some commenters also noted that the "without regard to" language is consistent with the recommended standard in the SEC staff Dodd-Frank Study, and suggested that it had the added benefit of potentially harmonizing with a future securities law standard for broker-dealers.

The final exemption retains the best interest definition as proposed, with minor adjustments. The first prong of the standard was revised to more closely track the statutory language of ERISA section 404(a) and is consistent with the Department's intent to hold investment advice fiduciaries to a prudent investment professional standard. Accordingly, the definition of best interest now requires advice that reflects "the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person *acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims,* based on the investment objectives, risk tolerance, financial circumstances and needs of the plan or IRA. . ." The exemption adopts the second prong of the proposed definition, "without regard to the financial or other interests of the fiduciary, any affiliate or other party," without change. The Department continues to believe that the "without regard to" language sets forth the appropriate, protective standard under which a fiduciary investment adviser should act. Although the exemption provides broad relief for fiduciary investment advisers to receive commissions based on their advice, the standard ensures that the advice will not be tainted by self-interest. Many of the alternative approaches suggested by commenters pose their own ambiguities and interpretive challenges, and lower standards run the risk of undermining this regulatory initiative's goal of reducing the impact of conflicts of interest on plans and IRAs.

The Department has not specifically incorporated the suitability obligation as an element of the Best Interest standard, as suggested by FINRA but many aspects of suitability are also elements of the Best Interest standard. An investment recommendation that is not suitable under the securities laws would not meet the Best Interest standard. Under FINRA's Rule 2111(a) on suitability, broker-dealers "must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer." The text of rule 2111(a), however, does not do any of the following: reference a best interest standard, clearly require brokers to put their client's interests ahead of their own, expressly prohibit the selection of the least suitable (but more remunerative) of available investments, or require them to take the kind of measures to avoid or mitigate conflicts of interests that are required as conditions of this exemption.

The Department recognizes that FINRA issued guidance on Rule 2111 in which it explains that "in interpreting the suitability rule, numerous cases explicitly state that a broker's recommendations must be consistent with his customers' best interests," and provided examples of conduct that would be prohibited under this standard, including conduct that this exemption would not allow.[53] The guidance goes on to state that "[t]he suitability requirement that a broker make only those recommendations that are consistent with the customer's best interests prohibits a broker from placing his or her interests ahead of the customer's interests." The Department, however, is reluctant to adopt as an express standard such guidance, which has not been formalized as a clear rule and that may be subject to change. Additionally, FINRA's suitability rule may be subject to interpretations which could conflict with interpretations by the Department, and the cases cited in the FINRA guidance, as read by the Department, involved egregious fact patterns that one would have thought violated the suitability standard, even without reference to the customer's "best interest." The scope of the guidance also is different than the scope of this exemption. For example, insurance providers who decide to accept conflicted compensation will need to comply with the terms of this exemption, but, in many instances, may not be subject to FINRA's guidance. Accordingly, after review of the issue, the Department has decided not to accept the comment. The Department has concluded that its articulation of a clear loyalty standard within the exemption, rather than by reference to the FINRA guidance, will provide clarity and certainty to investors, and better protect their interests.

The Best Interest standard, as set forth in the exemption, is intended to effectively incorporate the objective standards of care and undivided loyalty that have been applied under ERISA for more than 40 years. Under these objective standards, the investment advice fiduciary must adhere to a professional standard of care in making investment recommendations that are in the plan's or IRA's best interest. The investment advice fiduciary may not

revenue sharing. Section IV of the Best Interest Contract Exemption specifically addresses how the standard may be satisfied under such circumstances.

[53] FINRA Regulatory Notice 12–25, p. 3 (2012).

base his or her recommendations on his or her own financial interest in the transaction. Nor may the investment advice fiduciary recommend the investment unless it meets the objective prudent person standard of care. Additionally, the duties of loyalty and prudence embodied in ERISA are objective obligations that do not require proof of fraud or misrepresentation, and full disclosure is not a defense to making an imprudent recommendation or favoring one's own interests at the plan's or IRA's expense.

Several commenters requested additional guidance on the Best Interest standard. Investment advice fiduciaries that are concerned about satisfying the standard may wish to consult the policies and procedures requirement in Section II(d) of the Best Interest Contract Exemption. While these policies and procedures are not a condition of the PTE 84–24, they may provide useful guidance for financial institutions wishing to ensure that individual advisers adhere to the Impartial Conduct Standards. The preamble to the Best Interest Contract Exemption provides examples of policies and procedures prudently designed to ensure that advisers adhere to the Impartial Conduct Standards. The examples are not intended to be exhaustive or mutually exclusive, and they range from examples that focus on eliminating or nearly eliminating compensation differentials to examples that permit, but police, the differentials.

A few commenters also questioned the requirement in the Best Interest standard that recommendations be made without regard to the interests of "*other parties.*" The commenters indicated they did not know the purpose of the reference to "other parties" and asked that it be deleted. The Department intends the reference to make clear that a fiduciary operating within the Impartial Conduct Standards should not take into account the interests of any party other than the plan or IRA—whether the other party is related to the fiduciary or not—in making a recommendation. For example, an entity that may be unrelated to the fiduciary but could still constitute an "other party," for these purposes, is the manufacturer of the investment product being recommended.

Other commenters asked for confirmation that the Best Interest standard is applied based on the facts and circumstances as they existed at the time of the recommendation, and not based on hindsight. Consistent with the well-established legal principles that exist under ERISA today, the Department confirms that the Best Interest standard is not a hindsight standard, but rather is based on the facts as they existed at the time of the recommendation. Thus, the courts have evaluated the prudence of a fiduciary's actions under ERISA by focusing on the process the fiduciary used to reach its determination or recommendation—whether the fiduciaries, "at the time they engaged in the challenged transactions, employed the proper procedures to investigate the merits of the investment and to structure the investment." [54] The standard does not measure compliance by reference to how investments subsequently performed or turn the fiduciaries relying on the exemption into guarantors of investment performance, even though they gave advice that was prudent and loyal at the time of transaction.[55]

This is not to suggest that the ERISA section 404 prudence standard or the Best Interest standard are solely procedural standards. Thus, the prudence obligation, as incorporated in the Best Interest standard, is an objective standard of care that requires the fiduciary relying on the exemption to investigate and evaluate investments, make recommendations, and exercise sound judgment in the same way that knowledgeable and impartial professionals would. "[T]his is not a search for subjective good faith—a pure heart and an empty head are not enough." [56] Whether or not the fiduciary is actually familiar with the sound investment principles necessary to make particular recommendations, the fiduciary must adhere to an objective professional standard. Additionally, fiduciaries are held to a particularly stringent standard to prudence when they have a conflict of interest.[57] For this reason, the Department declines to provide a safe harbor based on "procedural prudence" as requested by a commenter.

The Department additionally confirms its intent that the phrase "without regard to" be given the same meaning as the language in ERISA section 404 that requires a fiduciary to act "solely in the interest of" participants and beneficiaries, as such standard has been interpreted by the Department and the courts. Therefore, the standard would not, as some commenters suggested, foreclose the investment advice fiduciary from being paid. In response to concerns about the satisfaction of the standard in the context of proprietary product recommendations, the Department has provided additional clarity and specific guidance in the preamble on this issue.

In response to commenter concerns, the Department also confirms that the Best Interest standard does not impose an unattainable obligation on investment advice fiduciaries to somehow identify the single "best" investment for the plan or IRA out of all the investments in the national or international marketplace, assuming such advice were even possible. Instead, as discussed above, the Best Interest standard set out in the exemption, incorporates two fundamental and well-established fiduciary obligations: the duties of prudence and loyalty. Thus, the advice fiduciary's obligation under the Best Interest standard is to give advice that adheres to professional standards of prudence, and to put the plan's or IRA's financial interests in the driver's seat, rather than the competing interests of the advice fiduciary or other parties.

To the extent parties want more certainty as to compliance with the Impartial Conduct Standards, the Department refers them to examples provided in the Best Interest Contract Exemption's preamble discussion of policies and procedures that could be adopted to support compliance with the Impartial Conduct Standards.

Finally, in response to questions regarding the extent to which this or other provisions impose an ongoing monitoring obligation on fiduciaries, the text does not impose a monitoring requirement. As noted in the preamble to the Best Interest Contract Exemption, adherence to a Best Interest standard does not mandate an ongoing or long-term relationship, but instead leaves that to agreements, arrangements, and

[54] *Donovan* v. *Mazzola,* 716 F.2d 1226, 1232 (9th Cir. 1983).

[55] One commenter requested an adjustment to the "prudence" component of the Best Interest standard, under which the standard would be that of a "prudent person serving clients with similar retirement needs and offering a similar array of products." In this way, the commenter sought to accommodate varying perspectives and opinions on particular investment products and business practices. The Department disagrees with the comment because it could be read as qualifying the stringency of the prudence obligation based on the financial institution's or adviser's independent decisions on which products to offer, rather than on the needs of the particular retirement investor. Therefore, the Department did not adopt this suggestion.

[56] *Donovan* v. *Cunningham,* 716 F .2d 1455, 1467 (5th Cir. 1983), *cert. denied*, 467 U.S. 1251 (1984); *see also DiFelice* v. *U.S. Airways, Inc.*, 497 F. 3d 410, 418 (4th ir. 2007) ("Good faith does not provide a defense to a claim of a breach of these fiduciary duties; 'a pure heart and an empty head are not enough.'")

[57] *Donovan* v. *Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982) ("the[ ] decisions [of the fiduciary] must be made with an eye single to the interests of the participants and beneficiaries"); *see also Bussian* v. *RJR Nabisco, Inc.,* 223 F.3d 286, 298 (5th Cir. 2000); *Leigh* v. *Engle*, 727 F.2d 113, 126 (7th Cir. 1984).

understandings of the parties. This is consistent with the Department's interpretation of an investment advice fiduciary's monitoring responsibility as articulated in the preamble to the Regulation.

b. Misleading Statements

The second Impartial Conduct Standard, set forth in Section II(b), requires that

> The statements by the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter about recommended investments, fees, Material Conflicts of Interest, and any other matters relevant to a Plan's or IRA owner's investment decisions, are not materially misleading at the time they are made.

Section II(b) continues, "[f]or this purpose, the insurance agent's or broker's, pension consultant's, insurance company's or investment company Principal Underwriter's failure to disclose a Material Conflict of Interest relevant to the services it is providing or other actions it is taking in relation to a Plan's or IRA owner's investment decisions is considered a misleading statement." In response to commenters, the Department adjusted the text to clarify that the standard is measured at the time of the representations, *i.e.,* the statements must not be misleading "at the time they are made." Similarly, the Department added a materiality standard in response to comments.

Some comments focused on the proposed definition of Material Conflict of Interest. As proposed, a Material Conflict of Interest was defined to exist when a person has a financial interest that could affect the exercise of its best judgment as a fiduciary in rendering advice to a plan or IRA. Some commenters took the position that the proposal did not adequately explain the term "material" or incorporate a "materiality" standard into the definition. A commenter wrote that the proposed definition was so broad it would be difficult for financial institutions to comply with the various aspects of the exemption related to Material Conflicts of Interest, such as provisions requiring disclosures of Material Conflicts of Interest.

Another commenter indicated that the Department should not use the term "material" in defining conflicts of interest. The commenter believed that it could result in a standard that was too subjective from the perspective of the investment advice fiduciary, and could undermine the protectiveness of the exemption.

After consideration of the comments, the Department adjusted the definition of Material Conflict of Interest to provide that a material conflict of interest exists when a fiduciary has a "financial interest that *a reasonable person would conclude* could affect the exercise of its best judgment as a fiduciary in rendering advice to a Plan or IRA." This language responds to concerns about the breadth and potential subjectivity of the standard.

The Department did not accept certain other comments, however. One commenter requested that the Department add a qualifier providing that the standard is violated only if the statement was "reasonably relied" on by the retirement investor. The Department rejected the comment. The Department's aim is to ensure that investment advice fiduciaries uniformly adhere to the Impartial Conduct Standards, including the obligation to avoid materially misleading statements, when they give advice.

One commenter asked the Department to require only that the adviser "reasonably believe" the statements are not misleading. The Department is concerned that this standard too could undermine the protections of this condition by requiring retirement investors or the Department to prove the adviser's actual belief rather than focusing on whether the statement is objectively misleading. However, to address commenters' concerns about the risks of engaging in a prohibited transaction, as noted above, the Department has clarified that the standard is measured at the time of the representations and has added a materiality standard. The Department believes that plans and IRAs are best served by statements and representations that are free from material misstatements. Investment advice fiduciaries best avoid liability—and best promote the interests of plans and IRAs—by making accurate communications a consistent standard in all their interactions with their customers.

Another commenter suggested that the Department adopt FINRA's "Frequently Asked Questions regarding Rule 2210" in this connection.[58] FINRA's Rule 2210, Communications with the Public, sets forth a number of procedural rules and standards that are designed to, among other things, prevent broker-dealer communications from being misleading. The Department agrees that adherence to FINRA's standards can promote materially accurate communications, and certainly believes that investment advice fiduciaries should pay careful attention to such guidance documents. After review of the rule and FAQs, however, the Department declines to simply adopt FINRA's guidance, which addresses written communications, since the exemption is broader in this respect. In the Department's view, the meaning of the standard is clear, and is already part of plan fiduciary's obligations under ERISA. If, however, issues arise in implementation of the exemption, the Department will consider requests for additional guidance.

c. Other Interpretive Issues

Some commenters asserted that some of the exemption's terms were too vague and would result in the exemption failing to meet the "administratively feasible" requirement under ERISA section 408(a) and Code section 4975(c)(2). The Department disagrees with these commenters' suggestion that ERISA section 408(a) and Code section 4975(c)(2) fail to be satisfied by this exemption's principles-based approach, or that the exemption's standards are unduly vague. It is worth repeating that the Impartial Conduct Standards are built on concepts that are longstanding and familiar in ERISA and the common law of trusts and agency. Far from requiring adherence to novel standards with no antecedents, the exemption primarily requires adherence to basic well-established obligations of fair dealing and fiduciary conduct. This section is designed to provide specific interpretations and responses to a number of specific issues raised in connection with a number of the Impartial Conduct Standards.

In this regard, the Department received several comments regarding the sale of proprietary insurance products. Generally, commenters expressed concern that the proposed amendments to the exemption appeared to be setting barriers to the sale of proprietary products, and the receipt of differential compensation such as commissions and health benefits and the ability to earn a profit inherent in such sales. Commenters maintained that the advantages of a proprietary sales force include the in-depth training received by such agents on the proprietary products. Comments requested that the Department clarify whether PTE 84–24 continues to cover the sale of proprietary products and the receipt of differential compensation as a result of the sale.

In response to commenters, the Department specifically notes that the Impartial Conduct Standards (either as proposed or finalized) are not properly

[58] *Currently available at http://www.finra.org/industry/finra-rule-2210-questions-and-answers.*

interpreted to foreclose the recommendation of proprietary products. The Department recognizes that insurance sales frequently involve proprietary products, and it does not intend to forbid such sales. Section IV of the Best Interest Contract Exemption specifically addresses the Best Interest standard in the context of proprietary products. While not a specific condition of this exemption, financial institutions would clearly satisfy the standard by complying with the requirements of that section.

The Impartial Conduct Standards also are not properly interpreted to foreclose the receipt of commissions or other transaction-based payments. To the contrary, a significant purpose of granting this amended exemption is to continue to permit such payments, as long as investment advice fiduciaries are willing to adhere to Best Interest standards. In particular, the Department confirms that the receipt of a commission on an annuity product does not result in a per se violation of any of the Impartial Conduct Standards or other conditions of the exemption, even though such a commission may be greater than the commission on a mutual fund purchase of the same amount as long as the commission meets the requirement of ''reasonable compensation'' and other applicable conditions.

Several commenters stated the Impartial Conduct Standards could be interpreted to exclude any compensation other than commissions paid to the agent, such as employee benefits for agents selling the insurance companies' proprietary products and meeting production goals. The commenters pointed out that many insurance companies use a business model whereby their agents are statutory employees under the Code. In order to receive employee benefits, the agents must predominately sell the employing insurance companies' products. Commenters argued that the provision of employee benefits such as health care and retirement benefits does not create a conflict of interest.

The Department did not intend the exemption to effectively prohibit the receipt of employee benefits by statutory employees. The final exemption makes clear in Section I(b)(1) that such payments can be provided. Additionally, the Department confirms that the receipt by an insurance agent or broker of reasonable and customary deferred compensation or subsidized health or pension benefit arrangements such as typically provided to an ''employee'' as defined in Code section 3121(d)(3) does not, in and of itself, violate the Impartial Conduct Standards. However, insurance companies providing such payments should take special care that the payments do not undermine such insurance agents' or brokers' ability to adhere to the standards.

Some commenters urged the Department to state that fiduciary status does not apply to the manufacturer company that issues an annuity, insurance or investment product in the ordinary course of its business so long as the company and its employees do not render investment advice for a fee or represent that it is acting as a fiduciary. Another commenter expressed the opinion that the sale of proprietary products should not in and of itself create a fiduciary relationship. The Department responds that application of the Regulation determines the status of investment advice fiduciaries. This exemption provides relief that is necessary for parties with fiduciary status under the Regulation. However, the Department notes that the Best Interest Contract Exemption requires that a financial institution (which could be an insurer) acknowledge fiduciary status, ensure that an appropriate supervisory structure is in place to implement policies and procedures, police incentives, and generally oversee the conduct of individual advisers, so that the conduct comports with the fiduciary norms required in the Impartial Conduct Standards.

Commissions

While PTE 84–24 provides an exemption for the specified parties to receive commissions in connection with the purchase of insurance or annuity contracts and investment company securities, it did not contain a separate definition of commission. The Department has viewed the exemption as limited to sales commissions on insurance or annuity contracts and investment company securities, as opposed to any related or alternative forms of compensation. This exemption was originally granted in 1977, and the conditions were crafted with simple commission payments in mind. In the interim, the exemption was not amended or formally interpreted to broadly permit more types of payments. To provide certainty with respect to the payments permitted by the exemption, however, the amended exemption now provides a specific definition of Insurance Commission and Mutual Fund Commission.

These definitions should dispel any concern that commissions are no longer permitted under the exemption, or that the Impartial Conduct Standards cannot be satisfied with respect to such commission payments. This exemption remains specifically available for commissions as they are defined herein. Moreover, as noted above, the Department confirms that the receipt of a commission on an annuity product does not, in and of itself, violate any of the Impartial Conduct Standards, even though such a commission would be greater than the commission on a mutual fund purchase of the same amount.

In the final amendment, Section VI(f) defines an Insurance Commission to mean a sales commission paid by the insurance company to the insurance agent, insurance broker or pension consultant for the service of effecting the purchase of an insurance or annuity contract, including renewal fees and trailers that are paid in connection with the purchase of the insurance or annuity contract.[59] The term Insurance Commission does not include revenue sharing payments, administrative fees or marketing fees. Similarly, Section VI(i) of the exemption defines Mutual Fund Commission as ''a commission or sales load paid either by the Plan or the investment company for the service of effecting or executing the purchase of investment company securities, but does not include a 12b–1 fee, revenue sharing payment, administrative fee, or marketing fee.''[60]

The definition of Insurance Commission in the final amendment was revised slightly from the proposed amendment. As proposed, the definition excluded ''revenue sharing payments, administrative fees or marketing payments, *or payments from parties other than the insurance company or its Affiliates.''* Commenters questioned whether the phrase ''or payments from parties other than the insurance company or its Affiliates'' would require a direct payment from the insurance company, and thought this appeared to conflict with the description of the covered transaction in Section I(a), which specifically says the exemption applies to ''direct and indirect''

[59] The proposed definition of Insurance Commission included commissions paid on the ''purchase or sale'' of an insurance or annuity contract. Because the exemption extends only to the commissions on the purchase of an insurance or annuity contract, the language ''or sale'' was deleted in this final amendment.

[60] The proposed definition of Mutual Fund Commission included commissions paid for the service of effecting or executing the ''purchase or sale'' of investment company securities. Because the exemption extends only the commissions on the purchase of investment company securities, the language ''or sale'' was deleted in this final amendment.

payments. Commenters explained that commissions may be paid to insurance agents, insurance brokers and pension consultants, through other intermediaries.

It was not the Department's intent with respect to the Insurance Commission definition to disrupt the practice of paying commissions through a third party, such as an independent marketing organization. Accordingly the final amendment does not include the language ''payments from parties other than the insurance company or its Affiliates'' from the definition. The Department nevertheless cautions that the change does not extend relief under the exemption to revenue sharing or other payments not within the definition of Insurance Commission.[61]

A few commenters have requested that the Department clarify whether or not ''gross dealer concessions'' or ''overrides'' would be considered Insurance Commissions under the new definition. The commenters explained that ''gross dealer concessions'' and ''overrides'' are commission payments made to someone who oversees the agent that is working directly with the customer. The Department responds that, as these types of payments generally represent a portion of the overall commission payment associated with an insurance or annuity transaction, they are included within the amended exemption's definition of Insurance Commission. In connection with this clarification, however, the Department revised the disclosure conditions to reflect that both the agent's or broker's commission and the gross dealer concession or override must be disclosed if the exemption is relied upon for such payments.

Many of the comments received from the industry expressed the opinion more generally that the proposed definitions of Insurance Commission and Mutual Fund Commission were too narrow and should be expanded to include the receipt of all types of payments for all sales of annuities and mutual funds such as revenue sharing payments, administrative fees, marketing fees and 12b–1 fees. Commenters stated that due to the increased disclosures required by the Department and the Securities and Exchange Commission's simplification of the disclosures for 12b–1 fees and other mutual fund fees in prospectuses there is no reason why any form of disclosed and agreed upon compensation should not be allowed. Some commenters stated that the definition of Insurance Commission in the proposal would create uncertainty in the industry as to what is permissible compensation under PTE 84–24 and may cause reduction in sales of annuity products that provide valuable lifetime income benefits. These commenters argued that the exclusion of revenue sharing payments, administrative fees or marketing payments is inconsistent with current business models and would create ambiguity with respect to long standing industry practices under which such payments are received. They stated that such restrictions would not be necessary in light of the Best Interest standard.

Some commenters represented that revenue sharing payments are received by the insurance company or financial institution, itself, as opposed to the individual adviser, and are used to offset expenses related to servicing the annuity contract or mutual fund account and therefore do not create a conflict of interest at the agent level or point of sale. Additionally, one commenter asserted that revenue sharing and marketing fees are not retained but instead credited back on a daily basis to the insurance company separate account to offset other fees of the separate account and therefore are credited back to the participants invested in that separate account. A few other commenters argued that the conflicts of interest arising from revenue sharing, administrative fees and marketing fees can be addressed by only allowing the payments when they are paid on the basis of total aggregate sales and are not linked to a specific investment product.

The Department was not persuaded by these comments to expand the definitions of Insurance Commission or Mutual Fund Commission beyond the historical intent of the exemption. The Department specifically provided relief for such payments in the Best Interest Contract Exemption. That exemption addresses the payment structures that have developed since PTE 84–24 was originally adopted. The Department intends that relief for such payments be provided through the Best Interest Contract Exemption on the grounds that that exemption was drafted to specifically address the unique conflicts of interest that are created by these types of payments.

In addition, it is the Department's understanding that third party payments such as revenue sharing and 12b–1 fees generally are not paid in connection with the Fixed Rate Annuity Contracts that are covered by the amended exemption. The expanded definitions are, therefore, unnecessary because the investments that would generate such payments are covered by the Best Interest Contract Exemption, rather than this exemption.

The Department does not believe this exemption was properly interpreted over the years to provide relief for payments such as administrative services fees, which are not akin to a commission. No determination has been made that the conditions of the exemption are protective in the context of such payments. Without further information on these fees, or suggested additional conditions addressed at these types of payments, the Department declines to take such an expansive approach to relief from the prohibited transaction rules under the terms of this exemption. For parties who are interested in broader relief in this area, the Best Interest Contract Exemption is available.

Reasonable Compensation

Section III(c) of the amended exemption imposes a reasonable compensation standard as a condition of the exemption. The requirement is that:

> The combined total of all fees and compensation received by the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter for their services does not exceed reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2).

The language of the requirement differs from the definition in the proposal, but it is not intended as a substantive change. The language in the proposal provided:

> The combined total of all fees, Insurance Commissions, Mutual Fund Commissions and other consideration received by the insurance agent or broker, pension consultant, insurance company, or investment company Principal Underwriter:
>
> (1) For the provision of services to the plan or IRA; and
>
> (2) In connection with the purchase of insurance or annuity contracts or securities issued by an investment company is not in excess of ''reasonable compensation'' within the contemplation of section 408(b)(2) and 408(c)(2) of the Act and sections 4975(d)(2)and 4975(d)(10) of the Code. If such total is in excess of ''reasonable compensation,'' the ''amount involved'' for purposes of the civil penalties of section 502(i) of the Act and the excise taxes imposed by section 4975 (a) and (b) of the Code is the amount of compensation in excess of ''reasonable compensation.''

The language was changed in the amendment to correspond to the same provision in the Best Interest Contract Exemption. Commenters indicated that there should be a common reasonable compensation standard across the exemptions. Commenters on the Best

[61] Under the exemption, the term ''insurance company'' includes the insurance company and its affiliates.

Interest Contract Exemption also expressed a preference for a reference to the ERISA section 408(b)(2) and Code section 4975(d)(2) provisions on reasonable compensation.

More generally, commenters asked that the Department provide more certainty as to the meaning of the reasonable compensation standard. There was concern that the standard could be applied retroactively rather than based on the parties' reasonable beliefs as to the reasonableness of the compensation at the time of the recommendation. Commenters also indicated uncertainty as to how to comply with the condition and asked whether it would be necessary to survey the market to determine market rates. Some commenters requested that the Department include the words ''and customary'' in the reasonable compensation definition, to specifically permit existing compensation arrangements. One commenter raised the concern that the reasonable compensation determination raised antitrust concerns because it would require investment advice fiduciaries to agree upon a market rate and result in anti-competitive behavior.

Commenters also asked how the standard would be satisfied for Proprietary Products, particularly insurance and annuity contracts. In such a case, commenters indicated, the retirement investor is not only paying for a service, but also for insurance guarantees; a standard that appeared to focus solely on services appeared inapposite. Commenters asked about the treatment of the insurance company's spread, which was described, in the case of a fixed annuity, or the fixed component of a variable annuity, as the difference between the fixed return credited to the contract holder and the insurer's general account investment experience. One commenter indicated that the calculation should not include affiliates' or related entities' compensation as this would appear to put them at a comparative disadvantage.

The Department confirms that the standard is the same as the well-established requirement set forth in ERISA section 408(b)(2) and Code section 4975(d)(2), and the regulations thereunder. The reasonableness of the fees depends on the particular facts and circumstances at the time of the recommendation. Several factors inform whether compensation is reasonable including, *inter alia,* the market pricing of service(s) provided and the underlying asset(s), the scope of monitoring, and the complexity of the product. No single factor is dispositive in determining whether compensation is reasonable; the essential question is whether the charges are reasonable in relation to what the investor receives. Consistent with the Department's prior interpretations of this standard, the Department confirms that parties relying on this exemption do not have to recommend the investment that is the lowest cost or that generates the lowest fees without regard to other relevant factors. Recommendation of the lowest cost or lowest fee product is also not a requirement under the Impartial Conduct Standards in Section II of the exemption.

Some commenters suggested that the reasonable compensation determination be made by another plan fiduciary. However, the exemption (like the statutory obligation) obligates investment advice fiduciaries to avoid overcharging their plan and IRA customers, despite any conflicts of interest associated with their compensation. Fiduciaries and other service providers may not charge more than reasonable compensation regardless of whether another fiduciary has signed off on the compensation. The reasonable compensation condition has long been required under PTE 84–24 and the approach in the final amendment is consistent with other class exemptions granted and amended today. Nothing in the exemptions, however, precludes fiduciaries from seeking impartial review of their fee structures to safeguard against abuse, and they may well want to include such reviews in their policies and procedures.

Further, the Department disagrees that the requirement is inconsistent with antitrust laws. Nothing in the exemption contemplates or requires that advisers or financial institutions agree upon a price with their competitors. The focus of the reasonable compensation condition is on preventing overcharges to plans and IRAs, not promoting anti-competitive practices. Indeed, if advisers and financial institutions consulted with competitors to set prices, the agreed-upon price could well violate the condition.

In response to concerns about application of the standard to investment products that bundle together services and investment guarantees or other benefits, such as annuities, the Department responds that the reasonable compensation condition is intended to apply to the compensation received by the financial institution, adviser, and any Affiliates in same manner as the reasonable compensation condition set forth in ERISA section 408(b)(2) and Code section 4975(d)(2). Accordingly, the exemption's reasonable compensation standard covers compensation received directly from the plan or IRA and indirect compensation received from any source other than the plan or IRA in connection with the recommended transaction.[62] In the case of a charge for an annuity or insurance contract that covers both the provision of services and the purchase of the guarantees and financial benefits provided under the contract, it is appropriate to consider the value of the guarantees and benefits in assessing the reasonableness of the arrangement, as well as the value of the services. When assessing the reasonableness of a charge, one generally needs to consider the value of all the services and benefits provided for the charge, not just some. If parties need additional guidance in this respect, they should refer to the Department's interpretations under ERISA section 408(b)(2) and Code section 4975(d)(2) and the Department will provide additional guidance if necessary.

A commenter urged the Department to provide that compensation received by an Affiliate would not have to be considered in applying the reasonable compensation standard. According to the commenter, including such compensation in the assessment of reasonable compensation would place proprietary products at a disadvantage. The Department disagrees with the proposition that a proprietary product would be disadvantaged merely because more of the compensation goes to affiliated parties than in the case of competing products, which allocate more of the compensation to non-affiliated parties. The availability of the exemption, however, does not turn on how compensation is allocated between affiliates and non-affiliates. Certainly, the Department would not expect that a proprietary product would be at a disadvantage in the marketplace because it carefully ensures that the associated compensation is reasonable. Assuming the Best Interest standard is satisfied and the compensation is reasonable, the exemption should not impede the recommendation of

[62] Such compensation includes, for example charges against the investment, such as commissions, sales loads, sales charges, redemption fees, surrender charges, exchange fees, account fees and purchase fees, as well as compensation included in operating expenses and other ongoing charges, such as wrap fees, mortality, and expense fees. For purposes of this exemption, the ''spread'' is not treated as compensation. A commenter described the ''spread'', in the case of a fixed annuity, or the fixed component of a variable annuity, as the difference between the fixed return credited to the contract holder and the insurer's general account investment experience.

proprietary products. Accordingly, the Department disagrees with the commenter.

The Department declines suggestions to provide specific examples of "reasonable" amounts or specific safe harbors, as requested by some commenters. Ultimately, the "reasonable compensation" standard is a market based standard. At the same time, the Department is unwilling to condone all "customary" compensation arrangements and declines to adopt a standard that turns on whether the agreement is "customary." For example, it may in some instances be "customary" to charge customers fees that are not transparent or that bear little relationship to the value of the services actually rendered, but that does not make the charges reasonable.

Conditions for Transaction Described in Section I(a)(1) Through (4)

Section IV establishes certain conditions and limitations applicable to the transactions described in Section I(b)(1)–(4). Section IV(a) identifies certain parties that may not rely on the exemption, including discretionary trustees, plan administrators, fiduciaries expressly authorized in writing to manage, acquire or dispose of the asset of the plan or IRA on a discretionary basis, and employers of employees covered by a plan. Section IV(b) and (c) establish pre-transaction disclosures and approval requirements, and Section IV(d) indicates when repeat disclosures must be provided.

One commenter asked about the applicability of these conditions to transactions described in Section I(b)(5) and (6), which generally relate to master and prototype plan sponsors. The commenter expressed the view that these transactions should not be excluded from the conditions of Section IV.

The covered transactions described in Section I(b)(5) and (6) are narrowly tailored to apply to the provider of a master or prototype plan that receives compensation in connection with a transaction involving an insurance or Fixed Rate Annuity Contract, or investment company securities. The preamble to PTE 77–9, the predecessor of PTE 84–24, stated that the transactions are limited to the circumstances where the insurance company, investment company or investment company principal underwriter is a fiduciary or service provider to a plan solely by reason of sponsorship of a master or prototype plan but has no other relationship to the plan, such as being the investment adviser to the plan directly or through an affiliate.[63] Therefore, the relief provided does not extend to the circumstances in which the insurance company or mutual fund principal underwriter is causing itself to receive compensation. Given the limited nature of the exemption, the Department found it appropriate to provide different conditions for this transaction.

a. Section IV(b) and (c)—Transaction Disclosure

Section IV(b) sets forth disclosure and consent requirements for Fixed Rate Annuity Contracts and insurance contracts. As amended, the exemption imposes the following conditions:

(b)(1) With respect to a transaction involving the purchase with Plan or IRA assets of a Fixed Rate Annuity Contract or insurance contract, or the receipt of an Insurance Commission thereon, the insurance agent or broker or pension consultant provides to an independent fiduciary with respect to the Plan, or in the case of an IRA, to the IRA owner, prior to the execution of the transaction the following information in writing and in a form calculated to be understood by a plan fiduciary or IRA owner who has no special expertise in insurance or investment matters:

(A) If the agent, broker, or consultant is an Affiliate of the insurance company whose contract is being recommended, or if the ability of the agent, broker or consultant to recommend Fixed Rate Annuity Contracts or insurance contracts is limited by any agreement with the insurance company, the nature of the affiliation, limitation, or relationship;

(B) The Insurance Commission, expressed to the extent feasible as an absolute dollar figure, or otherwise, as a percentage of gross annual premium payments, asset accumulation value or contract value, for the first year and for each of the succeeding renewal years, that will be paid directly or indirectly by the insurance company to the agent, broker, or consultant in connection with the purchase of the recommended contract, including, if applicable, separate identification of the amount of the Insurance Commission that will be paid to any other person as a gross dealer concession, override, or similar payment; and

(C) A statement of any charges, fees, discounts, penalties or adjustments which may be imposed under the recommended contract in connection with the purchase, holding, exchange, termination, or sale of the contract.

Subsection (B) of this condition was revised in several respects from the existing language of the exemption. Originally, the exemption provided that disclosure must be made of "[t]he sales commission, expressed as a percentage of gross annual premium payments for the first year and for each of the succeeding renewal years, that will be paid by the insurance company to the agent, broker or consultant in connection with the purchase of the recommended contract." Some commenters requested that the Insurance Commission be expressed as a percentage of asset accumulation value or contract value, in addition to the gross annual premium payments. Another commenter indicated that in some cases, such as a retirement benefit contribution paid to an agent that is considered an Insurance Commission, it is difficult to represent the Insurance Commission as a percentage and therefore requested that a dollar figure be permitted. The Department accepted these comments, and indicated that all Insurance Commissions should be expressed as a dollar figure unless that is not feasible, in which case a percentage will be permitted. Expression of the Insurance Commission as a dollar amount results in an accurate, salient and simple disclosure that facilitates a clearer understanding of the conflicts associated with the investment. But where it is difficult to express Insurance Commissions in dollars, the disclosure will allow for percentage disclosures.

A commenter also questioned whether the required disclosure for commissions would encompass payments made to the agent indirectly by entities other than the insurance company. The Department revised the language of subsection (B) to indicate disclosure must be made of the Insurance Commission paid directly or indirectly by the insurance company. As explained in the definition of Insurance Commission and discussed above, the amended exemption more clearly sets forth the exemption's historical limitation to such payments.

Subsection (C) was minimally revised to provide that the exemption requires a "statement" of any charges, fees, discounts, penalties or adjustments, rather than a "description." This change was made to ensure that the level of specificity provided by the disclosures is not limited to an unduly general narrative description but rather to a more precise statement of the amounts of these charges, fees, discounts, penalties or adjustments. However, the statement can reference dollar amounts, percentages, formulas, or other means reasonably designed to present materially accurate disclosure. Similar language is used in the Best Interest Contract Exemption disclosures, and the change was made to correspond to the approach in that exemption.

For consistency across exemptions, the Department made corresponding amendments to the language in Section

[63] 42 FR 32395 (June 24, 1977).

IV(c), which sets forth the disclosure provisions applicable to investment company transactions.

Regarding the disclosures, a few commenters stated that the requirement to disclose the gross annual premium payments in year 1 and in succeeding years, as well as to describe any fees, charges, penalties, discounts or adjustments under the contract, would be difficult because independent broker-dealers do not create, maintain, or compile this type of information, and would need to expend significant resources to develop systems to compile or obtain the information to be disclosed. Another commenter argued the Department should limit the disclosure of compensation to the commissions as it would be impossible to disclose all additional forms of compensation.

These disclosure requirements are not new conditions, however, but rather have been a part of this exemption since it was initially granted in 1977,[64] and are an integral part of the exemption, which aims to ensure full disclosure of material conflicts of interest, so that retirement investors can make fully informed choices. The Department did not make changes in response to the comment because these disclosures are necessary to informing the plan or IRA customer of the fiduciary's conflicts.

b. Section IV(b)(2) and (c)(2)—Approval

Additional clarifying changes were also made to Section IV(b)(2) which addresses approval of the transaction following receipt of the disclosure. In the amended exemption, Section IV(b)(2) provides:

Following the receipt of the information required to be disclosed in paragraph (b)(1), and prior to the execution of the transaction, the fiduciary or IRA owner acknowledges in writing receipt of the information and approves the transaction on behalf of the Plan or IRA. The fiduciary may be an employer of employees covered by the Plan but may not be an insurance agent or broker, pension consultant, or insurance company involved in the transaction (*i.e.,* an independent fiduciary). The independent fiduciary may not receive, directly or indirectly (*e.g.,* through an Affiliate), any compensation or other consideration for his or her own personal account from any party dealing with the Plan in connection with the transaction.

The section in the originally granted exemption referred to acknowledgment of the disclosure and approval by an ''independent fiduciary.'' The language stated:

Following the receipt of the information required to be disclosed in paragraph (b)(1), and prior to the execution of the transaction, the independent fiduciary acknowledges in writing receipt of such information and approves the transaction on behalf of the plan. Such fiduciary may be an employer of employees covered by the plan, but may not be an insurance agent or broker, pension consultant or insurance company involved in the transaction. Such fiduciary may not receive, directly or indirectly (*e.g.* through an affiliate), any compensation or other consideration for his or her own personal account from any party dealing with the plan in connection with the transaction.

Commenters asked for clarification of this requirement in the context of IRAs. The Department revised the language of the section to indicate that the independent fiduciary *or IRA owner* must provide this acknowledgment and approval.

This change addresses another issue, raised by commenters, regarding the independence requirement as applicable to IRA owners. Under the original independence requirement, the fiduciary approving the transaction may not be the insurance agent or broker, pension consultant, or insurance company involved in the transaction (or an affiliate, including a family member). The Department did not add ''or IRA owner'' to this independence requirement and accordingly confirms that the independence requirement does not apply to IRA owners. This allows insurance agents and brokers to recommend Fixed Rate Annuity Contracts and insurance contracts to family members and receive a commission. The Department did not make corresponding changes to Section IV(c)(2) because transactions with IRAs involving investment company securities are not covered by the exemption.

Some commenters asked for a negative consent procedure in Section IV(b)(2) in which consent could be demonstrated by a failure to object to a written disclosure. They referenced Section IV(c)(2), which is applicable to investment company transactions, and states that ''[u]nless facts or circumstances would indicate the contrary, the approval may be presumed if the fiduciary permits the transaction to proceed after receipt of the written disclosure.''

The Department declined to adjust the consent procedure in the context of Fixed Rate Annuity Contract and insurance contract sales. The Department believes that investments in these products are significant enough that a negative consent procedure is not warranted.

c. Section IV(d)—Repeat Disclosures

Finally, a revision was made to Section IV(d), which sets forth the requirement for disclosure to be made in connection with additional purchases of Fixed Rate Annuity Contracts, insurance contracts, or securities issued by an investment company. Under the revised condition, the written disclosure required under Section IV(b) and (c) need not be repeated, unless:

(1) More than one year has passed since the disclosure was made with respect to the purchase of the same kind of contract or security, or

(2) The contract or security being recommended for purchase or the Insurance Commission or Mutual Fund Commission with respect thereto is materially different from that for which the approval described in paragraphs (b) and (c) of this Section was obtained.

This requirement was changed from three years, in the existing exemption, to one year in the final amendment. This change corresponds to the approach taken in the Best Interest Contract Exemption that these types of disclosures should be made on at least an annual basis. For example, in the Best Interest Contract Exemption, the transaction disclosure required by Section III(a) is required to be repeated on an annual basis with respect to additional recommendations of the same investment. This reflects the Department's view that if conflicted arrangements exist, plans and IRAs should receive sufficient notice to enable them to provide informed consent to the transaction, and a one year interval is the appropriate time in which the disclosure should be repeated, under the circumstances of this exemption as well as the Best Interest Contract Exemption.

In addition, the language was revised so that the one year period runs from the purchase of an annuity. If any disclosures were given with respect to a recommendation that was not acted upon by the customer, the one year period does not apply.

In connection with the changes to this section, the Department clarified in the introductory language that these disclosures are required to be made only with respect to additional transactions that are *recommended* by the investment advice fiduciary.

Recordkeeping

Section V of the amended exemption includes a recordkeeping requirement under which the insurance agent or broker, pension consultant, insurance company, or investment company principal underwriter engaging in the transaction must maintain records of the

[64] See PTE 77–9, 42 FR 32395 (June 24, 1977) (predecessor to PTE 84–24).

transaction for six years, accessible for audit and examination. A commenter on this provision recommended that the word ''reasonably'' be inserted prior to the term ''accessible.'' The commenter asserted that this clarification would remove the subjective views of the person requesting to examine or audit the records. The commenter also recommended that the Department clarify that fiduciaries, employers, employee organizations, participants, and their employees and representatives only have access to information concerning their own plans. This commenter also stated the exemption should clarify that any failure to maintain the required records with respect to a given transaction or set of transactions does not affect the relief for other transactions.

The Department has accepted these comments and made the requested revisions. Thus, the Department specifically clarified that ''[f]ailure to maintain the required records necessary to determine whether the conditions of this exemption have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions.'' In addition, in accordance with other exemptions granted and amended today, financial institutions are also not required to disclose records if such disclosure would be precluded by 12 U.S.C. 484, relating to visitorial powers over national banks and federal savings associations.[65]

Definitions

The definition of ''Plan,'' set forth in Section VI(l) of the amended exemption, provides that a Plan means any employee benefit plan described in section 3(3) of the Act and any plan described in section 4975(e)(1)(A) of the Code. The proposal did not contain a definition of Plan. This definition was added in response to commenters who questioned the exemption's application to plans such as Simplified Employee Pensions (SEPs), Savings Incentive Match Plans for Employees (SIMPLEs) and Keoghs. The Department intends for the definition of Plan to include all of these plans.

The definition of ''relative'' set forth in Section VI(n) refers to a ''relative'' as that term is defined in ERISA section 3(15) (or a ''member of the family'' as that term is defined in Code section 4975(e)(6)). These provisions include spouses, ancestors, lineal descendants and spouses of a lineal descendant. Originally, the definition used in the exemption was more expansive, and, in addition to these entities also included ''a brother, a sister, or a spouse of a brother or a sister.'' A commenter stated that this definition was broader than the definition of ''relative'' in the other exemptions granted and amended today, and asked that the Department eliminate the references to brothers, sisters and their spouses. The Department concurs and has changed the text so that the definitions are consistent across exemptions.

Section VI(d) defines ''Individual Retirement Account'' or ''IRA'' as any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and an HSA described in section 223(d) of the Code. This definition is unchanged from the proposal.

The Department received comments on both the application of the proposed Regulation and the exemption proposals to other non-ERISA plans covered by Code section 4975, such as HSAs, Archer Medical Savings Accounts and Coverdell Education Savings Accounts. The Department notes that these accounts are given tax preferences as are IRAs. Further, some of the accounts, such as HSAs, can be used as long term savings accounts for retiree health care expenses. These types of accounts also are expressly defined by Code section 4975(e)(1) as plans that are subject to the Code's prohibited transaction rules. Thus, although they generally may hold fewer assets and may exist for shorter durations than IRAs, there is no statutory reason to treat them differently than other conflicted transactions and no basis for suspecting that the conflicts are any less influential with respect to advice on these arrangements. Accordingly, the Department does not agree with the commenters that the owners of these accounts are entitled to less protection than IRA investors. The Regulation continues to include advisers to these ''plans,'' and this exemption provides relief to them in the same manner as it does for individual retirement accounts described in section 408(a) of the Code.

Grandfathering

The Department received several comments from the industry requesting that the exemption include a grandfathering provision for pre-existing annuity contracts. The commenters stated that the grandfathering provision would help the industry avoid costly unraveling of ongoing client relationships. Many of the commenters requested that the grandfathering provision include coverage for transactions occurring after the Applicability Date of the exemption but based on advice that was given prior to the Applicability Date. The commenters argued that without a grandfathering provision existing relationships will become fiduciary relationships creating undue compliance burdens and costs that were not priced into the contracts and as a result many advisers may be forced to abandon existing IRA relationships.

The Department has not included a grandfathering provision in this amended exemption, however some of the relief requested by commenters is available in the Best Interest Contract Exemption. Specifically, Section VII of the Best Interest Contract Exemption sets forth an exemption for investments that are pre-existing at the time of the Applicability Date and is available for pre-existing insurance and annuity contracts. Under Section VII of the Best Interest Contract Exemption, additional advice may be provided on existing investments after the Applicability Date, and additional compensation may be received, if the 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, and the advice is rendered without regard to the financial or other interests of the investment advice fiduciary or any affiliate or other party.

The exemption set forth in Section VII of the Best Interest Contract Exemption is generally limited to securities or other property purchased prior to the Applicability Date, and does not generally extend to advice on additional contributions to an annuity purchased prior to the Applicability Date. Although commenters requested broader relief in this area, the Department has declined to permit advice on additional contributions to existing investments, without compliance with the conditions of this

[65] A commenter with respect to the Best Interest Contract Exemption raised concerns that the Department's right to review a bank's records under that exemption could conflict with federal banking laws that prohibit agencies other than the Office of the Comptroller of the Currency (OCC) from exercising ''visitorial'' powers over national banks and federal savings associations. To address the comment, financial institutions are not required to disclose records if the disclosure would be precluded by 12 U.S.C. 484. A corresponding change was made in this exemption.

exemption or the conditions of Section I of the Best Interest Contract Exemption. The primary purpose of the exemption for pre-existing investments in Section VII of the Best Interest Contract Exemption is to preserve compensation for services already rendered and to permit orderly transition from past arrangements, not to exempt future advice and investments from the important protections of the Regulation and this amended exemption or the Best Interest Contract Exemption. Permitting investment advice fiduciaries to recommend additional investments in an existing insurance or annuity contract, without the safeguards provided by the fiduciary norms in this amended exemption, would permit conflicts to flourish unchecked.

Applicability Date

The Regulation will become effective June 7, 2016 and this amended exemption is issued on that same date. The Regulation is effective at the earliest possible effective date under the Congressional Review Act. For the exemption, the issuance date serves as the date on which the amended exemption is intended to take effect for purposes of the Congressional Review Act. This date was selected in order to provide certainty to plans, plan fiduciaries, plan participants and beneficiaries, IRAs, and IRA owners that the new protections afforded by the Regulation are officially part of the law and regulations governing their investment advice providers, and to inform financial services providers and other affected service providers that the Regulation and amended exemption are final and not subject to further amendment or modification without additional public notice and comment. The Department expects that this effective date will remove uncertainty as an obstacle to regulated firms allocating capital and other resources toward transition and longer term compliance adjustments to systems and business practices.

The Department has also determined that, in light of the importance of the Regulation's consumer protections and the significance of the continuing monetary harm to retirement investors without the rule's changes, that an Applicability Date of April 10, 2017, is appropriate for plans and their affected financial services and other service providers to adjust to the basic change from non-fiduciary to fiduciary status. The amendment to and partial revocation of PTE 84–24, as finalized herein, can be relied on beginning on the Applicability Date. For the avoidance of doubt, no revocation will be applicable prior to the Applicability Date.

Paperwork Reduction Act Statement

In accordance with the requirements of the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506(c)(2)), the Department solicited comments on the information collections included in the proposed Amendment to and Partial Revocation of PTE 84–24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters. 80 FR 22010 (Apr. 20, 2015). The Department also submitted an information collection request (ICR) to OMB in accordance with 44 U.S.C. 3507(d), contemporaneously with the publication of the proposal, for OMB's review. The Department received two comments from one commenter that specifically addressed the paperwork burden analysis of the information collections. Additionally many comments were submitted, described elsewhere in this preamble and in the preamble to the accompanying final rule, which contained information relevant to the costs and administrative burdens attendant to the proposals. The Department took into account such public comments in connection with making changes to the prohibited transaction exemption, analyzing the economic impact of the proposals, and developing the revised paperwork burden analysis summarized below.

In connection with publication of this final amendment to and partial revocation of PTE 84–24, the Department is submitting an ICR to OMB requesting approval of a new collection of information under a new OMB Control Number. The Department will notify the public when OMB approves the ICR.

A copy of the ICR may be obtained by contacting the PRA addressee shown below or at *http://www.RegInfo.gov.* PRA ADDRESSEE: G. Christopher Cosby, Office of Policy and Research, U.S. Department of Labor, Employee Benefits Security Administration, 200 Constitution Avenue NW., Room N–5718, Washington, DC 20210. Telephone: (202) 693–8410; Fax: (202) 219–4745. These are not toll-free numbers.

As discussed in detail below, PTE 84–24, as amended, provides an exemption for certain prohibited transactions that occur when investment advice fiduciaries and other service providers receive compensation for their recommendation that plans or IRAs purchase "Fixed Rate Annuity Contracts" and insurance contracts. Relief is also provided for certain prohibited transactions that occur when investment advice fiduciaries and other service providers receive compensation as a result of recommendations that plans purchase securities in an investment company registered under the Investment Company Act of 1940. The amended exemption permits insurance agents, insurance brokers, pension consultants, and investment company principal underwriters that are parties in interest or fiduciaries with respect to plan investors to effect these purchases and receive a commission on them. The amended exemption is also available for the prohibited transaction that occurs when the insurance company selling the Fixed Rate Annuity Contract or insurance contract is a party in interest or disqualified person with respect to the plan or IRA. As amended, the exemption requires fiduciaries engaging in these transactions to adhere to certain Impartial Conduct Standards, including acting in the best interest of the plans and IRAs when providing advice.

The amendment revises the disclosure and recordkeeping requirements of the exemption by requiring insurance agents and brokers, pension consultants, insurance companies, and investment company principal underwriters to make certain disclosures to and receive an advance authorization from plan fiduciaries or, as applicable, IRA owners, in order to receive relief from ERISA's and the Code's prohibited transaction rules for the receipt of compensation when plans and IRAs enter into certain recommended insurance and mutual fund transactions. The amendment will require insurance agents and brokers, pension consultants, insurance companies, and investment company principal underwriters relying on PTE 84–24 to maintain records necessary to demonstrate that the conditions of the exemption have been met. These requirements are ICRs subject to the PRA.

The Department has made the following assumptions in order to establish a reasonable estimate of the paperwork burden associated with these ICRs:

- 51.8 percent of disclosures to and advance authorizations from plans [66]

[66] According to data from the National Telecommunications and Information Administration (NTIA), 33.4 percent of individuals age 25 and over have access to the Internet at work. According to a Greenwald & Associates survey, 84 percent of plan participants find it acceptable to make electronic delivery the default option, which is used as the proxy for the number of participants Continued

and 44.1 percent of disclosures to and advance authorizations from IRAs [67] will be distributed electronically via means already used by respondents in the normal course of business, and the costs arising from electronic distribution will be negligible, while the remaining disclosures and advance authorizations will be distributed on paper and mailed at a cost of $0.05 per page for materials and $0.49 for First class Postage;

- Insurance agents and brokers, pension consultants, insurance companies, investment company principal underwriters, and plans will use existing in-house resources to prepare the legal authorizations and disclosures, and maintain the recordkeeping systems necessary to meet the requirements of the exemption;
- A combination of personnel will perform the tasks associated with the ICRs at an hourly wage rate of $167.32 for a financial manager, $55.21 for clerical personnel, and $133.61 for a legal professional; [68]
- Three percent of plans and three percent of IRAs will engage in covered transactions with insurance agents and brokers, pension consultants, and insurance companies annually;
- Approximately 1,500 insurance agents and brokers, pension consultants, and insurance companies will take advantage of this exemption with all of their client plans and IRAs; [69] and
- Ten investment company principal underwriters will take advantage of this exemption and each will do so once with one client plan annually.[70]

Disclosures and Consent Forms

In order to receive commissions in conjunction with the purchase of insurance contracts or Fixed Rate Annuity Contracts, Section IV(b) of PTE 84–24 as amended requires the insurance agent or broker or pension consultant to obtain advance written authorization from a plan fiduciary independent of the insurance company (the independent fiduciary), or, in the case of an IRA, the IRA owner, following certain disclosures, including: If the agent, broker, or consultant is an Affiliate of the insurance company whose contract is being recommended, or if the ability of the agent, broker, or consultant to recommend insurance or Fixed Rate Annuity Contracts is limited by any agreement with the insurance company, the nature of the affiliation, limitation, or relationship; the insurance commission; and a statement of any charges, fees, discounts, penalties, or adjustments which may be imposed under the recommended contract in connection with the purchase, holding, exchange, termination, or sale of the contract.

In order to receive commissions in conjunction with the purchase of securities issued by an investment company, Section IV(c) of PTE 84–24 as amended requires the investment company principal underwriter to obtain approval from an independent plan fiduciary following certain disclosures: If the person recommending securities issued by an investment company is the principal underwriter of the investment company whose securities are being recommended, the nature of the relationship and of any limitation it places upon the principal underwriter's ability to recommend investment company securities; the Mutual Fund Commission; and a statement of any charges, fees, discounts, penalties, or adjustments which may be imposed under the recommended securities in connection with the purchase, holding, exchange, termination, or sale of the securities. Unless facts or circumstances would indicate the contrary, the approval required under Section IV(c) may be presumed if the independent plan fiduciary permits the transaction to proceed after receipt of the written disclosure.

Legal Costs

According to 2013 Annual Return/Report of Employee Benefit (Form 5500) data and IRS Statistics of Income data, the Department estimates that there are approximately 681,000 ERISA covered pension plans and approximately 54.4 million IRAs. Of these plans and IRAs, the Department assumes that, as stated previously, three percent of these plans and three percent of these IRAs will engage in transactions covered under PTE 84–24 annually with insurance agents or brokers and pension consultants. In the plan universe, the Department assumes that a legal professional will spend five hours per plan reviewing the disclosures and preparing an authorization form for each of the approximately 20,000 plans engaging in covered transactions each year. In the IRA universe, IRA holders are also required to provide an authorization, but the Department assumes that a legal professional working on behalf of each of the 1,500 insurance companies or pension consultants will spend three hours drafting a standard authorization form for IRA holders to sign and return. The Department also estimates that it will take two hours of legal time for each of the approximately 1,500 insurance companies and pension consultants, and one hour of legal time for each of the 10 investment company principal underwriters, to produce the disclosures.[71] This legal work results in a total of approximately 110,000 hours annually at an equivalent cost of $14.7 million.

who will not opt out that are automatically enrolled (for a total of 28.1 percent receiving electronic disclosure at work). Additionally, the NTIA reports that 38.9 percent of individuals age 25 and over have access to the Internet outside of work. According to a Pew Research Center survey, 61 percent of Internet users use online banking, which is used as the proxy for the number of Internet users who will opt in for electronic disclosure (for a total of 23.7 percent receiving electronic disclosure outside of work). Combining the 28.1 percent who receive electronic disclosure at work with the 23.7 percent who receive electronic disclosure outside of work produces a total of 51.8 percent who will receive electronic disclosure overall.

[67] According to data from the NTIA, 72.4 percent of individuals age 25 and older have access to the Internet. According to a Pew Research Center survey, 61 percent of Internet users use online banking, which is used as the proxy for the number of Internet users who will opt in for electronic disclosure. Combining these data produces an estimate of 44.1 percent of individuals who will receive electronic disclosures.

[68] For a description of the Department's methodology for calculating wage rates, see *http://www.dol.gov/ebsa/pdf/labor-cost-inputs-used-in-ebsa-opr-ria-and-pra-burden-calculations-march-2016.pdf.* The Department's methodology for calculating the overhead cost input of its wage rates was adjusted from the proposed amendment to this PTE to the final amendment to this PTE. In the proposal, the Department based its overhead cost estimates on longstanding internal EBSA calculations for the cost of overhead. In response to a public comment stating that the overhead cost estimates were too low and without any supporting evidence, the Department incorporated published U.S. Census Bureau survey data on overhead costs into its wage rate estimates.

[69] According to 2013 Form 5500 data, 1,007 pension consultants service the retirement market. Additionally, SNL Financial data show that 398 life insurance companies reported receiving either individual or group annuity considerations in 2014. The Department has used these data as the count of insurance companies working in the ERISA-covered plan and IRA markets. The Department has rounded up to 1,500 to account for any other pension consultants or insurance companies that may not otherwise be accounted for.

[70] In the Department's experience, investment company principal underwriters almost never use PTE 84–24. Therefore, the Department assumes that 10 investment company principal underwriters will engage in one transaction annually under PTE 84–24.

[71] The Department assumes that it will require one hour of legal time per financial institution to prepare plan-oriented disclosures and one hour of legal time per financial institution to prepare IRA-oriented disclosures. Because insurance agents and pension consultants are permitted to use PTE 84–24 in their transactions with both plans and IRAs, this totals two hours of legal burden each. Because investment company principal underwriters are only permitted to use PTE 84–24 in their transactions with plans, this totals one hour of legal burden each.

Production and Distribution of Required Disclosures

The Department estimates that approximately 20,000 plans and 1.6 million IRAs have engage in covered transactions with insurance agents or brokers and pension consultants under this exemption each year. The Department assumes that 10 plans engage in covered transactions with investment company principal underwriters under this exemption each year.

The Department estimates that 20,000 plans will send insurance agents or brokers and pension consultants a two-page authorization letter and 1.6 million IRAs will receive a two-page authorization letter from insurance agents or brokers and pension consultants to sign and return each year. Prior to obtaining authorization, insurance companies and pension consultants will send the same 20,000 plans and 1.6 million IRAs a seven-page pre-authorization disclosure. Paper copies of the authorization letter and the pre-authorization disclosure will be mailed for 48.2 percent of the plans and distributed electronically for the remaining 51.8 percent. Paper copies of the authorization letter and the pre-authorization disclosure will be mailed to 55.9 percent of the IRAs and distributed electronically to the remaining 44.1 percent. The Department estimates that electronic distribution will result in a de minimis cost, while paper distribution will cost approximately $1.3 million. Paper distribution of the letter and disclosure will also require two minutes of clerical preparation time [72] resulting in a total of 62,000 hours at an equivalent cost of approximately $3.4 million.

The Department estimates that 10 plans will receive the seven-page pre-transaction disclosure from investment company principal underwriters; 51.8 percent will be distributed electronically and 48.2 percent will be mailed. The Department estimates that electronic distribution will result in a de minimis cost, while the paper distribution will cost $4. Paper distribution will also require two minutes of clerical preparation time resulting in a total of 10 minutes at an equivalent cost of $9. Approval to investment company principal underwriters will be granted orally at de minimis cost.

[72] The Department has run experiments involving clerical staff suggesting that most notices can be printed and prepared for mailing in less than one minute per disclosure. Therefore, an estimate of two minutes per disclosure is a conservative estimate.

Recordkeeping Requirement

Section V of PTE 84–24, as amended, requires insurance agents and brokers, insurance companies, pension consultants, and investment company principal underwriters to maintain or cause to be maintained for six years and disclosed upon request the records necessary for the Department, IRS, plan fiduciary, contributing employer or employee organization whose members are covered by the plan, plan participant, beneficiary or IRA owner, to determine whether the conditions of this exemption have been met.

The Department assumes that each institution will maintain these records in their normal course of business. Therefore, the Department has estimated that the additional time needed to maintain records consistent with the exemption will only require about one-half hour, on average, annually for a financial manager to organize and collate the documents or else draft a notice explaining that the information is exempt from disclosure, and an additional 15 minutes of clerical time to make the documents available for inspection during normal business hours or prepare the paper notice explaining that the information is exempt from disclosure. Thus, the Department estimates that a total of 45 minutes of professional time (30 minutes of financial manager time and 15 minutes of clerical time) per financial institution per year would be required for a total hour burden of 1,000 hours at an equivalent cost of $147,000.

In connection with the recordkeeping and disclosure requirements discussed above, Section V(b) (2) and (3) of PTE 84–24 provides that parties relying on the exemption do not have to disclose trade secrets or other confidential information to members of the public (*i.e.,* plan fiduciaries, contributing employers or employee organizations whose members are covered by the plan, participants and beneficiaries and IRA owners), but that in the event a party refuses to disclose information on this basis, it must provide a written notice to the requester advising of the reasons for the refusal and advising that the Department may request such information. The Department's experience indicates that this provision is not commonly invoked, and therefore, the written notice is rarely, if ever, generated. Therefore, the Department believes the cost burden associated with this clause is de minimis. No other cost burden exists with respect to recordkeeping.

Overall Summary

Overall, the Department estimates that in order to meet the conditions of this amended exemption, almost 22,000 financial institutions and plans will produce 3.3 million disclosures and notices annually. These disclosures and notices will result in over 172,000 burden hours annually, at an equivalent cost of $18.2 million. This amended exemption will also result in a total annual cost burden of over $1.3 million.

These paperwork burden estimates are summarized as follows:

Type of Review: New collection (Request for new OMB Control Number).

Agency: Employee Benefits Security Administration, Department of Labor.

Titles: (1) Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 84–24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies and Investment Company Principal Underwriters.

OMB Control Number: 1210–NEW.

Affected Public: Businesses or other for-profits; not for profit institutions.

Estimated Number of Respondents: 21,940.

Estimated Number of Annual Responses: 3,306,610.

Frequency of Response: Initially, Annually, When engaging in exempted transaction.

Estimated Total Annual Burden Hours: 172,301 hours.

Estimated Total Annual Burden Cost: $1,319,353.

General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under ERISA section 408(a) and Code section 4975(c)(2) does not relieve a fiduciary or other party in interest or disqualified person with respect to a plan from certain other provisions of ERISA and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of ERISA section 404 which require, among other things, that a fiduciary discharge his or her duties respecting the plan solely in the interests of the plan's participants and beneficiaries and in a prudent fashion in accordance with ERISA section 404(a)(1)(B);

(2) The Department finds that the class exemption as amended is administratively feasible, in the interests of the plan and of its

participants and beneficiaries and IRA owners, and protective of the rights of the plan's participants and beneficiaries and IRA owners;

(3) The class exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the class exemption; and

(4) This amended class exemption is supplemental to, and not in derogation of, any other provisions of ERISA and the Code, including statutory or administrative exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

Amended Exemption

Section I. Covered Transactions

(a) In general. ERISA and the Code prohibit fiduciary advisers to employee benefit plans and IRAs from self-dealing, including receiving compensation that varies based on their investment advice, and from receiving compensation from third parties in connection with their advice. ERISA and the Code also prohibit fiduciaries and other parties related to plans and IRAs from engaging in purchases and sales of products with the plans and IRAs. This exemption permits certain, specified persons, including specified persons who are fiduciaries due to their provision of investment advice to plans and IRAs, to receive these types of compensation in connection with transactions involving insurance contracts, specified annuity contracts, and investment company securities, as described below.

(b) Exemptions. The restrictions of ERISA section 406(a)(1)(A) through (D) and 406(b) and the taxes imposed by Code section 4975(a) and (b) by reason of Code section 4975(c)(1)(A) through (F), do not apply to any of the following transactions if the conditions set forth in Sections II, III, IV, and V, as applicable, are met:

(1) The receipt, directly or indirectly, by an insurance agent or broker or a pension consultant of an Insurance Commission and related employee benefits from an insurance company in connection with the purchase, with assets of a Plan or IRA, including through a rollover or distribution, of an insurance contract or a Fixed Rate Annuity Contract. A Fixed Rate Annuity Contract is a fixed annuity contract issued by an insurance company that is either an immediate annuity contract or a deferred annuity contract that (i) satisfies applicable state standard nonforfeiture laws at the time of issue, or (ii) in the case of a group fixed annuity, guarantees return of principal net of reasonable compensation and provides a guaranteed declared minimum interest rate in accordance with the rates specified in the standard nonforfeiture laws in that state that are applicable to individual annuities; in either case, the benefits of which do not vary, in part or in whole, based on the investment experience of a separate account or accounts maintained by the insurer or the investment experience of an index or investment model. A Fixed Rate Annuity Contract does not include a variable annuity or an indexed annuity or similar annuity.

(2) The receipt of a Mutual Fund Commission by a Principal Underwriter for an investment company registered under the Investment Company Act of 1940 (an investment company) in connection with the purchase, with Plan assets, including through a rollover or distribution, of securities issued by an investment company.

(3)(i) The effecting by an insurance agent or broker, or pension consultant of a transaction for the purchase, with assets of a Plan or IRA, including through a rollover or distribution, of a Fixed Rate Annuity Contract or insurance contract, or (ii) the effecting by a Principal Underwriter of a transaction for the purchase, with assets of a Plan, including through a rollover or distribution, of securities issued by an investment company.

(4) The purchase, with assets of a Plan or IRA, including through a rollover or distribution, of a Fixed Rate Annuity Contract or insurance contract from an insurance company, and the receipt of compensation or other consideration by the insurance company.

(5) The purchase, with assets of a Plan, of a Fixed Rate Annuity Contract or insurance contract from an insurance company which is a fiduciary or a service provider (or both) with respect to the Plan solely by reason of the sponsorship of a Master or Prototype Plan.

(6) The purchase, with assets of a Plan, of securities issued by an investment company from, or the sale of such securities to, an investment company or an investment company Principal Underwriter, when the investment company, Principal Underwriter, or the investment company investment adviser, is a fiduciary or a service provider (or both) with respect to the Plan solely by reason of: (A) The sponsorship of a Master or Prototype Plan; or (B) the provision of Nondiscretionary Trust Services to the Plan; or (C) both (A) and (B).

(c) Scope of these Exemptions.

(1) The exemptions set forth in Section I(b) do not apply to the purchase by a Plan or IRA, each as defined in Section VI, of a variable annuity contract, indexed annuity contract, or similar contract; and

(2) The exemptions set forth in Section I(b) do not apply to the purchase by an IRA of investment company securities.

Section II. Impartial Conduct Standards

If the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter is a fiduciary within the meaning of ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B) with respect to the assets involved in the transaction, the following conditions must be satisfied with respect to the transaction to the extent they are applicable to the fiduciary's actions:

(a) When exercising fiduciary authority described in ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B) with respect to the assets involved in the transaction, the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter acts in the Best Interest of the Plan or IRA at the time of the transaction; and

(b) The statements by the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter about recommended investments, fees, Material Conflicts of Interest, and any other matters relevant to a Plan's or IRA owner's investment decisions, are not materially misleading at the time they are made. For this purpose, the insurance agent's or broker's, pension consultant's, insurance company's or investment company Principal Underwriter's failure to disclose a Material Conflict of Interest relevant to the services it is providing or other actions it is taking in relation to a Plan's or IRA owner's investment decisions is considered a misleading statement.

Section III. General Conditions

(a) The transaction is effected by the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter in the ordinary course of its business as such a person.

(b) The transaction is on terms at least as favorable to the Plan or IRA as an arm's length transaction with an unrelated party would be.

(c) The combined total of all fees and compensation received by the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter for their services does not exceed reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2),

Section IV. Conditions for Transactions Described in Section I(b)(1) Through (4)

The following conditions apply solely to a transaction described in paragraphs (b)(1), (2), (3) or (4) of Section I:

(a) The insurance agent or broker, pension consultant, insurance company, or investment company Principal Underwriter is not (1) a trustee of the Plan or IRA (other than a Nondiscretionary Trustee who does not render investment advice with respect to any assets of the Plan), (2) a plan administrator (within the meaning of ERISA section 3(16)(A) and Code section 414(g)), (3) a fiduciary who is expressly authorized in writing to manage, acquire, or dispose of the assets of the Plan or IRA on a discretionary basis, or (4) an employer any of whose employees are covered by the Plan. Notwithstanding the above, an insurance agent or broker, pension consultant, insurance company, or investment company Principal Underwriter that is Affiliated with a trustee or an investment manager (within the meaning of Section VI(e)) with respect to a Plan or IRA may engage in a transaction described in Section I(b)(1)–(4) of this exemption (if permitted under Section I(b)) on behalf of the Plan or IRA if the trustee or investment manager has no discretionary authority or control over the Plan's or IRA's assets involved in the transaction other than as a Nondiscretionary Trustee.

(b)(1) With respect to a transaction involving the purchase with Plan or IRA assets of a Fixed Rate Annuity Contract or insurance contract, or the receipt of an Insurance Commission thereon, the insurance agent or broker or pension consultant provides to an independent fiduciary with respect to the Plan, or in the case of an IRA, to the IRA owner, prior to the execution of the transaction the following information in writing and in a form calculated to be understood by a plan fiduciary or IRA owner who has no special expertise in insurance or investment matters:

(A) If the agent, broker, or consultant is an Affiliate of the insurance company whose contract is being recommended, or if the ability of the agent, broker, or consultant to recommend Fixed Rate Annuity Contracts or insurance contracts is limited by any agreement with the insurance company, the nature of the affiliation, limitation, or relationship;

(B) The Insurance Commission, expressed to the extent feasible as an absolute dollar figure, or otherwise, as a percentage of gross annual premium payments, asset accumulation value, or contract value, for the first year and for each of the succeeding renewal years, that will be paid directly or indirectly by the insurance company to the agent, broker, or consultant in connection with the purchase of the recommended contract, including, if applicable, separate identification of the amount of the Insurance Commission that will be paid to any other person as a gross dealer concession, override, or similar payment; and

(C) A statement of any charges, fees, discounts, penalties or adjustments which may be imposed under the recommended contract in connection with the purchase, holding, exchange, termination, or sale of the contract.

(2) Following the receipt of the information required to be disclosed in paragraph (b)(1), and prior to the execution of the transaction, the fiduciary or IRA owner acknowledges in writing receipt of the information and approves the transaction on behalf of the Plan or IRA. The fiduciary may be an employer of employees covered by the Plan but may not be an insurance agent or broker, pension consultant, or insurance company involved in the transaction (*i.e.,* an independent fiduciary). The independent fiduciary may not receive, directly or indirectly (*e.g.,* through an Affiliate), any compensation or other consideration for his or her own personal account from any party dealing with the Plan in connection with the transaction.

(c)(1) With respect to a transaction involving the purchase with plan assets of securities issued by an investment company or the receipt of a Mutual Fund Commission thereon by an investment company Principal Underwriter, the investment company Principal Underwriter provides to an independent fiduciary with respect to the Plan, prior to the execution of the transaction, the following information in writing and in a form calculated to be understood by a plan fiduciary who has no special expertise in insurance or investment matters:

(A) If the person recommending securities issued by an investment company is the Principal Underwriter of the investment company whose securities are being recommended, the nature of the relationship and of any limitation it places upon the Principal Underwriter's ability to recommend investment company securities;

(B) The Mutual Fund Commission, expressed to the extent feasible, as an absolute dollar figure, or otherwise, as a percentage of the dollar amount of the Plan's gross payment and of the amount actually invested, that will be received by the Principal Underwriter in connection with the purchase of the recommended securities issued by the investment company; and

(C) A statement of any charges, fees, discounts, penalties, or adjustments which may be imposed under the recommended securities in connection with the purchase, holding, exchange, termination, or sale of the securities.

(2) Following the receipt of the information required to be disclosed in paragraph (c)(1), and prior to the execution of the transaction, the independent fiduciary approves the transaction on behalf of the Plan. Unless facts or circumstances would indicate the contrary, the approval may be presumed if the fiduciary permits the transaction to proceed after receipt of the written disclosure. The fiduciary may be an employer of employees covered by the Plan, but may not be a Principal Underwriter involved in the transaction. The independent fiduciary may not receive, directly or indirectly (*e.g.,* through an Affiliate), any compensation or other consideration for his or her own personal account from any party dealing with the Plan in connection with the transaction.

(d) With respect to additional recommendations regarding purchases of Fixed Rate Annuity Contracts, insurance contract, or securities issued by an investment company, the written disclosure required under paragraphs (b) and (c) of this Section IV need not be repeated, unless:

(1) More than one year has passed since the disclosure was made with respect to the purchase of the same kind of contract or security, or

(2) The contract or security being recommended for purchase or the Insurance Commission or Mutual Fund Commission with respect thereto is materially different from that for which the approval described in paragraphs (b) and (c) of this Section was obtained.

Section V. Recordkeeping Requirements

(a) The insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter engaging in the covered transactions maintains or causes to be maintained for a period of six years, in a manner that is reasonably accessible for audit and examination, the records necessary to enable the persons described in Section V(b) to determine whether the conditions of this exemption have been met, except that:

(1) If the records necessary to enable the persons described in Section V(b) below to determine whether the conditions of the exemption have been met are lost or destroyed, due to circumstances beyond the control of the insurance agent or broker, pension consultant, insurance company, or investment company Principal Underwriter, then no prohibited transaction will be considered to have occurred solely on the basis of the unavailability of those records; and

(2) No party in interest, other than the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter shall be subject to the civil penalty that may be assessed under ERISA section 502(i) or the taxes imposed by Code section 4975(a) and (b) if the records are not maintained or are not available for examination as required by paragraph (b) below; and

(b)(1) Except as provided below in subparagraph (2) or as precluded by 12 U.S.C. 484, and notwithstanding any provisions of ERISA section 504(a)(2) and (b), the records referred to in the above paragraph are reasonably available at their customary location for examination during normal business hours by—

(A) Any duly authorized employee or representative of the Department or the IRS;

(B) Any fiduciary of the Plan or any duly authorized employee or representative of the fiduciary;

(C) Any contributing employer and any employee organization whose members are covered by the Plan, or any authorized employee or representative of these entities; or

(D) Any participant or beneficiary of the Plan or the duly authorized representative of the participant or beneficiary or IRA owner; and

(2) None of the persons described in subparagraph (1)(B)–(D) above shall be authorized to examine records regarding a transaction involving a Plan or IRA unrelated to the person, or trade secrets or commercial or financial information of the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter which is privileged or confidential.

(3) Should the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter refuse to disclose information on the basis that the information is exempt from disclosure, the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter shall, by the close of the thirtieth (30th) day following the request, provide a written notice advising that person of the reasons for the refusal and that the Department may request the information.

(c) Failure to maintain the required records necessary to determine whether the conditions of this exemption have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions.

Section VI. Definitions

For purposes of this exemption:

(a) The term ''Affiliate'' of a person means:

(1) Any person directly or indirectly controlling, controlled by, or under common control with the person;

(2) Any officer, director, employee (including, in the case of Principal Underwriter, any registered representative thereof, whether or not the person is a common law employee of the Principal Underwriter), or relative of any such person, or any partner in such person; or

(3) Any corporation or partnership of which the person is an officer, director, or employee, or in which the person is a partner.

(b) The insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter that is a fiduciary acts in the ''Best Interest'' of the Plan or IRA when the fiduciary acts 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 Plan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate or other party.

(c) The term ''control'' means the power to exercise a controlling influence over the management or policies of a person other than an individual.

(d) The terms ''Individual Retirement Account'' or ''IRA'' mean any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and an HSA described in section 223(d) of the Code.

(e) The terms ''insurance agent or broker,'' ''pension consultant,'' ''insurance company,'' ''investment company,'' and ''Principal Underwriter'' mean such persons and any Affiliates thereof.

(f) The term ''Insurance Commission'' mean a sales commission paid by the insurance company to the insurance agent or broker or pension consultant for the service of effecting the purchase of a Fixed Rate Annuity Contract or insurance contract, including renewal fees and trailers, but not revenue sharing payments, administrative fees, or marketing payments.

(g) The term ''Master or Prototype Plan'' means a Plan which is approved by the Service under Rev. Proc. 2011–49, 2011–44 I.R.B. 608 (10/31/2011), as modified, or its successors.

(h) A ''Material Conflict of Interest'' exists when a person has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Plan or IRA.

(i) The term ''Mutual Fund Commission'' means a commission or sales load paid either by the Plan or the investment company for the service of effecting or executing the purchase of investment company securities, but does not include a 12b–1 fee, revenue sharing payment, administrative fee, or marketing fee.

(j) The term ''Nondiscretionary Trust Services'' means custodial services, services ancillary to custodial services, none of which services are discretionary, duties imposed by any provisions of the Code, and services performed pursuant to directions in accordance with ERISA section 403(a)(1). The term ''Nondiscretionary Trustee'' of a Plan or IRA means a trustee whose powers and duties with respect to the Plan are limited to the provision of Nondiscretionary Trust Services. For purposes of this exemption, a person who is otherwise a Nondiscretionary Trustee will not fail to be a Nondiscretionary Trustee solely by reason of his having been delegated, by the sponsor of a Master or Prototype Plan, the power to amend the Plan.

(k) The term ''Fixed Rate Annuity Contract'' means a fixed annuity contract issued by an insurance company that is either an immediate annuity contract or a deferred annuity contract that (i) satisfies applicable state standard nonforfeiture laws at the time of issue, or (ii) in the case of a group fixed annuity, guarantees return of principal net of reasonable compensation and provides a guaranteed declared minimum interest rate in accordance with the rates specified in the standard nonforfeiture laws in that state that are applicable to individual annuities; in either case, the benefits of which do not vary, in part or in whole, based on the investment experience of a separate account or accounts maintained by the insurer or the investment experience of an index or investment model. A Fixed Rate Annuity Contract does not include a variable annuity or an indexed annuity or similar annuity.

(l) The term ''Plan'' means any employee benefit plan described in section 3(3) of the Act and any plan described in section 4975(e)(1)(A) of the Code.

(m) The term ''Principal Underwriter'' is defined in the same manner as that term is defined in section 2(a)(29) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(29)).

(n) The term ''relative'' means a ''relative'' as that term is defined in ERISA section 3(15) (or a ''member of the family'' as that term is defined in Code section 4975(e)(6)).

Signed at Washington, DC, this 1st day of April, 2016.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

BILLING CODE 4510–29–P

Appendix I - Comparing Different Types of Deferred Annuities

	Fixed-Rate	Fixed-Indexed	Variable
Overview	• A contract providing a guaranteed, specified rate of interest on premiums paid.	• A contract providing for the crediting of interest based on changes in a market index.	• A contract with an account value that rises or falls based on the performance of investment options, known as "subaccounts," chosen by the contract owner.
		Returns	
Allocation of Investment Risk	• Premiums are guaranteed to earn at least a minimum specified interest rate. The insurance company may in its discretion credit interest at rates higher than the minimum. • Under most current state laws, upon surrender of the contract the buyer is guaranteed to always receive at least 87.5% of premiums paid, credited with a minimum interest rate such as 1%. This is known as the Nonforfeiture Amount.	• Returns are less predictable because the interest credited at the end of each index period depends on changes in a market index. • The surrender value must always equal at least the Nonforfeiture Amount and the interest rate is guaranteed to never be less than zero during each index period. • In general, returns depend on what index is linked and how the index-linked gains are calculated.[3] Many current product designs offer alternatives to traditional indexes such as the S&P 500 and allow owners to allocate premiums among different indexes. These alternative indexes may include precious commodities, international and emerging markets, and proprietary indexes developed by insurance companies. • Changes in the index can be determined by several methods such as annual reset, high water mark, low water mark, point-to-point, and index averaging.[3]	• Returns are variable based on the performance of underlying funds in the subaccounts.[1] • The insurance company does not guarantee investment performance. Investment risk is borne by the contract owner. • A variable annuity contract can offer hundreds of subaccounts and generally allows owners to transfer or reallocate their account values among the various subaccounts.

	Fixed-Rate	Fixed-Indexed	Variable
	Returns		
		• Index-linked gains are not always fully credited. How much of the gain in the index will be credited depends on the particular features of the annuity such as participation rates, interest rate caps, and spread/margin/asset fees.[3] • The insurer generally reserves the right to change participation rates, interest rate caps, and spread/margin/asset fees, subject to minimums and maximums specified in the contract[3]	
	Surrender Charges & Surrender Period		
Fees	• If the owner withdraws all or part of the value out of the annuity within a specified period, surrender charge will be applied.[1]	• same as fixed-rate	• same as fixed-rate
	• The buyer can often receive a partial withdrawal (usually up to 10%) without paying surrender charges[1] and the charge may be waived in certain circumstances, such as confinement in a nursing home.	• same as fixed-rate	• same as fixed-rate
	• State laws generally require “free-look” provisions under which the owner can return the contract free of charge within a stated number of days after purchase.[2]	• same as fixed-rate	• same as fixed-rate
	• Some annuities have a market value adjustment (MVA). If at the time of surrender interest rates are higher than at the time of purchase, the MVA could reduce the amount paid on surrender; conversely, if interest rates have fallen, the MVA could increase the surrender value.[1,2]	• same as fixed-rate	

	Fixed-Rate	Fixed-Indexed	Variable
		Other Fees & Charges	
Fees	• Generally no express fees[6]	• Generally no express fees[6] • Often sold with a guaranteed lifetime withdrawal benefit, which requires a rider fee.	• Contract Fee[2] • Transaction Fee • Mortality and Expense risk fee • Underlying fund fees • Additional fees or charges for certain product features (often contained in "riders" to the base contract) such as stepped-up death benefits, guaranteed minimum income benefits, and principal protection.[4]
Guaranteed Optional Benefits		Guaranteed Living Benefit Riders[7]	
	• Seldom offered.	• The most popular benefit, the guaranteed lifetime withdrawal benefit, is offered with 84% of all new fixed indexed annuity sales in 2014.[5]	• Contracts constituting 83% of all new variable annuity sales in 2014 offered guaranteed living benefit riders.[5]
		Death Benefit	
	• Annuities pay a death benefit to the beneficiary upon death of the owner or annuitant during the accumulation phase.[2] Benefit is typically the greater of the accumulated account value or the Nonforfeiture Amount. Different rules govern death benefits during the payout phase.	• same as fixed-rate	• If the owner dies during the accumulation period, the beneficiary generally receives the greater of (a) the accumulated account value or (b) premium payments less prior withdrawals. An enhanced guaranteed minimum death benefit may be available for an additional fee.[8]

Sources: 1: NAIC Buyer's Guide for Deferred Annuities, 2013

2: NAIC Buyers' Guide to Fixed Deferred Annuities with Appendix for Equity-Indexed Annuities, 1999

3: FINRA Investor Alert "Equity-Indexed Annuities: A Complex Choice," 2012

4: FINRA Investor Alert "Variable Annuities: Beyond the Hard Sell," 2012

5: LIMRA "U.S. Individual Annuity Yearbook 2014"

6: The insurer covers its expenses via the margin of premiums received over the cost of the annuity benefits, commonly referred to a "spread."

7: Guaranteed living benefits are available for additional fees and generally protect against investment risks by guaranteeing the level of account values or annuity payments, regardless of market performance. There are three types of guaranteed living benefits—guaranteed minimum income, guaranteed minimum accumulation, and guaranteed minimum withdrawal (including lifetime withdrawal benefits).

8: Some fixed-indexed annuities also offer this benefit for an additional fee.

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DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

[Application Number D–11327]

ZRIN 1210–ZA25

Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 86–128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; Amendment to and Partial Revocation of PTE 75–1, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefits Plans and Certain Broker-Dealers, Reporting Dealers and Banks.

AGENCY: Employee Benefits Security Administration (EBSA), Department of Labor.

ACTION: Adoption of amendments to and partial revocations of PTEs 86–128 and 75–1.

SUMMARY: This document contains amendments to Prohibited Transaction Exemptions (PTEs) 86–128 and 75–1, exemptions from certain prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986 (the Code). The ERISA and Code provisions at issue generally prohibit fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs) from engaging in self-dealing in connection with transactions involving plans and IRAs. PTE 86–128 allows fiduciaries to receive compensation in connection with certain securities transactions entered into by plans and IRAs. The amendments increase the safeguards of the exemption. This document also contains a revocation of PTE 86–128 with respect to transactions involving investment advice fiduciaries and IRAs, and of PTE 75–1, Part II(2), and PTE 75–1, Parts I(b) and I(c), in light of existing or newly finalized relief, including the relief provided in the ''Best Interest Contract Exemption,'' published elsewhere in this issue of the **Federal Register**. The amendments and revocations affect participants and beneficiaries of plans, IRA owners and certain fiduciaries of plans and IRAs.

DATES: *Issance date:* These amendments and partial revocations are issued June 7, 2016.

Applicability date: These amendments are applicable to transactions occurring on or after April 10, 2017. For more information, see *Applicability Date,* below.

FOR FURTHER INFORMATION CONTACT: Brian Shiker or Erin Hesse, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor, 200 Constitution Avenue NW., Suite 400, Washington DC 20210, (202) 693–8540 (not a toll-free number).

SUPPLEMENTARY INFORMATION: The Department is amending and partially revoking PTEs 86–128 and 75–1 on its own motion, pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637 (October 27, 2011)).

Executive Summary

Purpose of Regulatory Action

These amendments and revocations are being granted in connection with its publication today, elsewhere in this issue of the **Federal Register**, of a final regulation defining who is a ''fiduciary'' of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries (Regulation). The Regulation also applies to the definition of a ''fiduciary'' of a plan (including an IRA) under the Code. The Regulation amends a prior regulation, dating to 1975, specifying when a person is a ''fiduciary'' under ERISA and the Code by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. The Regulation takes into account the advent of 401(k) 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 existing regulation was issued. In light of the extensive changes in retirement investment practices and relationships, the Regulation updates 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.

PTE 86–128 permits certain fiduciaries to receive fees in connection with certain mutual fund and other securities transactions entered into by plans and IRAs. A number of changes are finalized with respect to the scope of the exemption and of another existing exemption, PTE 75–1, including revocation of many transactions originally permitted with respect to IRAs. These amendments and revocations affect the conditions under which fiduciaries may receive fees and compensation when they transact with plans and IRAs.

The amendments and the partial revocations to PTEs 86–128 and 75–1 are part of the Department's regulatory initiative to mitigate the effects of harmful conflicts of interest associated with fiduciary investment advice. In the absence of an exemption, ERISA and the Code generally prohibit fiduciaries from using their authority to affect or increase their own compensation. A new exemption for receipt of compensation by fiduciaries that provide investment advice to IRA owners,[1] plan participants and beneficiaries, and certain plan fiduciaries, is adopted elsewhere in this issue of the **Federal Register**, in the ''Best Interest Contract Exemption.'' In the Department's view, the provisions of the Best Interest Contract Exemption better protect the interests of IRAs with respect to investment advice regarding the transactions for which relief was revoked.

ERISA section 408(a) specifically authorizes the Secretary of Labor to grant administrative exemptions from ERISA's prohibited transaction provisions.[2] Regulations at 29 CFR

[1] For purposes of this amendment, the terms ''Individual Retirement Account'' or ''IRA'' mean any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

[2] Code section 4975(c)(2) authorizes the Secretary of the Treasury to grant exemptions from the parallel prohibited transaction provisions of the Code. Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)) (Reorganization Plan) generally transferred the authority of the Secretary of the Treasury to grant administrative exemptions under Code section 4975 to the Secretary of Labor. To rationalize the administration and interpretation of dual provisions under ERISA and the Code, the Reorganization Plan divided the interpretive and rulemaking authority for these provisions between the Secretaries of Labor and of the Treasury, so that, in general, the agency with responsibility for a given provision of Title I of ERISA would also have responsibility for the corresponding provision in the Code. Among the sections transferred to the Department were the prohibited transaction provisions and the definition of a fiduciary in both Title I of ERISA and in the Code. ERISA's prohibited transaction rules, 29 U.S.C. 1106–1108, apply to ERISA-covered plans, and the Code's corresponding prohibited transaction rules, 26 U.S.C. 4975(c), apply both to ERISA-covered pension plans that are tax-qualified pension plans, as well as other tax-advantaged arrangements, such as IRAs, that are not subject to the fiduciary responsibility and prohibited transaction rules in ERISA. Specifically, section 102(a) of the Reorganization Plan provides the Department of Labor with ''all authority'' for ''regulations, rulings, opinions, and exemptions under section 4975 [of the Code]'' subject to certain exceptions not relevant here. Reorganization Plan section 102. In President Carter's message to Congress regarding the Reorganization Plan, he made explicitly clear

Continued

exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions.

For purposes of this exemption, the terms "broker-dealer," "reporting dealer" and "bank" shall include such persons and any affiliates thereof, and the term "affiliate" shall be defined in the same manner as that term is defined in 29 CFR 2510.3–21(e) and 26 CFR 54.4975–9(e).

Signed at Washington, DC, this 1st day of April, 2016.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

[FR Doc. 2016–07929 Filed 4–6–16; 11:15 am]

BILLING CODE 4510–29–P

DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

[Application Number D–11820]

ZRIN 1210–ZA25

Amendments to Class Exemptions 75–1, 77–4, 80–83 and 83–1

AGENCY: Employee Benefits Security Administration (EBSA), U.S. Department of Labor.

ACTION: Adoption of Amendments to Class Exemptions.

SUMMARY: This document contains amendments to prohibited transaction exemptions (PTEs) 75–1, 77–4, 80–83 and 83–1. Generally, the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (the Code) prohibit fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs) from engaging in self-dealing, including using their authority, control or responsibility to affect or increase their own compensation. These exemptions generally permit fiduciaries to receive compensation or other benefits as a result of the use of their fiduciary authority, control or responsibility in connection with investment transactions involving plans or IRAs. The amendments require the fiduciaries to satisfy uniform Impartial Conduct Standards in order to obtain the relief available under each exemption. The amendments affect participants and beneficiaries of plans, IRA owners, and fiduciaries with respect to such plans and IRAs.

DATES: *Issuance date:* These amendments are issued June 7, 2016.

Applicability date: These amendments are applicable to transactions occurring on or after April 10, 2017.

FOR FURTHER INFORMATION CONTACT: Brian Shiker, Linda Hamilton or Susan Wilker, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor, (202) 693–8824 (this is not a toll-free number).

SUPPLEMENTARY INFORMATION: The Department is amending the class exemptions on its own motion, pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637 (October 27, 2011)).

Executive Summary

Purpose of Regulatory Action

The Department grants these amendments to PTEs 75–1, 77–4, 80–83 and 83–1 in connection with its publication today, elsewhere in this issue of the **Federal Register**, of a final regulation defining who is a "fiduciary" of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries (Regulation). The Regulation also applies to the definition of a "fiduciary" of a plan (including an IRA) under the Code. The Regulation amends a prior regulation, dating to 1975, specifying when a person is a "fiduciary" under ERISA and the Code by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. The Regulation takes into account the advent of 401(k) 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 existing regulation was issued. In light of the extensive changes in retirement investment practices and relationships, the Regulation updates 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.

In connection with the adoption of the Regulation, PTEs 75–1, Part III, 75–1, Part IV, 77–4, 80–83 and 83–1 are amended to increase the safeguards of the exemptions. As amended, new "Impartial Conduct Standards" are made conditions of the exemptions. Fiduciaries are required to act in accordance with these standards in transactions permitted by the exemptions. The standards are incorporated in multiple class exemptions, including the exemptions that are the subject of this notice, other existing exemptions, and two new exemptions published elsewhere in this issue of the **Federal Register**, to ensure that fiduciaries relying on the exemptions are held to a uniform set of standards and that these standards are applicable to transactions involving both plans and IRAs. The amendments apply prospectively to fiduciaries relying on the exemptions.

ERISA section 408(a) specifically authorizes the Secretary of Labor to grant and amend administrative exemptions from ERISA's prohibited transaction provisions.[1] Regulations at 29 CFR 2570.30 to 2570.52 describe the procedures for applying for an administrative exemption. In amending these exemptions, the Department has determined that the amended exemptions are administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners.

Summary of the Major Provisions

This notice amends prohibited transaction exemptions 75–1, Part III,

[1] Code section 4975(c)(2) authorizes the Secretary of the Treasury to grant exemptions from the parallel prohibited transaction provisions of the Code. Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)) ("Reorganization Plan") generally transferred the authority of the Secretary of the Treasury to grant administrative exemptions under Code section 4975 to the Secretary of Labor. To rationalize the administration and interpretation of dual provisions under ERISA and the Code, the Reorganization Plan divided the interpretive and rulemaking authority for these provisions between the Secretaries of Labor and of the Treasury, so that, in general, the agency with responsibility for a given provision of Title I of ERISA would also have responsibility for the corresponding provision in the Code. Among the sections transferred to the Department were the prohibited transaction provisions and the definition of a fiduciary in both Title I of ERISA and in the Code. ERISA's prohibited transaction rules, 29 U.S.C. 1106–1108, apply to ERISA-covered plans, and the Code's corresponding prohibited transaction rules, 26 U.S.C. 4975(c), apply both to ERISA-covered pension plans that are tax-qualified pension plans, as well as other tax-advantaged arrangements, such as IRAs, that are not subject to the fiduciary responsibility and prohibited transaction rules in ERISA. Specifically, section 102(a) of the Reorganization Plan provides the Department of Labor with "all authority" for "regulations, rulings, opinions, and exemptions under section 4975 [of the Code]" subject to certain exceptions not relevant here. Reorganization Plan section 102. In President Carter's message to Congress regarding the Reorganization Plan, he made explicitly clear that as a result of the plan, "Labor will have statutory authority for fiduciary obligations. . . . Labor will be responsible for overseeing fiduciary conduct under these provisions." Reorganization Plan, Message of the President. This exemption provides relief from the indicated prohibited transaction provisions of both ERISA and the Code.

75–1, Part IV, 77–4, 80–83 and 83–1. Each amendment incorporates the same Impartial Conduct Standards. Generally stated, the Impartial Conduct Standards require fiduciaries to: Act in the "best interest" of plans and IRAs; charge no more than reasonable compensation; and make no misleading statements to the plan or IRA, when engaging in the transactions that are the subject of these exemptions. The amendments require a fiduciary that satisfies ERISA section 3(21)(A)(i) or (ii), or the corresponding provisions of Code section 4975(e)(3)(A) or (B), with respect to the assets involved in the investment transaction, to meet the standards with respect to the investment transactions described in the applicable exemption.

Executive Order 12866 and 13563 Statement

Under Executive Orders 12866 and 13563, the Department must determine whether a regulatory action is "significant" and therefore subject to the requirements of the Executive Order and subject to review by the Office of Management and Budget (OMB). Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing and streamlining rules, and of promoting flexibility. It also requires federal agencies to develop a plan under which the agencies will periodically review their existing significant regulations to make the agencies' regulatory programs more effective or less burdensome in achieving their regulatory objectives.

Under Executive Order 12866, "significant" regulatory actions are subject to the requirements of the Executive Order and review by the OMB. Section 3(f) of Executive Order 12866, defines a "significant regulatory action" as an action that is likely to result in a rule (1) having an annual effect on the economy of $100 million or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as "economically significant" regulatory actions); (2) creating serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order. Pursuant to the terms of the Executive Order, OMB has determined that this action is "significant" within the meaning of Section 3(f)(4) of the Executive Order. Accordingly, the Department has undertaken an assessment of the costs and benefits of the proposal, and OMB has reviewed this regulatory action. The Department's complete Regulatory Impact Analysis is available at *www.dol.gov/ebsa.*

Background

Regulation Defining a Fiduciary

As explained more fully in the preamble to the Regulation, ERISA is a comprehensive statute designed to protect the interests of plan participants and beneficiaries, the integrity of employee benefit plans, and the security of retirement, health, and other critical benefits. The broad public interest in ERISA-covered plans is reflected in its imposition of fiduciary responsibilities on parties engaging in important plan activities, as well as in the tax-favored status of plan assets and investments. One of the chief ways in which ERISA protects employee benefit plans is by requiring that plan fiduciaries comply with fundamental obligations rooted in the law of trusts. In particular, plan fiduciaries must manage plan assets prudently and with undivided loyalty to the plans and their participants and beneficiaries.[2] In addition, they must refrain from engaging in "prohibited transactions," which ERISA does not permit because of the dangers posed by the fiduciaries' conflicts of interest with respect to the transactions.[3] When fiduciaries violate ERISA's fiduciary duties or the prohibited transaction rules, they may be held personally liable for the breach.[4] In addition, violations of the prohibited transaction rules are subject to excise taxes under the Code.

The Code also has rules regarding fiduciary conduct with respect to tax-favored accounts that are not generally covered by ERISA, such as IRAs. In particular, fiduciaries of these arrangements, including IRAs, are subject to the prohibited transaction rules, and, when they violate the rules, to the imposition of an excise tax enforced by the Internal Revenue Service. Unlike participants in plans covered by Title I of ERISA, IRA owners do not have a statutory right to bring suit against fiduciaries for violations of the prohibited transaction rules.

Under this statutory framework, the determination of who is a "fiduciary" is of central importance. Many of ERISA's and the Code's protections, duties, and liabilities hinge on fiduciary status. In relevant part, ERISA section 3(21)(A) and Code section 4975(e)(3) provide that a person is a fiduciary with respect to a plan or IRA to the extent he or she (1) exercises any discretionary authority or discretionary control with respect to management of such plan or IRA, or exercises any authority or control with respect to management or disposition of its assets; (2) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan or IRA, or has any authority or responsibility to do so; or, (3) has any discretionary authority or discretionary responsibility in the administration of such plan or IRA.

The statutory definition deliberately casts a wide net in assigning fiduciary responsibility with respect to plan and IRA assets. Thus, "any authority or control" over plan or IRA assets is sufficient to confer fiduciary status, and any persons who render "investment advice for a fee or other compensation, direct or indirect" are fiduciaries, regardless of whether they have direct control over the plan's or IRA's assets and regardless of their status as an investment adviser or broker under the federal securities laws. The statutory definition and associated responsibilities were enacted to ensure that plans, plan participants, and IRA owners can depend on persons who provide investment advice for a fee to provide recommendations that are untainted by conflicts of interest. In the absence of fiduciary status, the providers of investment advice are neither subject to ERISA's fundamental fiduciary standards, nor accountable under ERISA or the Code for imprudent, disloyal, or biased advice.

In 1975, the Department issued a regulation, at 29 CFR 2510.3–21(c) defining the circumstances under which a person is treated as providing "investment advice" to an employee benefit plan within the meaning of ERISA section 3(21)(A)(ii) (the "1975

[2] ERISA section 404(a).

[3] ERISA section 406. ERISA also prohibits certain transactions between a plan and a "party in interest."

[4] ERISA section 409; *see also* ERISA section 405.

regulation'').[5] The 1975 regulation narrowed the scope of the statutory definition of fiduciary investment advice by creating a five-part test for fiduciary advice. Under the 1975 regulation, for advice to constitute ''investment advice,'' an adviser must—(1) render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property (2) on a regular basis (3) pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary that (4) the advice will serve as a primary basis for investment decisions with respect to plan assets, and that (5) the advice will be individualized based on the particular needs of the plan. The 1975 regulation provided that an adviser is a fiduciary with respect to any particular instance of advice only if he or she meets each and every element of the five-part test with respect to the particular advice recipient or plan at issue.

The market for retirement advice has changed dramatically since the Department first promulgated the 1975 regulation. Individuals, rather than large employers and professional money managers, have become increasingly responsible for managing retirement assets as IRAs and participant-directed plans, such as 401(k) plans, have supplanted defined benefit pensions. At the same time, the variety and complexity of financial products have increased, widening the information gap between advisers and their clients. Plan fiduciaries, plan participants and IRA investors must often rely on experts for advice, but are unable to assess the quality of the expert's advice or effectively guard against the adviser's conflicts of interest. This challenge is especially true of retail investors with smaller account balances who typically do not have financial expertise, and can ill-afford lower returns to their retirement savings caused by conflicts. The IRA accounts of these investors often account for all or the lion's share of their assets and can represent all of savings earned for a lifetime of work. Losses and reduced returns can be devastating to the investors who depend upon such savings for support in their old age. As baby boomers retire, they are increasingly moving money from ERISA-covered plans, where their employer has both the incentive and the fiduciary duty to facilitate sound investment choices, to IRAs where both good and bad investment choices are myriad and advice that is conflicted is commonplace. These rollovers are expected to approach $2.4 trillion cumulatively from 2016 through 2020.[6] These trends were not apparent when the Department promulgated the 1975 regulation. At that time, 401(k) plans did not yet exist and IRAs had only just been authorized.

As the marketplace for financial services has developed in the years since 1975, the five-part test has now come to undermine, rather than promote, the statutes' text and purposes. The narrowness of the 1975 regulation has allowed advisers, brokers, consultants and valuation firms to play a central role in shaping plan and IRA investments, without ensuring the accountability that Congress intended for persons having such influence and responsibility. Even when plan sponsors, participants, beneficiaries and IRA owners clearly relied on paid advisers for impartial guidance, the 1975 regulation has allowed many advisers to avoid fiduciary status and disregard basic fiduciary obligations of care and prohibitions on disloyal and conflicted transactions. As a consequence, these advisers have been able to steer customers to investments based on their own self-interest (*e.g.,* products that generate higher fees for the adviser even if there are identical lower-fee products available), give imprudent advice, and engage in transactions that would otherwise be prohibited by ERISA and the Code without fear of accountability under either ERISA or the Code.

In the Department's amendments to the 1975 regulation defining fiduciary advice within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) (the ''Regulation'') which are also published in this issue of the **Federal Register**, the Department is replacing the existing regulation with one that more appropriately distinguishes between the sorts of advice relationships that should be treated as fiduciary in nature and those that should not, in light of the legal framework and financial marketplace in which IRAs and plans currently operate.[7]

The Regulation describes the types of advice that constitute ''investment advice'' with respect to plan or IRA assets for purposes of the definition of a fiduciary at ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B). The Regulation covers ERISA-covered plans, IRAs, and other plans not covered by Title I of ERISA, such as Keogh plans, and health savings accounts described in section 223(d) of the Code.

As amended, the Regulation provides that a person renders investment advice with respect to assets of a plan or IRA if, among other things, the person provides, directly to a plan, a plan fiduciary, plan participant or beneficiary, IRA or IRA owner, the following types of advice, for a fee or other compensation, whether 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; and

(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, selection of other persons to provide investment advice or investment management services, types of investment account arrangements (brokerage versus advisory), 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.

In addition, in order to be treated as a fiduciary, such person, either directly or indirectly (*e.g.,* through or together with any affiliate), must: Represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code with respect to the advice described; represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code; render 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 direct the advice to a specific advice recipient or recipients regarding the advisability of a particular investment or management decision with respect to securities or

[5] The Department of Treasury issued a virtually identical regulation, at 26 CFR 54.4975–9(c), which interprets Code section 4975(e)(3).

[6] Cerulli Associates, ''Retirement Markets 2015.''

[7] The Department initially proposed an amendment to its regulation defining a fiduciary within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) on October 22, 2010, at 75 FR 65263. It subsequently announced its intention to withdraw the proposal and propose a new rule, consistent with the President's Executive Orders 12866 and 13563, in order to give the public a full opportunity to evaluate and comment on the new proposal and updated economic analysis. The first proposed amendment to the rule was withdrawn on April 20, 2015, *see* 80 FR 21927.

other investment property of the plan or IRA.

The Regulation also provides that as a threshold matter in order to be fiduciary advice, the communication must be a ''recommendation'' as defined therein. The Regulation, as a matter of clarification, provides that a variety of other communications do not constitute ''recommendations,'' including non-fiduciary investment education; general communications; and specified communications by platform providers. These communications which do not rise to the level of ''recommendations'' under the Regulation are discussed more fully in the preamble to the final Regulation.

The Regulation also specifies certain circumstances where the Department has determined that a person will not be treated as an investment advice fiduciary even though the person's activities technically may satisfy the definition of investment advice. For example, the Regulation contains a provision excluding recommendations to independent fiduciaries with financial expertise that are acting on behalf of plans or IRAs in arm's length transactions, if certain conditions are met. The independent fiduciary must be a bank, insurance carrier qualified to do business in more than one state, investment adviser registered under the Investment Advisers Act of 1940 or by a state, broker-dealer registered under the Securities Exchange Act of 1934 (Exchange Act), or any other independent fiduciary that holds, or has under management or control, assets of at least $50 million, and: (1) The person making the recommendation must know or reasonably believe 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 (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition); (2) the person must fairly inform 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 must fairly inform the independent fiduciary of the existence and nature of the person's financial interests in the transaction; (3) the person must know or reasonably believe that the independent fiduciary of the plan or IRA is a fiduciary under ERISA or the Code, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition); and (4) the person cannot 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.

Similarly, the Regulation provides that the provision of any advice to an employee benefit plan (as described in ERISA section 3(3)) by a person who is a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, or a swap clearing firm in connection with a swap or security-based swap, as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a) and section 3(a) of the Exchange Act (15 U.S.C. 78c(a)) is not investment advice if certain conditions are met. Finally, the Regulation describes certain communications by employees of a plan sponsor, plan, or plan fiduciary that would not cause the employee to be an investment advice fiduciary if certain conditions are met.

Prohibited Transactions

The Department anticipates that the Regulation will cover many investment professionals who did not previously consider themselves to be fiduciaries under ERISA or the Code. Under the Regulation, these entities will be subject to the prohibited transaction restrictions in ERISA and the Code that apply specifically to fiduciaries. ERISA section 406(a)(1)(A)–(D) and Code section 4975(c)(1)(A)–(D) prohibit certain transactions between plans or IRAs and ''parties in interest,'' as defined in ERISA section 3(14), or ''disqualified persons,'' as defined in Code section 4975(e)(2). Fiduciaries and other service providers are parties in interest and disqualified persons under ERISA and the Code. As a result, they are prohibited from engaging in (1) the sale, exchange or leasing of property with a plan or IRA, (2) the lending of money or other extension of credit to a plan or IRA, (3) the furnishing of goods, services or facilities to a plan or IRA and (4) the transfer to or use by or for the benefit of a party in interest of plan assets.

ERISA section 406(b)(1) and Code section 4975(c)(1)(E) prohibit a fiduciary from dealing with the income or assets of a plan or IRA in his or her own interest or his or her own account. ERISA section 406(b)(2), which does not apply to IRAs, provides that a fiduciary shall 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.'' ERISA section 406(b)(3) and Code section 4975(c)(1)(F) prohibit a fiduciary from receiving any consideration for his own personal account from any party dealing with the plan or IRA in connection with a transaction involving assets of the plan or IRA.

Parallel regulations issued by the Departments of Labor and the Treasury explain that these provisions impose on fiduciaries of plans and IRAs a duty not to act on conflicts of interest that may affect the fiduciary's best judgment on behalf of the plan or IRA.[8] The prohibitions extend to a fiduciary causing a plan or IRA to pay an additional fee to such fiduciary, or to a person in which such fiduciary has an interest that may affect the exercise of the fiduciary's best judgment as a fiduciary. Likewise, a fiduciary is prohibited from receiving compensation from third parties in connection with a transaction involving the plan or IRA.[9]

Investment professionals typically receive compensation for services to retirement investors in the retail market through a variety of arrangements, which would typically violate the prohibited transaction rules applicable to plan fiduciaries. 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. A fiduciary's receipt of such payments would generally violate the prohibited transaction provisions of ERISA section 406(b) and Code section 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.

Prohibited Transaction Exemptions

As the prohibited transaction provisions demonstrate, ERISA and the Code strongly disfavor conflicts of interest. In appropriate cases, however,

[8] Subsequent to the issuance of these regulations, Reorganization Plan No. 4 of 1978, 5 U.S.C. App. (2010), divided rulemaking and interpretive authority between the Secretaries of Labor and the Treasury. The Secretary of Labor was given interpretive and rulemaking authority regarding the definition of fiduciary under both Title I of ERISA and the Internal Revenue Code. *Id.* section 102(a) (''all authority of the Secretary of the Treasury to issue [regulations, rulings opinions, and exemptions under section 4975 of the Code] is hereby transferred to the Secretary of Labor'')

[9] 29 CFR 2550.408b–2(e); 26 CFR 54.4975–6(a)(5).

the statutes provide exemptions from their broad prohibitions on conflicts of interest. For example, ERISA section 408(b)(14) and Code section 4975(d)(17) specifically exempt transactions involving the provision of fiduciary investment advice to a participant or beneficiary of an individual account plan or IRA owner if the advice, resulting transaction, and the adviser's fees meet stringent conditions carefully designed to guard against conflicts of interest.

In addition, the Secretary of Labor has discretionary authority to grant administrative exemptions under ERISA and the Code on an individual or class basis, but only if the Secretary first finds that the exemptions are (1) administratively feasible, (2) in the interests of plans and their participants and beneficiaries and IRA owners, and (3) protective of the rights of the participants and beneficiaries of such plans and IRA owners. Accordingly, fiduciary advisers may always give advice without need of an exemption if they avoid the sorts of conflicts of interest that result in prohibited transactions. However, when they choose to give advice in which they have a conflict of interest, they must rely upon an exemption.

Pursuant to its exemption authority, the Department has previously granted several conditional administrative class exemptions that are available to fiduciary advisers in defined circumstances. As a general proposition, these exemptions focused on specific advice arrangements and provided relief for narrow categories of compensation. Reliance on these exemptions is subject to certain conditions that the Department has found necessary to protect the interests of plans and IRAs.

In connection with the development of the Department's Regulation under ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B), the Department considered public input indicating the need for additional prohibited transaction relief for the wide variety of compensation structures that exist today in the marketplace for investment transactions. After consideration of the issue, the Department proposed two new class exemptions and proposed amendments to a number of existing exemptions. As part of this initiative, the Department proposed to incorporate the Impartial Conduct Standards, described in greater detail below, in the new and certain existing exemptions. In this regard, the Department proposed to incorporate the Impartial Conduct Standards in PTEs 75–1, Part III, 75–1, Part IV, 77–4, 80–83 and 83–1. These exemptions provide relief for the following specific transactions:

- PTE 75–1, Part III [10] permits a fiduciary to cause a plan or IRA to purchase securities from a member of an underwriting syndicate other than the fiduciary, when the fiduciary is also a member of the syndicate;
- PTE 75–1, Part IV [11] permits a plan or IRA to purchase securities in a principal transaction from a fiduciary that is a market maker with respect to such securities;
- PTE 77–4 [12] provides relief for a plan's or IRA's purchase or sale of open-end investment company shares where the investment adviser for the open-end investment company is also a fiduciary to the plan or IRA;
- PTE 80–83 [13] provides relief for a fiduciary causing a plan or IRA to purchase a security when the proceeds of the securities issuance may be used by the issuer to retire or reduce indebtedness to the fiduciary or an affiliate; and
- PTE 83–1 [14] provides relief for the sale of certificates in an initial issuance of certificates, by the sponsor of a mortgage pool to a plan or IRA, when the sponsor, trustee or insurer of the mortgage pool is a fiduciary with respect to the plan or IRA assets invested in such certificates.

The Department's intent in proposing the amendments was to provide additional protections for all plans, but most particularly for IRA owners. That is because fiduciaries' dealings with IRAs are governed by the Code, not by ERISA,[15] and the Code, unlike ERISA, does not directly impose responsibilities of prudence and loyalty on fiduciaries. The amendments to the exemptions condition relief on the satisfaction of these responsibilities. For purposes of these amendments, the term IRA means any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.[16]

These amended exemptions follow a lengthy public notice and comment process, which gave interested persons an extensive opportunity to comment on the proposed Regulation and exemption proposals. The proposals initially provided for 75-day comment periods, ending on July 6, 2015, but the Department extended the comment periods to July 21, 2015. The Department then held four days of public hearings on the new regulatory package, including the proposed exemptions, in Washington, DC from August 10 to 13, 2015, at which over 75 speakers testified. The transcript of the hearing was made available on September 8, 2015, and the Department provided additional opportunity for interested persons to comment on the proposals or hearing transcript until September 24, 2015. A total of over 3000 comment letters were received on the new proposals. There were also over 300,000 submissions made as part of 30 separate petitions submitted on the proposal. These comments and petitions came from consumer groups, plan sponsors, financial services companies, academics, elected government officials, trade and industry associations, and others, both in support and in opposition to the rule.[17] The Department has reviewed all comments, and after careful consideration of the comments, has decided to grant the amendments to the exemptions.

Description of the Amendments

These amended exemptions require fiduciaries relying on the exemptions to comply with fundamental Impartial Conduct Standards. Generally stated, the Impartial Conduct Standards require that, in connection with the transactions

[10] Exemptions from Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks, 40 FR 50845 (Oct. 31, 1975), as amended at 71 FR 5883 (Feb. 3, 2006).

[11] Exemptions from Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks, 40 FR 50845 (Oct. 31, 1975), as amended at 71 FR 5883 (Feb. 3, 2006).

[12] Class Exemption for Certain Transactions Between Investment Companies and Employee Benefit Plans, 42 FR 18732 (Apr. 8, 1977).

[13] Class Exemption for Certain Transactions Involving Purchase of Securities Where Issuer May Use Proceeds to Reduce or Retire Indebtedness to Parties in Interest, 45 FR 73189 (Nov. 4, 1980), as amended at 67 FR 9483 (March 1, 2002).

[14] Class Exemption for Certain Transactions Involving Mortgage Pool Investment Trusts, 48 FR 895 (Jan. 7, 1983), as amended at 67 FR 9483 (March 1, 2002).

[15] *See* ERISA section 404.

[16] The Department notes that PTE 2002–13 amended PTEs 80–83 and 83–1 so that the terms "employee benefit plan" and "plan" refer to an employee benefit plan described in ERISA section 3(3) and/or a plan described in section 4975(e)(1) of the Code. *See* 67 FR 9483 (March 1, 2002). At the same time, in the preamble to PTE 2002–13, the Department explained that it had determined, after consulting with the Internal Revenue Service, that plans described in 4975(e)(1) of the Code are included within the scope of relief provided by PTEs 75–1 and 77–4, because they were issued jointly by the Department and the Service. For simplicity and consistency with the other new exemptions and amendments to existing exemptions published elsewhere in this issue of the **Federal Register**, the Department uses this specific definition of IRA.

[17] As used throughout this preamble, the term "comment" refers to information provided through these various sources, including written comments, petitions and witnesses at the public hearing.

covered by the exemptions, the fiduciary acts in the plan's or IRA's best interest, does not charge more than reasonable compensation, and does not make misleading statements to the plan or IRA about the recommended transactions. As defined in the amendments, a fiduciary acts in the best interest of a plan or IRA when it acts 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 plan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate [18] or other party.

The Impartial Conduct Standards represent fundamental obligations of fair dealing and fiduciary conduct. The concepts of prudence, undivided loyalty and reasonable compensation are all deeply rooted in ERISA and the common law of agency and trusts.[19] These longstanding concepts of law and equity were developed in significant part to deal with the issues that arise when agents and persons in a position of trust have conflicting loyalties, and accordingly, are well-suited to the problems posed by conflicted investment advice. The phrase ''without regard to'' is a concise expression of ERISA's duty of loyalty, as expressed in section 404(a)(1)(A) of ERISA and applied in the context of advice. It is consistent with the formulation stated in the common law, and it is consistent with the language used by Congress in Section 913(g)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act),[20] and cited in the Staff of U.S. Securities and Exchange Commission ''Study on Investment Advisers and Broker-Dealers, As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act'' (Jan. 2011) [21] (SEC staff Dodd-Frank Study). The Department notes, however, that the standard is not intended to outlaw investment advice fiduciaries' provision of advice from investment menus that are restricted on the basis of proprietary products or revenue sharing. Finally, the ''reasonable compensation'' obligation is already required under ERISA section 408(b)(2) and Code section 4975(d)(2) of service providers, including financial services providers, whether fiduciaries or not.[22]

Under the amendments, the Impartial Conduct Standards are conditions of the exemptions with respect to all plans and IRAs. Transactions that violate the requirements would not be in the interests of or protective of plans and their participants and beneficiaries and IRA owners. However, unlike some of the other exemptions finalized today in this issue of the **Federal Register**, there is no requirement under these exemptions that parties contractually commit to the Impartial Conduct Standards.[23]

The Department received many comments on the proposal to include the Impartial Conduct Standards as part of these existing exemptions. A number of commenters focused on the Department's authority to impose the Impartial Conduct Standards as conditions of the exemptions. Commenters' arguments regarding the Impartial Conduct Standards as applicable to IRAs and non-ERISA plans were based generally on the fact that the standards, as noted above, are consistent with longstanding principles of prudence and loyalty set forth in ERISA section 404, but which have no counterpart in the Code. Commenters took the position that because Congress did not choose to impose the standards of prudence and loyalty on fiduciaries with respect to IRAs and non-ERISA plans, the Department exceeded its authority in proposing similar standards as a condition of relief in a prohibited transaction exemption.

With respect to ERISA plans, commenters stated that Congress' separation of the duties of prudence and loyalty (in ERISA section 404) from the prohibited transaction provisions (in ERISA section 406), showed an intent that the two should remain separate. Commenters additionally questioned why the conduct standards were necessary for ERISA plans, when such plans already have an enforceable right to fiduciary conduct that is both prudent and loyal. Commenters asserted that imposing the Impartial Conduct Standards as conditions of the exemptions created strict liability for prudence violations.

Some commenters additionally took the position that Congress, in the Dodd-Frank Act, gave the SEC the authority to establish standards for broker-dealers and investment advisers and therefore, the Department did not have the authority to act in that area.

The Department disagrees that these amendments to the exemptions exceed its authority. The Department has clear authority under ERISA section 408(a) and the Reorganization Plan [24] to grant administrative exemptions from the prohibited transaction provisions of both ERISA and the Code. Congress gave the Department broad discretion to grant or deny exemptions and to craft conditions for those exemptions, subject only to the overarching requirement that the exemption be administratively feasible, in the interests of plans, plan participants and beneficiaries and IRA owners, and protective of their rights.[25] Nothing in ERISA or the Code suggests that the Department is forbidden to borrow from time-honored trust-law standards and principles developed by the courts to ensure proper fiduciary conduct.

The Impartial Conduct Standards represent, in the Department's view, baseline standards of fundamental fair dealing that must be present when fiduciaries make conflicted investment recommendations to retirement investors. After careful consideration, the Department determined that broad relief could be provided to investment advice fiduciaries receiving conflicted compensation only if such fiduciaries provided advice in accordance with the

[18] In some of the amended exemptions, the text of the Best Interest standard does not specifically refer to an affiliate. The reference was not necessary in those exemptions because they define the term ''fiduciary'' to include ''such fiduciary and any affiliates of such fiduciary.''

[19] See generally ERISA sections 404(a), 408(b)(2); Restatement (Third) of Trusts section 78 (2007), and Restatement (Third) of Agency section 8.01.

[20] Section 913(g) governs ''Standard of Conduct'' and subsection (1) provides that ''The Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.''

[21] Available at *https://www.sec.gov/news/studies/2011/913studyfinal.pdf.*

[22] ERISA section 408(b)(2) and Code section 4975(d)(2) exempt certain arrangements between ERISA plans, IRAs, and non-ERISA plans, and service providers, that otherwise would be prohibited transactions under ERISA section 406 and Code section 4975. Specifically, ERISA section 408(b)(2) and Code section 4975(d)(2) provide relief from the prohibited transaction rules for service contracts or arrangements if the contract or arrangement is reasonable, the services are necessary for the establishment or operation of the plan or IRA, and no more than reasonable compensation is paid for the services.

[23] The Department also points out that there is no requirement in the other exemptions finalized today to contractually warrant compliance with applicable federal and state laws, as was proposed. However, it is still the Department's view that significant violations of applicable federal or state law could also amount to violations of the Impartial Conduct Standards, such as the best interest standard, in which case, relief would be unavailable for transactions occurring in connection with such violations.

[24] *See* fn. 1, *supra,* discussing of Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)).

[25] *See* ERISA section 408(a) and Code section 4975(c)(2).

Impartial Conduct Standards—*i.e.,* if they provided prudent advice without regard to the interests of such fiduciaries and their affiliates and related entities, in exchange for reasonable compensation and without misleading the investors.

These Impartial Conduct Standards are necessary to ensure that advisers' recommendations reflect the best interest of their retirement investor customers, rather than the conflicting financial interests of the advisers and their financial institutions. As a result, advisers and financial institutions bear the burden of showing compliance with the exemption and face liability for engaging in a non-exempt prohibited transaction if they fail to provide advice that is prudent or otherwise in violation of the standards. The Department does not view this as a flaw in the exemptions, as commenters suggested, but rather as a significant deterrent to violations of important conditions under the exemptions.

The Department similarly disagrees that Congress' directive to the SEC in the Dodd-Frank Act limits its authority to establish appropriate and protective conditions in the context of a prohibited transaction exemption. Section 913 of that Act directs the SEC to conduct a study on the standards of care applicable to brokers-dealers and investment advisers, and issue a report containing, among other things:

an analysis of whether [sic] any identified legal or regulatory gaps, shortcomings, or overlap in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers.[26]

Section 913 authorizes, but does not require, the SEC to issue rules addressing standards of care for broker-dealers and investment advisers for providing personalized investment advice about securities to retail customers.[27] Nothing in the Dodd-Frank Act indicates that Congress meant to preclude the Department's regulation of fiduciary investment advice under ERISA or its application of such a regulation to securities brokers or dealers. To the contrary, Dodd-Frank in directing the SEC study specifically directed the SEC to consider the effectiveness of existing legal and regulatory standard of care under other federal and state authorities.[28] The Dodd-Frank Act did not take away the Department's responsibility with respect the definition of fiduciary under ERISA and in the Code; nor did it qualify the Department's authority to issue exemptions that are administratively feasible, in the interests of plans, participants and beneficiaries, and IRA owners, and protective of the rights of participants and beneficiaries of the plans and IRA owners.

Some commenters suggested that it would be unnecessary to impose the Impartial Conduct Standards on advisers with respect to ERISA plans, as fiduciaries to these plans already are required to operate within similar statutory fiduciary obligations. The Department considered this comment but has determined not to eliminate the conduct standards as conditions of the exemptions for ERISA plans.

One of the Department's goals is to ensure equal footing for all retirement investors. The SEC staff Dodd-Frank Study required by section 913 of the Dodd-Frank Act found that investors were frequently confused by the differing standards of care applicable to broker-dealers and registered investment advisers. The Department hopes to minimize such confusion in the market for retirement advice by holding fiduciaries to similar standards, regardless of whether they are giving the advice to an ERISA plan, IRA, or a non-ERISA plan.

Moreover, inclusion of the standards as conditions of these existing exemptions adds an important additional safeguard for ERISA and IRA investors alike because the party engaging in a prohibited transaction has the burden of showing compliance with an applicable exemption, when violations are alleged.[29] In the Department's view, this burden-shifting is appropriate because of the dangers posed by conflicts of interest, as reflected in the Department's Regulatory Impact Analysis and the difficulties retirement investors have in effectively policing such violations.[30] One important way for financial institutions to ensure that they can meet this burden is by implementing strong anti-conflict policies and procedures, and by refraining from creating incentives to violate the Impartial Conduct Standards. Thus, the standards' treatment as exemption conditions creates an important incentive for financial institutions to carefully monitor and oversee their advisers' conduct for adherence with fiduciary norms.

Other commenters generally asserted that the Impartial Conduct Standards were too vague and would result in the exemption failing to meet the "administratively feasible" requirement under ERISA section 408(a) and Code section 4975(c)(2). The Department disagrees with these commenters' suggestions that ERISA section 408(a) and Code section 4975(c)(2) fail to be satisfied by a principles-based approach, or that standards are unduly vague. It is worth repeating that the Impartial Conduct Standards are built on concepts that are longstanding and familiar in ERISA and the common law of trusts and agency. Far from requiring adherence to novel standards with no antecedents, the exemptions primarily require adherence to well-established fundamental obligations of fair dealing and fiduciary conduct. This preamble provides specific interpretations and responses to a number of issues raised in connection with a number of the Impartial Conduct Standards.

Comments on each of the Impartial Conduct Standards are discussed below. In this regard, the Department notes that some commenters focused their comments on the Impartial Conduct Standards in the other exemption proposals, including the proposed Best Interest Contract Exemption, which is finalized elsewhere in this issue of the **Federal Register**. The Department determined it was important that the provisions of the exemptions, including the Impartial Conduct Standards, be uniform and compatible across exemptions. For this reason, the Department considered all comments made on any of the exemption proposals on a consolidated basis, and corresponding changes were made across the exemptions. For ease of use, this preamble includes the same general discussion of comments as in the Best Interest Contract Exemption, despite the fact that some comments discussed below were not made directly with respect to the exemptions amended in this Notice.

1. Best Interest

Under the first Impartial Conduct Standard, fiduciaries relying on the amended exemptions must act in the best interest of the plan or IRA at the time of the exercise of authority (including, in the case of an investment advice fiduciary, the recommendation). Best interest is defined to mean acting 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

[26] Dodd-Frank Act, sec. 913(d)(2)(B).

[27] 15 U.S.C. 80b–11(g)(1).

[28] Dodd-Frank Act, sec. 913(b)(1) and (c)(1).

[29] *See e.g., Fish* v. *GreatBanc Trust Company,* 749 F.3d 671 (7th Cir. 2014).

[30] *See* Fiduciary Investment Advice Final Rule Regulatory Impact Analysis.

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 the needs of the plan or IRA, without regard to the financial or other interests of the fiduciary or its affiliates or any other party.[31]

The Best Interest standard set forth in the amended exemptions is based on longstanding concepts derived from ERISA and the law of trusts. It is meant to express the concept, set forth in ERISA section 404 that a fiduciary is required to act ''solely in the interest of the participants . . . 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 a like character and with like aims.'' Similarly, both ERISA section 404(a)(1)(A) and the trust-law duty of loyalty require fiduciaries to put the interests of trust beneficiaries first, without regard to the fiduciaries' own self-interest. Under this standard, for example, a fiduciary, in choosing between two investments, could not select an investment because it is better for the fiduciary's bottom line, even though it is a worse choice for the plan or IRA.[32]

A wide range of commenters indicated support for a broad ''best interest'' standard. Some comments indicated that the best interest standard is consistent with the way advisers provide investment advice to clients today. However, a number of these commenters expressed misgivings as to the definition used in the proposed amendments, in particular, the ''without regard to'' formulation. The commenters indicated uncertainty as to the meaning of the phrase, including: Whether it permitted the fiduciary to be paid; and whether it permitted investment advice on proprietary products. One commenter was especially concerned that the amendments might restrict fiduciaries' ability to sell proprietary products, which are specifically permitted in PTE 77–4.

Other commenters asked the Department to use a different definition of ''Best Interest'' or simply use the exact language from ERISA's section 404 duty of loyalty. Others suggested definitional approaches that would require that the fiduciary ''not subordinate'' its customers' interests to its own interests, or that the fiduciary put its customers' interests ahead of its own interests, or similar constructs.[33]

The Financial Industry Regulatory Authority (FINRA)[34] suggested that the federal securities laws should form the foundation of the Best Interest standard. Specifically, FINRA urged that the Best Interest definition in the exemptions incorporate the ''suitability'' standard applicable to investment advisers and broker dealers under federal securities laws. According to FINRA, this would facilitate customer enforcement of the Best Interest standard by providing adjudicators with a well-established basis on which to find a violation.

Other commenters found the Best Interest standard to be an appropriate statement of the obligations of a fiduciary investment advice provider and believed it would provide concrete protections against conflicted recommendations. These commenters asked the Department to maintain the Best Interest definition as proposed. One commenter wrote that the term ''best interest'' is commonly and used in connection with a fiduciary's duty of loyalty and cautioned the Department against creating exemptions that failed to include the duty of loyalty. Others urged the Department to avoid definitional changes that would reduce current protections to plans and IRAs. Some commenters also noted that the ''without regard to'' language is consistent with the recommended standard in the SEC staff Dodd-Frank Study, and suggested that it had the added benefit of potentially harmonizing with a future securities law standard for broker-dealers.

The final amendments retain the Best Interest definition as proposed, with minor adjustments. The first prong of the standard was revised in each amended exemption to more closely track the statutory language of ERISA section 404(a), and, is consistent with the Department's intent to hold investment advice fiduciaries to a prudent investment professional standard. Accordingly, the definition of Best Interest now requires advice that ''reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person *acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims,* based on the investment objectives, risk tolerance, financial circumstances, and needs of the plan or IRA . . .'' The exemptions adopt the second prong of the proposed definition, ''without regard to the financial or other interests of the fiduciary, any affiliate or other party,'' without change. The Department continues to believe that the ''without regard to'' language sets forth the appropriate, protective standard under which a fiduciary investment adviser should act. Many of the alternative approaches suggested by commenters pose their own ambiguities and interpretive challenges, and lower standards run the risk of undermining this regulatory initiative's goal of reducing the impact of conflicts of interest on plans and IRAs.

The Department has not specifically incorporated the suitability obligation as an element of the Best Interest standard, as suggested by FINRA but many aspects of suitability are also elements of the Best Interest standard. An investment recommendation that is not suitable under the securities laws would not meet the Best Interest standard. Under FINRA's rule 2111(a) on suitability, broker-dealers ''must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer.'' The text of rule 2111(a), however, does not do any of the following: Reference a best interest standard, clearly require brokers to put their client's interests ahead of their own, expressly prohibit the selection of the least suitable (but more remunerative) of available investments, or require them to take the kind of measures to avoid or mitigate conflicts of interests that are required as conditions of these amended exemptions.

The Department recognizes that FINRA issued guidance on rule 2111 in which it explains that ''in interpreting the suitability rule, numerous cases explicitly state that a broker's recommendations must be consistent with his customers' best interests,'' and provided examples of conduct that would be prohibited under this standard, including conduct that these amended exemptions would not allow.[35] The guidance goes on to state

[31] As noted above, some of the amended exemptions' Best Interest definitions do not include the term ''affiliate,'' since the exemption defines the fiduciary to include its affiliate.

[32] The standard does not prevent investment advice fiduciaries from restricting their recommended investments to proprietary products or products that generate revenue sharing. Section IV of the Best Interest Contract Exemption specifically addresses how the standard may be satisfied under such circumstances.

[33] The alternative approaches are discussed in greater detail in the preamble to the Best Interest Contract Exemption, adopted elsewhere in today's issue of the **Federal Register**.

[34] FINRA is registered with the Securities and Exchange Commission (SEC) as a national securities association and is a self-regulatory organization, as those terms are defined in the Exchange Act, which operates under SEC oversight.

[35] FINRA Regulatory Notice 12–25, p. 3 (2012).

that ''[t]he suitability requirement that a broker make only those recommendations that are consistent with the customer's best interests prohibits a broker from placing his or her interests ahead of the customer's interests.'' The Department, however is reluctant to adopt as an express standard such guidance, which has not been formalized as a clear rule and that may be subject to change. Additionally, FINRA's suitability rule may be subject to interpretations which could conflict with interpretations by the Department, and the cases cited in the FINRA guidance, as read by the Department, involved egregious fact patterns that one would have thought violated the suitability standard, even without reference to the customer's ''best interest.''

Accordingly, after review of the issue, the Department has decided not to accept the comment. The Department has concluded that its articulation of a clear loyalty standard within the exemption, rather than by reference to the FINRA guidance, will provide clarity and certainty to investors and better protect their interests.

The Best Interest standard, as set forth in the exemptions, is intended to effectively incorporate the objective standards of care and undivided loyalty that have been applied under ERISA for more than forty years. Under these objective standards, the fiduciary must adhere to a professional standard of care in making investments or investment recommendations that are in the plan's or IRA's Best Interest. The fiduciary may not base his or her discretionary acquisitions or recommendations on the fiduciary's own financial interest in the transaction. Nor may the fiduciary acquire or recommend the investment unless it meets the objective prudent person standard of care. Additionally, the duties of loyalty and prudence embodied in ERISA are objective obligations that do not require proof of fraud or misrepresentation, and full disclosure is not a defense to making imprudent acquisitions or recommendations or favoring one's own interests at the plan's or IRA's expense.

Several commenters requested additional guidance on the Best Interest standard. Fiduciaries that are concerned about satisfying the standard may wish to consult the policies and procedures requirement in Section II(d) of the Best Interest Contract Exemption. While these policies and procedures are not a condition of these amended exemptions, they may provide useful guidance for financial institutions wishing to ensure that individual advisers adhere to the Impartial Conduct Standards. The preamble to the Best Interest Contract Exemption provides examples of policies and procedures prudently designed to ensure that advisers adhere to the Impartial Conduct Standards. The examples are not intended to be exhaustive or mutually exclusive, and range from examples that focus on eliminating or nearly eliminating compensation differentials to examples that permit, but police, the differentials.

A few commenters also questioned the requirement in the Best Interest standard that recommendations be made without regard to the interests of the fiduciary, any affiliate or ''*other party.*'' The commenters indicated they did not know the purpose of the reference to ''other parties'' and asked that it be deleted. The Department intends the reference to make clear that a fiduciary operating within the Impartial Conduct Standards should not take into account the interests of any party other than the plan or IRA—whether the other party is related to the fiduciary or not. For example, an entity that may be unrelated to the fiduciary but could still constitute an ''other party,'' for these purposes, is the manufacturer of the investment product being acquired or recommended.

Other commenters asked for confirmation that the Best Interest standard is applied based on the facts and circumstances as they existed at the time of the fiduciary's action, and not based on hindsight. Consistent with the well-established legal principles that exist under ERISA today, the Department confirms that the Best Interest standard is not a hindsight standard, but rather is based on the facts as they existed at the time of the transaction. Thus, the courts have evaluated the prudence of a fiduciary's actions under ERISA by focusing on the process the fiduciary used to reach its determination or recommendation—whether the fiduciary, ''at the time they engaged in the challenged transactions, employed the proper procedures to investigate the merits of the investment and to structure the investment.'' [36] The standard does not measure compliance by reference to how investments subsequently performed or turn fiduciaries into guarantors of investment performance, even though they gave advice that was prudent and loyal at the time of transaction.[37]

This is not to suggest that the ERISA section 404 prudence standard or Best Interest standard, are solely procedural standards. Thus, the prudence standard, as incorporated in the Best Interest standard, is an objective standard of care that requires investment advice fiduciaries to investigate and evaluate investments, make recommendations, and exercise sound judgment in the same way that knowledgeable and impartial professionals would. ''[T]his is not a search for subjective good faith—a pure heart and an empty head are not enough.'' [38] Whether or not the fiduciary is actually familiar with the sound investment principles necessary to make particular recommendations, the fiduciary must adhere to an objective professional standard. Additionally, fiduciaries are held to a particularly stringent standard of prudence when they have a conflict of interest.[39] For this reason, the Department declines to provide a safe harbor based on ''procedural prudence'' as requested by a commenter.

The Department additionally confirms its intent that the phrase ''without regard to'' be given the same meaning as the language in ERISA section 404 that requires a fiduciary to act ''solely in the interest of'' participants and beneficiaries, as such standard has been interpreted by the Department and the courts. Therefore, the standard would not, as some commenters suggested, foreclose the fiduciary from being paid. In response to concerns about the satisfaction of the standard in the context of proprietary product recommendations or investment menus limited to proprietary products and/or investments that generate third party payments, the Department has revised Section IV of the Best Interest Contract Exemption to provide additional clarity and specific guidance on this issue.

In response to commenter concerns, the Department also confirms that the

[36] *Donovan* v. *Mazzola,* 716 F.2d 1226, 1232 (9th Cir. 1983).

[37] One commenter requested an adjustment to the ''prudence'' component of the Best Interest standard, under which the standard would be that of a ''prudent person serving clients with similar retirement needs and offering a similar array of products.'' In this way, the commenter sought to accommodate varying perspectives and opinions on particular investment products and business practices. The Department disagrees with the comment, which could be read as qualifying the stringency of the prudence obligation based on the fiduciary's independent decisions on which products to offer, rather than on the needs of the particular retirement investor. Therefore, the Department did not adopt this suggestion.

[38] *Donovan* v. *Cunningham,* 716 F.2d 1455, 1467 (5th Cir. 1983), *cert. denied,* 467 U.S. 1251 (1984); *see also DiFelice* v. *U.S. Airways, Inc.,* 497 F.3d 410, 418 (4th Cir. 2007) (''Good faith does not provide a defense to a claim of a breach of these fiduciary duties; 'a pure heart and an empty head are not enough.' '').

[39] *Donovan* v. *Bierwirth,* 680 F.2d 263, 271 (2d Cir. 1982) (''the[ ] decisions [of the fiduciary] must be made with an eye single to the interests of the participants and beneficiaries''); *see also Bussian* v. *RJR Nabisco, Inc.,* 223 F.3d 286, 298 (5th Cir. 2000); *Leigh* v. *Engle,* 727 F.2d 113, 126 (7th Cir. 1984).

Best Interest standard does not impose an unattainable obligation on fiduciaries to somehow identify the single ''best'' investment for the plan or IRA out of all the investments in the national or international marketplace, assuming such advice were even possible. Instead, as discussed above, the Best Interest standard set out in the exemptions incorporates two fundamental and well-established fiduciary obligations: The duties of prudence and loyalty. Thus, the fiduciary's obligation under the Best Interest standard is to act in accordance with the professional standards of prudence, and to put the plan's or IRA's financial interests in the driver's seat, rather than the competing interests of the fiduciary or other parties.

Finally, in response to questions regarding the extent to which this Best Interest standard or other provisions of the amendments impose an ongoing monitoring obligation on fiduciaries, the text does not impose a monitoring requirement, but instead leaves that to the parties. This is consistent with the Department's interpretation of an investment advice fiduciary's monitoring responsibility as articulated in the preamble to the Regulation.

2. Reasonable Compensation

The Impartial Conduct Standards also include the reasonable compensation standard. Under this standard, compensation received by the fiduciary and its affiliates in connection with the applicable transaction may not exceed compensation for services that is reasonable within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2).

The obligation to pay no more than reasonable compensation to service providers is long recognized under ERISA and the Code. ERISA section 408(b)(2) and Code section 4975(d)(2), require that services arrangements involving plans and IRAs result in no more than reasonable compensation to the service provider. Accordingly fiduciaries—as service providers—have long been subject to this requirement, regardless of their fiduciary status. At bottom, the standard simply requires that compensation not be excessive, as measured by the market value of the particular services, rights, and benefits the fiduciary is delivering to the plan or IRA. Given the conflicts of interest associated with the commissions and other payments covered by the exemptions, and the potential for self-dealing, it is particularly important that fiduciaries adhere to these statutory standards, which are rooted in common law principles.[40]

Several commenters supported this standard. The requirement that compensation be limited to what is reasonable is an important protection of the exemptions and a well-established standard, they said. A number of other commenters requested greater specificity as to the meaning of the reasonable compensation standard. As proposed, the standard stated that all compensation received by the fiduciary and its affiliates in connection with the transaction must be reasonable in relation to the total services the fiduciary and its affiliates provide to the plan or IRA. Some commenters stated that the proposed reasonable compensation standard was too vague. Because the language of the proposal did not reference ERISA section 408(b)(2) and Code section 4975(d)(2), commenters asked whether the standard differed from those statutory provisions. In particular, some commenters questioned the meaning of the proposed language ''in relation to the total services the fiduciary provides to the plan or IRA.'' The commenters indicated that the proposal did not adequately explain this formulation of the reasonable compensation standard.

There was concern that the standard could be applied retroactively rather than based on the parties' reasonable beliefs as to the reasonableness of the compensation at the time of the recommendation. Commenters also indicated uncertainty as to how to comply with the condition and asked whether it would be necessary to survey the market to determine market rates. Some commenters requested that the Department include the words ''and customary'' in the reasonable compensation definition, to specifically permit existing compensation arrangements. One commenter raised the concern that the reasonable compensation determination raised antitrust concerns because it would require investment advice fiduciaries to agree upon a market rate and result in anti-competitive behavior.

Commenters also asked the Department to provide examples of scenarios that met the reasonable compensation standard and safe harbors and others requested examples of scenarios that would fail to meet these standards. FINRA and other commenters suggested that the Department incorporate existing FINRA rules 2121 and 2122, and NASD rule 2830 regarding the reasonableness of compensation for broker-dealers.[41]

Commenters also asked how the standard would be satisfied for proprietary products. One commenter indicated that the calculation should not include affiliates' or related entities' compensation as this would appear to put them at a comparative disadvantage.

Finally, a few commenters took the position that the reasonable compensation determination should not be a requirement of an exemption. In their view, a plan fiduciary that is not providing investment advice or exercising investment discretion should decide the reasonableness of the compensation paid to the one who is. Another commenter suggested that if an independent plan fiduciary sets the menu of investment options this should be sufficient to comply with the reasonable compensation standard.

In response to comments on this requirement, the Department has retained the reasonable compensation standard as a condition of the amended exemptions. As noted above, the ''reasonable compensation'' obligation is a feature of ERISA and the Code under current law that has long applied to financial services providers, whether fiduciaries or not. The standard is also applicable to fiduciaries under the common law of agency and trusts. It is particularly important that fiduciaries adhere to these standards when engaging in the transactions covered under these amended exemptions, so as to avoid exposing plans and IRAs to harms associated with conflicts of interest.

Although some commenters suggested that the reasonable compensation determination be made by another plan fiduciary, the exemptions (like the statutory obligation) obligate fiduciaries to avoid overcharging their plan and IRA customers, despite the conflicts of interest associated with their compensation. Fiduciaries and other services providers may not charge more than reasonable compensation regardless of whether another fiduciary has signed off on the compensation. Nothing in the exemptions, however, precludes fiduciaries from seeking impartial review of their fee structures to safeguard against abuse, and they may well want to include such reviews in their policies and procedures.

[40] *See generally* Restatement (Third) of Trusts section 38 (2003).

[41] FINRA's comment letter described NASD rule 2830 as imposing specific caps on compensation with respect to investment company securities that broker-dealers may sell. While the Department views this cap as an important protection of investors, it establishes an outside limit rather than a standard of reasonable compensation.

Further, the Department disagrees that the requirement is inconsistent with antitrust laws. Nothing in the exemption contemplates or requires that Advisers or Financial Institutions agree upon a price with their competitors. The focus of the reasonable compensation condition is on preventing overcharges to retirement investors, not promoting anti-competitive practices. Indeed, if Advisors and Financial Institutions consulted with competitors to set prices, the agreed-upon prices could well violate the condition.

In response to comments, however, the operative text of the final amendments was clarified to provide that, to the extent it applies to services, the reasonable compensation standard is the same as the well-established requirement set forth in ERISA section 408(b)(2) and Code section 4975(d)(2), and the regulations thereunder. The reasonableness of the fees depends on the particular facts and circumstances at the time of the recommendation. Several factors inform whether compensation is reasonable including, *inter alia,* the market pricing of service(s) provided and the underlying asset(s), the scope of monitoring, and the complexity of the product. No single factor is dispositive in determining whether compensation is reasonable; the essential question is whether the charges are reasonable in relation to what the investor receives. Consistent with the Department's prior interpretations of this standard, the Department confirms that a fiduciary does not have to recommend the transaction that is the lowest cost or that generates the lowest fees without regard to other relevant factors. In this regard, the Department declines to specifically reference FINRA's standard in the exemptions, but rather relies on ERISA's own longstanding reasonable compensation formulation.

In response to concerns about application of the standard to investment products that bundle together services and investment guarantees or other benefits, the Department responds that the reasonable compensation condition is intended to apply to the compensation received by the Financial Institution, Adviser, Affiliates, and Related Entities in same manner as the reasonable compensation condition set forth in ERISA section 408(b)(2) and Code section 4975(d)(2). Accordingly, the exemption's reasonable compensation standard covers compensation received directly from the plan or IRA and indirect compensation received from any source other than the plan or IRA in connection with the recommended transaction.[42] When assessing the reasonableness of a charge, one generally needs to consider the value of all the services and benefits provided for the charge, not just some. If parties need additional guidance in this respect, they should refer to the Department's interpretations under ERISA section 408(b)(2) and Code section 4975(d)(2) and the Department will provide additional guidance if necessary.

A commenter urged the Department to provide that compensation received by an Affiliate would not have to be considered in applying the reasonable compensation standard. According to the commenter, including such compensation in the assessment of reasonable compensation would place proprietary products at a disadvantage. The Department disagrees with the proposition that a proprietary product would be disadvantaged merely because more of the compensation goes to affiliated parties than in the case of competing products, which allocate more of the compensation to non-affiliated parties. The availability of the exemptions, however, does not turn on how compensation is allocated between affiliates and non-affiliates. Certainly, the Department would not expect that a proprietary product would be at a disadvantage in the marketplace because it carefully ensures that the associated compensation is reasonable. Assuming the Best Interest standard is satisfied and the compensation is reasonable, the exemption should not impede the recommendation of proprietary products. Accordingly, the Department disagrees with the commenter. The Department declines suggestions to provide specific examples of "reasonable" amounts or specific safe harbors. Ultimately, the "reasonable compensation" standard is a market based standard. As noted above, the standard incorporates the familiar ERISA section 408(b)(2) and Code section 4975(d)(2) standards The Department is unwilling to condone all "customary" compensation arrangements and declines to adopt a standard that turns on whether the agreement is "customary." For example, it may in some instances be "customary" to charge customers fees that are not transparent or that bear little relationship to the value of the services actually rendered, but that does not make the charges reasonable. Finally, the Department notes that all recommendations are subject to the overarching Best Interest standard, which incorporates the fundamental fiduciary obligations of prudence and loyalty. An imprudent recommendation for an investor to overpay for an investment transaction would violate that standard, regardless of whether the overpayment was attributable to compensation for services, a charge for benefits or guarantees, or something else.

[42] Such compensation includes, for example charges against the investment, such as commissions, sales loads, sales charges, redemption fees, surrender charges, exchange fees, account fees and purchase fees, as well as compensation included in operating expenses and other ongoing charges, such as wrap fees.

3. Misleading Statements

The final Impartial Conduct Standard requires that statements by the fiduciaries to the plans and IRAs about the recommended transaction, fees and compensation, material conflicts of interest, and any other matters relevant to a plan's or IRA owner's investment decisions, may not be materially misleading at the time they are made.

In response to commenters, the Department added a materiality standard to the definition of material conflict of interest and adjusted the text to clarify that the standard is measured at the time of the representations, *i.e.,* the statements must not be misleading "at the time they are made."

A number of commenters focused on the definition of material conflict of interest used in the proposals. As proposed, a material conflict of interest would have existed when a fiduciary "has a financial interest that could affect the exercise of its best judgment as a fiduciary in rendering advice to a plan or IRA owner." Some commenters took the position that the proposal did not adequately explain the term "material" or incorporate a "materiality" standard into the definition.

However, another commenter indicated that the Department should not use the term "material" in the definition of conflict of interest. The commenter believed that it could result in a standard that was too subjective from the perspective of the fiduciary relying on the exemption, and could undermine the protectiveness of the exemption.

After consideration of the comments, the Department adjusted the definition of material conflict of interest to provide that a material conflict of interest exists when the fiduciary has a "financial interest that *a reasonable person would conclude* could affect the exercise of its best judgment as a fiduciary in rendering advice to a plan or IRA owner." This language responds to concerns about the breadth and potential subjectivity of the standard.

The Department did not accept certain other comments. One commenter requested that the standard indicate that the statements must have been reasonably relied on by the plan or IRA. The Department rejected the comment. The Department's aim is to ensure that fiduciaries uniformly adhere to the Impartial Conduct Standards, including the obligation to avoid materially misleading statements, when they exercise discretion or provide investment advice to plans and IRAs.

One commenter asked the Department to require only that the fiduciary ''reasonably believe'' the statements are not misleading. The Department is concerned that this standard could undermine the protections of this condition, by requiring plans and IRAs to prove the fiduciary's actual belief rather than focusing on whether the statement is objectively misleading. However, to address commenters' concerns about the risks of engaging in a prohibited transaction, as noted above, the Department has clarified that the standard is measured at the time of the representations and has added a materiality standard.

The Department believes that plans and IRAs are best served by statements and representations that are free from material misstatements. Fiduciaries best avoid liability—and best promote the interests of the plans and IRAs—by ensuring that accurate communications are a consistent standard in all their interactions with their customers.

A commenter suggested that the Department adopt FINRA's ''Frequently Asked Questions regarding Rule 2210'' in this connection.[43] FINRA's rule 2210, Communications with the Public, sets forth a number of procedural rules and standards that are designed to, among other things, prevent broker-dealer communications from being misleading. The Department agrees that adherence to FINRA's standards can promote materially accurate communications, and certainly believes that fiduciaries should pay careful attention to such guidance documents. After review of the rule and FAQs, however, the Department declines to simply adopt FINRA's guidance, which addresses written communications, since the condition of the exemptions is broader in this respect. In the Department's view, the meaning of the standard is clear, and is already part of a plan fiduciary's obligations under ERISA. If, however, issues arise in implementation of the exemptions, the Department will consider requests for additional guidance.

Failure to Disclose

Commenters expressed concern about the statement in the third Impartial Conduct Standard that ''failure to disclose a material conflict of interest . . . is deemed to be a misleading statement.'' The commenters indicated that, without a materiality standard, this language would result in an overly broad and uncertain disclosure requirement. The requirement would be especially burdensome in light of the potential consequences of engaging in a non-exempt prohibited transaction, including rescission, repayment of lost earnings, excise tax, and personal liability, commenters said. One commenter stated that this was effectively a change to the existing disclosure requirements of the exemptions, particularly PTE 77–4.

The Department has considered these comments. As noted above, the amended exemptions include a materiality standard in the definition of material conflict of interest. Nevertheless, the Department was persuaded by commenters to eliminate the statement from the third Impartial Conduct Standard. When viewed as a whole, the Department believes the conditions already existing in these exemptions, with the addition of the Impartial Conduct Standards adopted in these final amendments, provide sufficient protections to retirement investors without this additional disclosure provision.

4. PTE 77–4

The Department received some comments specific to PTE 77–4 that were generally outside the scope of these amendments. A few commenters requested that PTE 77–4 be amended to permit fiduciaries to rely on negative consent under the exemption. Another commenter requested amendments or interpretations relating to the extent of relief provided by the exemption. For example, one commenter requested that the Department clarify that the prospectus delivery requirement found at PTE 77–4 section II(d) may be satisfied by identifying a Web site address where investment materials can be obtained. This commenter also requested that PTE 77–4 be expanded to include investments in commingled trusts and exchange-traded funds.

Regardless of possible merit, these requests raise issues outside the scope of these amendments. The amendments were focused on the implementation of the Impartial Conduct Standards with respect to these existing class exemptions, and were not intended to address other issues with respect to these exemptions. The issues raised in these comments were not proposed and commenters did not have the opportunity to address them. Therefore, the comments were not accepted at this time. Parties wishing to pursue these comments may seek an advisory opinion or an amendment to PTE 77–4 from the Department.

Applicability Date

The Regulation will become effective June 7, 2016 and these amended exemptions are issued on that same date. The Regulation is effective at the earliest possible effective date under the Congressional Review Act. For the exemptions, the issuance date serves as the date on which the amended exemptions are intended to take effect for purposes of the Congressional Review Act. This date was selected in order to provide certainty to plans, plan fiduciaries, plan participants and beneficiaries, IRAs, and IRA owners that the new protections afforded by the Regulation are officially part of the law and regulations governing their investment advice providers, and to inform financial services providers and other affected service providers that the Regulation and amended exemptions are final and not subject to further amendment or modification without additional public notice and comment. The Department expects that this effective date will remove uncertainty as an obstacle to regulated firms allocating capital and other resources toward transition and longer term compliance adjustments to systems and business practices.

The Department has also determined that, in light of the importance of the Regulation's consumer protections and the significance of the continuing monetary harm to retirement investors without the rule's changes, that an Applicability Date of April 10, 2017, is appropriate for plans and their affected financial services and other service providers to adjust to the basic change from non-fiduciary to fiduciary status. The amendments as finalized herein have the same Applicability Date; parties may therefore rely on the amended exemptions beginning on the Applicability Date.

General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under ERISA section 408(a) and Code section 4975(c)(2) does not relieve a fiduciary or other party in interest or disqualified

[43] *Currently available at http://www.finra.org/industry/finra-rule-2210-questions-and-answers.*

person with respect to a plan from certain other provisions of ERISA and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of ERISA section 404 which require, among other things, that a fiduciary discharge his or her duties respecting the plan solely in the interests of the plan's participants and beneficiaries and in a prudent fashion in accordance with ERISA section 404(a)(1)(B);

(2) The Department finds that the amended exemptions are administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of plans' participants and beneficiaries and IRA owners;

(3) The amended exemptions are applicable to a particular transaction only if the transactions satisfy the conditions specified in the amendments;

(4) The amended exemptions are supplemental to, and not in derogation of, any other provisions of ERISA and the Code, including statutory or administrative exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

Amendments to Class Exemptions

I. Prohibited Transaction Exemption 75–1, Part III

The Department amends Prohibited Transaction Exemption 75–1, Part III, under the authority of ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637, October 27, 2011).

A. A new section III(f) is inserted to read as follows:

(f) *Standards of Impartial Conduct.* If the fiduciary is a fiduciary within the meaning of section 3(21)(A)(i) or (ii) of the Act, or Code section 4975(e)(3)(A) or (B) with respect to the assets of a plan or IRA involved in the transaction, the fiduciary must comply with the following conditions with respect to the transaction:

(1) The fiduciary acts in the Best Interest of the plan or IRA at the time of the transaction.

(2) All compensation received by the fiduciary in connection with the transaction neither exceeds compensation for services that is reasonable within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2).

(3) The fiduciary's statements about recommended investments, fees and compensation, material conflicts of interest, and any other matters relevant to the plan's or IRA owner's investment decisions, are not materially misleading at the time they are made. A ''material conflict of interest'' exists when a fiduciary has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to the plan or IRA owner.

For purposes of this section, a fiduciary acts in the ''Best Interest'' of the plan or IRA when the fiduciary acts 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 plan or IRA, without regard to the financial or other interests of the fiduciary or any other party. Also for the purposes of this section, the term IRA means any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

B. Sections III(f) and III(g) are redesignated, respectively, as sections III(g) and III(h).

II. Prohibited Transaction Exemption 75–1, Part IV

The Department amends Prohibited Transaction Exemption 75–1, Part IV, under the authority of ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637, October 27, 2011).

A. A new section IV(e) is inserted to read as follows:

(e) *Standards of Impartial Conduct.* If the fiduciary is a fiduciary within the meaning of section 3(21)(A)(i) or (ii) of the Act, or Code section 4975(e)(3)(A) or (B) with respect to the assets of the plan or IRA involved in the transaction, the fiduciary must comply with the following conditions with respect to the transaction:

(1) The fiduciary acts in the Best Interest of the plan or IRA at the time of the transaction.

(2) All compensation received by the fiduciary in connection with the transaction neither exceeds compensation for services that is reasonable within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2).

(3) The fiduciary's statements about recommended investments, fees and compensation, material conflicts of interest, and any other matters relevant to the plan's or IRA owner's investment decisions, are not materially misleading at the time they are made. A ''material conflict of interest'' exists when a fiduciary has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to the plan or IRA owner.

For purposes of this section, a fiduciary acts in the ''Best Interest'' of the plan or IRA when the fiduciary acts 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 plan or IRA, without regard to the financial or other interests of the fiduciary or any other party. Also for the purposes of this section, the term IRA means any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

B. Sections IV(e) and IV(f) are redesignated, respectively, as sections IV(f) and IV(g).

III. Prohibited Transaction Exemption 77–4

The Department amends Prohibited Transaction Exemption 77–4 under the authority of ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637, October 27, 2011).

A new section II(g) is inserted to read as follows:

(g) *Standards of Impartial Conduct.* If the fiduciary is a fiduciary within the meaning of section 3(21)(A)(i) or (ii) of the Act, or Code section 4975(e)(3)(A) or (B) with respect to the assets of the plan or IRA involved in the transaction, the fiduciary must comply with the following conditions with respect to the transaction:

(1) The fiduciary acts in the Best Interest of the plan or IRA at the time of the transaction.

(2) All compensation received by the fiduciary and its affiliates in connection with the transaction neither exceeds

compensation for services that is reasonable within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2).

(3) The fiduciary's statements about recommended investments, fees and compensation, material conflicts of interest, and any other matters relevant to the plan's or IRA owner's investment decisions, are not materially misleading at the time they are made. A "material conflict of interest" exists when a fiduciary has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to the plan or IRA owner.

For purposes of this section, a fiduciary acts in the "Best Interest" of the plan or IRA when the fiduciary acts 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 plan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate or other party. Also for the purposes of this section, the term IRA means any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

IV. Prohibited Transaction Exemption 80–83

The Department amends Prohibited Transaction Exemption 80–83 under the authority of ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637, October 27, 2011).

A. A new section II(A)(2) is inserted to read as follows:

(2) *Standards of Impartial Conduct.* If the fiduciary is a fiduciary within the meaning of section 3(21)(A)(i) or (ii) of the Act, or Code section 4975(e)(3)(A) or (B) with respect to the assets of the plan or IRA involved in the transaction, the fiduciary must comply with the following conditions with respect to the transaction:

(a) The fiduciary acts in the Best Interest of the plan or IRA at the time of the transaction.

(b) All compensation received by the fiduciary and its affiliates in connection with the transaction neither exceeds compensation for services that is reasonable within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2).

(c) The fiduciary's statements about recommended investments, fees and compensation, material conflicts of interest, and any other matters relevant to the plan's or IRA owner's investment decisions, are not materially misleading at the time they are made. A "material conflict of interest" exists when a fiduciary has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to the plan or IRA owner.

For purposes of this section, a fiduciary acts in the "Best Interest" of the employee benefit plan or IRA when the fiduciary acts 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 employee benefit plan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate or other party. Also for the purposes of this section, the term IRA means any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

B. Section II(A)(2) is redesignated as section II(A)(3).

V. Prohibited Transaction Exemption 83–1

The Department amends Prohibited Transaction Exemption 83–1 under the authority of ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637, October 27, 2011).

A. A new section II(B) is inserted to read as follows:

(B) *Standards of Impartial Conduct.* Solely with respect to the relief provided under section I(B), if the sponsor, trustee or insurer of such pool who is a fiduciary is a fiduciary within the meaning of section 3(21)(A)(i) or (ii) of the Act, or Code section 4975(e)(3)(A) or (B) with respect to the assets of the plan or IRA involved in the transaction, the fiduciary must comply with the following conditions with respect to the transaction:

(1) The fiduciary acts in the Best Interest of the plan or IRA at the time of the transaction.

(2) All compensation received by the fiduciary and its affiliates in connection with the transaction neither exceeds compensation for services that is reasonable within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2).

(3) The fiduciary's statements about recommended investments, fees and compensation, material conflicts of interest, and any other matters relevant to the plan's or IRA owner's investment decisions, are not materially misleading at the time they are made. A "material conflict of interest" exists when a fiduciary has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to the plan or IRA owner.

For purposes of this section, a fiduciary acts in the "Best Interest" of the plan or IRA when the fiduciary acts 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 plan or IRA, without regard to the financial or other interests of the plan or IRA to the financial interests of the fiduciary, any affiliate or other party. Also for the purposes of this section, the term IRA means any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

Signed at Washington, DC, this 1st day of April, 2016.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

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DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

[Application Number D–11713]

ZRIN 1210–ZA25

Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs

AGENCY: Employee Benefits Security Administration (EBSA), U.S. Department of Labor.

ACTION: Adoption of Class Exemption.

SUMMARY: This document contains an exemption from certain prohibited transactions provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (the Code). The provisions at issue generally prohibit fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs) from purchasing and selling investments when the fiduciaries are acting on behalf of their own accounts (principal transactions). The exemption permits principal transactions and riskless principal transactions in certain investments between a plan, plan participant or beneficiary account, or an IRA, and a fiduciary that provides investment advice to the plan or IRA, under conditions to safeguard the interests of these investors. The exemption affects participants and beneficiaries of plans, IRA owners, and fiduciaries with respect to such plans and IRAs.

DATES:

Issuance date: This exemption is issued June 7, 2016.

Applicability date: This exemption is applicable to transactions occurring on or after April 10, 2017. See Section F of this preamble, *Applicability Date and Transition Rules* in this preamble, for further information.

FOR FURTHER INFORMATION CONTACT: Brian Shiker, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor (202) 693–8824 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Executive Summary

Purpose of Regulatory Action

The Department grants this exemption in connection with its publication today, elsewhere in this issue of the **Federal Register**, of a final regulation defining who is a ''fiduciary'' of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries (Regulation). The Regulation also applies to the definition of a ''fiduciary'' of a plan (including an IRA) under the Code. The Regulation amends a prior regulation, dating to 1975, specifying when a person is a ''fiduciary'' under ERISA and the Code by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. The Regulation takes into account the advent of 401(k) 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 existing regulation was issued. In light of the extensive changes in retirement investment practices and relationships, the Regulation updates 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.

This exemption allows investment advice fiduciaries to engage in purchases and sales of certain investments out of their inventory (*i.e.,* engage in principal transactions) with plans, participant or beneficiary accounts, and IRAs, under conditions designed to safeguard the interests of these investors. In the absence of an exemption, these transactions would be prohibited under ERISA and the Code. In this regard, ERISA and the Code generally prohibit fiduciaries with respect to plans and IRAs from purchasing or selling any property to plans, participant or beneficiary accounts, or IRAs. Fiduciaries also may not engage in self-dealing or, under ERISA, act in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan or the interests of its participants and beneficiaries. When a fiduciary purchases or sells an investment in a principal transaction or riskless principal transaction, it violates these prohibitions.

ERISA section 408(a) specifically authorizes the Secretary of Labor to grant administrative exemptions from ERISA's prohibited transaction provisions.[1] Regulations at 29 CFR 2570.30 to 2570.52 describe the procedures for applying for an administrative exemption. In granting this exemption, the Department has determined that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners.

Summary of the Major Provisions

The exemption allows an individual investment advice fiduciary (an Adviser)[2] and the firm that employs or otherwise contracts with the Adviser (a Financial Institution) to engage in principal transactions and riskless principal transactions involving certain investments, with plans, participant and beneficiary accounts, and IRAs. The exemption limits the type of investments that may be purchased or sold and contains conditions which the

[1] Code section 4975(c)(2) authorizes the Secretary of the Treasury to grant exemptions from the parallel prohibited transaction provisions of the Code. Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)) (Reorganization Plan) generally transferred the authority of the Secretary of the Treasury to grant administrative exemptions under Code section 4975 to the Secretary of Labor. To rationalize the administration and interpretation of dual provisions under ERISA and the Code, the Reorganization Plan divided the interpretive and rulemaking authority for these provisions between the Secretaries of Labor and of the Treasury, so that, in general, the agency with responsibility for a given provision of Title I of ERISA would also have responsibility for the corresponding provision in the Code. Among the sections transferred to the Department were the prohibited transaction provisions and the definition of a fiduciary in both Title I of ERISA and in the Code. ERISA's prohibited transaction rules, 29 U.S.C. 1106–1108, apply to ERISA-covered plans, and the Code's corresponding prohibited transaction rules, 26 U.S.C. 4975(c), apply both to ERISA-covered pension plans that are tax-qualified pension plans, as well as other tax-advantaged arrangements, such as IRAs, that are not subject to the fiduciary responsibility and prohibited transaction rules in ERISA. Specifically, section 102(a) of the Reorganization Plan provides the Department of Labor with ''all authority'' for ''regulations, rulings, opinions, and exemptions under section 4975 [of the Code]'' subject to certain exceptions not relevant here. Reorganization Plan section 102. In President Carter's message to Congress regarding the Reorganization Plan, he made explicitly clear that as a result of the plan, ''Labor will have statutory authority for fiduciary obligations. . . . Labor will be responsible for overseeing fiduciary conduct under these provisions.'' Reorganization Plan, Message of the President. This exemption provides relief from the indicated prohibited transaction provisions of both ERISA and the Code.

[2] By using the term ''Adviser,'' the Department does not intend to limit the exemption to investment advisers registered under the Investment Advisers Act of 1940 or under state law. As explained herein, an Adviser must be an investment advice fiduciary of a plan or IRA who is an employee, independent contractor, agent, or registered representative of a registered investment adviser, bank, or registered broker-dealer.

Adviser and Financial Institution must satisfy in order to rely on the exemption. To safeguard the interests of plans, participants and beneficiaries, and IRA owners, the exemption requires Financial Institutions to give the appropriate fiduciary of the plan or IRA owner a written statement in which the Financial Institution acknowledges its fiduciary status and that of its Advisers. The Financial Institution and Adviser must adhere to enforceable standards of fiduciary conduct and fair dealing when providing investment advice regarding the transaction to Retirement Investors. In the case of IRAs and non-ERISA plans, the exemption requires that these standards be set forth in an enforceable contract with the Retirement Investor. Under the exemption's terms, Financial Institutions are not required to enter into a contract with ERISA plan investors, but they are obligated to acknowledge fiduciary status in writing, and adhere to these same standards of fiduciary conduct, which the investors can effectively enforce pursuant to section 502(a)(2) and (3) of ERISA. Under this standards-based approach, the Adviser and Financial Institution must give prudent advice that is in the customer's Best Interest, avoid misleading statements, and seek to obtain the best execution reasonably available under the circumstances with respect to the transaction. Additionally, Financial Institutions must adopt policies and procedures reasonably designed to mitigate any harmful impact of conflicts of interest, and must disclose their conflicts of interest to Retirement Investors.

The exemption is calibrated to align the Adviser's interests with those of the plan or IRA customer, while leaving the Adviser and the Financial Institution the flexibility and discretion necessary to determine how best to satisfy the exemption's standards in light of the unique attributes of their business. Financial Institutions relying on the exemption must obtain the Retirement Investor's consent to participate in principal transactions and riskless principal transactions, and the Financial Institutions are subject to recordkeeping requirements.

Executive Order 12866 and 13563 Statement

Under Executive Orders 12866 and 13563, the Department must determine whether a regulatory action is "significant" and therefore subject to the requirements of the Executive Order and subject to review by the Office of Management and Budget (OMB). Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing and streamlining rules, and of promoting flexibility. It also requires federal agencies to develop a plan under which the agencies will periodically review their existing significant regulations to make the agencies' regulatory programs more effective or less burdensome in achieving their regulatory objectives.

Under Executive Order 12866, "significant" regulatory actions are subject to the requirements of the Executive Order and review by the OMB. Section 3(f) of Executive Order 12866, defines a "significant regulatory action" as an action that is likely to result in a rule (1) having an annual effect on the economy of $100 million or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as "economically significant" regulatory actions); (2) creating serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order. Pursuant to the terms of the Executive Order, OMB has determined that this action is "significant" within the meaning of Section 3(f)(1) of the Executive Order. Accordingly, the Department has undertaken an assessment of the costs and benefits of the proposal, and OMB has reviewed this regulatory action. The Department's complete Regulatory Impact Analysis is available at *www.dol.gov/ebsa.*

I. Background

The Department proposed this class exemption on its own motion, pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637 (October 27, 2011)).

A. Regulation Defining a Fiduciary

As explained more fully in the preamble to the Regulation, ERISA is a comprehensive statute designed to protect the interests of plan participants and beneficiaries, the integrity of employee benefit plans, and the security of retirement, health, and other critical benefits. The broad public interest in ERISA-covered plans is reflected in its imposition of stringent fiduciary responsibilities on parties engaging in important plan activities, as well as in the tax-favored status of plan assets and investments. One of the chief ways in which ERISA protects employee benefit plans is by requiring that plan fiduciaries comply with fundamental obligations rooted in the law of trusts. In particular, plan fiduciaries must manage plan assets prudently and with undivided loyalty to the plans and their participants and beneficiaries.[3] In addition, they must refrain from engaging in "prohibited transactions," which ERISA does not permit because of the dangers posed by the fiduciaries' conflicts of interest with respect to the transactions.[4] When fiduciaries violate ERISA's fiduciary duties or the prohibited transaction rules, they may be held personally liable for the breach.[5] In addition, violations of the prohibited transaction rules are subject to excise taxes under the Code.

The Code also has rules regarding fiduciary conduct with respect to tax-favored accounts that are not generally covered by ERISA, such as IRAs. In particular, fiduciaries of these arrangements, including IRAs, are subject to the prohibited transaction rules and, when they violate the rules, to the imposition of an excise tax enforced by the Internal Revenue Service. Unlike participants in plans covered by Title I of ERISA, IRA owners do not have a statutory right to bring suit against fiduciaries for violations of the prohibited transaction rules.

Under this statutory framework, the determination of who is a "fiduciary" is of central importance. Many of ERISA's and the Code's protections, duties, and liabilities hinge on fiduciary status. In relevant part, ERISA section 3(21)(A) and Code section 4975(e)(3) provide that a person is a fiduciary with respect to a plan or IRA to the extent he or she (i) exercises any discretionary authority or discretionary control with respect to management of such plan or IRA, or exercises any authority or control with respect to management or disposition of

[3] ERISA section 404(a).

[4] ERISA section 406. ERISA also prohibits certain transactions between a plan and a party in interest.

[5] ERISA section 409; *see also* ERISA section 405.

its assets; (ii) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan or IRA, or has any authority or responsibility to do so; or, (iii) has any discretionary authority or discretionary responsibility in the administration of such plan or IRA.

The statutory definition deliberately casts a wide net in assigning fiduciary responsibility with respect to plan and IRA assets. Thus, "any authority or control" over plan or IRA assets is sufficient to confer fiduciary status, and any persons who render "investment advice for a fee or other compensation, direct or indirect" are fiduciaries, regardless of whether they have direct control over the plan's or IRA's assets and regardless of their status as an investment adviser or broker under the federal securities laws. The statutory definition and associated responsibilities were enacted to ensure that plans, plan participants and IRA owners can depend on persons who provide investment advice for a fee to provide recommendations that are untainted by conflicts of interest. In the absence of fiduciary status, the providers of investment advice are neither subject to ERISA's fundamental fiduciary standards, nor accountable under ERISA or the Code for imprudent, disloyal, or biased advice.

In 1975, the Department issued a regulation, at 29 CFR 2510.3–21(c)(1975) defining the circumstances under which a person is treated as providing "investment advice" to an employee benefit plan within the meaning of section 3(21)(A)(ii) of ERISA (the 1975 regulation).[6] The 1975 regulation narrowed the scope of the statutory definition of fiduciary investment advice by creating a five-part test for fiduciary advice. Under the 1975 regulation, for advice to constitute "investment advice," an adviser must—(1) render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property (2) on a regular basis (3) pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary that (4) the advice will serve as a primary basis for investment decisions with respect to plan assets, and that (5) the advice will be individualized based on the particular needs of the plan. The 1975 regulation provided that an adviser is a fiduciary with respect to any particular instance of advice only if he or she meets each and every element of the five-part test with respect to the particular advice recipient or plan at issue.

The market for retirement advice has changed dramatically since the Department first promulgated the 1975 regulation. Individuals, rather than large employers and professional money managers, have become increasingly responsible for managing retirement assets as IRAs and participant-directed plans, such as 401(k) plans, have supplanted defined benefit pensions. At the same time, the variety and complexity of financial products have increased, widening the information gap between advisers and their clients. Plan fiduciaries, plan participants and IRA investors must often rely on experts for advice, but are unable to assess the quality of the expert's advice or effectively guard against the adviser's conflicts of interest. This challenge is especially true of retail investors, who typically do not have financial expertise and can ill-afford lower returns to their retirement savings caused by conflicts. The IRA accounts of these investors often account for all or the lion's share of their assets, and can represent all of savings earned for a lifetime of work. Losses and reduced returns can be devastating to the investors who depend upon such savings for support in their old age. As baby boomers retire, they are increasingly moving money from ERISA-covered plans, where their employer has both the incentive and the fiduciary duty to facilitate sound investment choices, to IRAs where both good and bad investment choices are myriad and advice that is conflicted is commonplace. These rollovers are expected to approach $2.4 trillion cumulatively from 2016 through 2020.[7] These trends were not apparent when the Department promulgated the 1975 regulation. At that time, 401(k) plans did not yet exist and IRAs had only just been authorized.

As the marketplace for financial services has developed in the years since 1975, the five-part test has now come to undermine, rather than promote, the statutes' text and purposes. The narrowness of the 1975 regulation has allowed advisers, brokers, consultants and valuation firms to play a central role in shaping plan and IRA investments, without ensuring the accountability that Congress intended for persons having such influence and responsibility. Even when plan sponsors, participants, beneficiaries, and IRA owners clearly relied on paid advisers for impartial guidance, the 1975 regulation has allowed many advisers to avoid fiduciary status and disregard basic fiduciary obligations of care and prohibitions on disloyal and conflicted transactions. As a consequence, these advisers have been able to steer customers to investments based on their own self-interest (*e.g.,* products that generate higher fees for the adviser even if there are identical lower-fee products available), give imprudent advice, and engage in transactions that would otherwise be prohibited by ERISA and the Code without fear of accountability under either ERISA or the Code.

In the Department's amendments to the 1975 regulation defining fiduciary advice within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) (the Regulation), which are also published in this issue of the **Federal Register**, the Department is replacing the existing regulation with one that more appropriately distinguishes between the sorts of advice relationships that should be treated as fiduciary in nature and those that should not, in light of the legal framework and financial marketplace in which IRAs and plans currently operate.[8]

The Regulation describes the types of advice that constitute "investment advice" with respect to plan or IRA assets for purposes of the definition of a fiduciary at ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B). The Regulation covers ERISA-covered plans, IRAs, and other plans not covered by Title I, such as Keogh plans, and health savings accounts described in Code section 223(d).

As amended, the Regulation provides that a person renders investment advice with respect to assets of a plan or IRA if, among other things, the person provides, directly to a plan, a plan fiduciary, plan participant or beneficiary, IRA or IRA owner, the following types of advice, for a fee or other compensation, whether direct or indirect:

(i) A recommendation as to the advisability of acquiring, holding, disposing of, or exchanging, securities or other investment property, or a

[6] The Department of Treasury issued a virtually identical regulation, at 26 CFR 54.4975–9(c), which interprets Code section 4975(e)(3).

[7] Cerulli Associates, "Retirement Markets 2015."

[8] The Department initially proposed an amendment to its regulation defining a fiduciary within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) on October 22, 2010, at 75 FR 65263. It subsequently announced its intention to withdraw the proposal and propose a new rule, consistent with the President's Executive Orders 12866 and 13563, in order to give the public a full opportunity to evaluate and comment on the new proposal and updated economic analysis. The first proposed amendment to the rule was withdrawn on April 20, 2015, *see* 80 FR 21927.

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; and

(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, selection of other persons to provide investment advice or investment management services, types of investment account arrangements (brokerage versus advisory), 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.

In addition, in order to be treated as a fiduciary, such person, either directly or indirectly (*e.g.,* through or together with any Affiliate), must: Represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code with respect to the advice described; represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code; render 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 direct 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.

The Regulation also provides that as a threshold matter in order to be fiduciary advice, the communication must be a ''recommendation'' as defined therein. The Regulation, as a matter of clarification, provides that a variety of other communications do not constitute ''recommendations,'' including non-fiduciary investment education; general communications; and specified communications by platform providers. These communications which do not rise to the level of ''recommendations'' under the Regulation are discussed more fully in the preamble to the final Regulation.

The Regulation also specifies certain circumstances where the Department has determined that a person will not be treated as an investment advice fiduciary even though the person's activities technically may satisfy the definition of investment advice. For example, the Regulation contains a provision excluding recommendations to independent fiduciaries with financial expertise that are acting on behalf of plans or IRAs in arm's length transactions, if certain conditions are met. The independent fiduciary must be a bank, insurance carrier qualified to do business in more than one state, investment adviser registered under the Investment Advisers Act of 1940 or by a state, broker-dealer registered under the Securities Exchange Act of 1934 (Exchange Act), or any other independent fiduciary that holds, or has under management or control, assets of at least $50 million, and: (1) The person making the recommendation must know or reasonably believe 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 (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition); (2) the person must fairly inform 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 must fairly inform the independent fiduciary of the existence and nature of the person's financial interests in the transaction; (3) the person must know or reasonably believe that the independent fiduciary of the plan or IRA is a fiduciary under ERISA or the Code, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition); and (4) the person cannot 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.

Similarly, the Regulation provides that the provision of any advice to an employee benefit plan (as described in ERISA section 3(3)) by a person who is a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, or a swap clearing firm in connection with a swap or security-based swap, as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a) and section 3(a) of the Exchange Act (15 U.S.C. 78c(a)) is not investment advice if certain conditions are met. Finally, the Regulation describes certain communications by employees of a plan sponsor, plan, or plan fiduciary that would not cause the employee to be an investment advice fiduciary if certain conditions are met.

B. Prohibited Transactions

The Department anticipates that the Regulation will cover many investment professionals who did not previously consider themselves to be fiduciaries under ERISA or the Code. Under the Regulation, these entities will be subject to the prohibited transaction restrictions in ERISA and the Code that apply specifically to fiduciaries. ERISA section 406(b)(1) and Code section 4975(c)(1)(E) prohibit a fiduciary from dealing with the income or assets of a plan or IRA in his own interest or his own account. ERISA section 406(b)(2), which does not apply to IRAs, provides that a fiduciary shall 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.'' ERISA section 406(b)(3) and Code section 4975(c)(1)(F) prohibit a fiduciary from receiving any consideration for his own personal account from any party dealing with the plan or IRA in connection with a transaction involving assets of the plan or IRA.

Parallel regulations issued by the Departments of Labor and the Treasury explain that these provisions impose on fiduciaries of plans and IRAs a duty not to act on conflicts of interest that may affect the fiduciary's best judgment on behalf of the plan or IRA.[9] The prohibitions extend to a fiduciary causing a plan or IRA to pay an additional fee to such fiduciary, or to a person in which such fiduciary has an interest that may affect the exercise of the fiduciary's best judgment as a fiduciary. Likewise, a fiduciary is prohibited from receiving compensation from third parties in connection with a transaction involving the plan or IRA.[10]

The purchase or sale of an investment in a principal transaction or riskless principal transaction between a plan or IRA and a fiduciary, resulting from the fiduciary's provision of investment advice, implicates the prohibited

[9] Subsequent to the issuance of these regulations, Reorganization Plan No. 4 of 1978, 5 U.S.C. App. (2010), divided rulemaking and interpretive authority between the Secretaries of Labor and the Treasury. The Secretary of Labor was given interpretive and rulemaking authority regarding the definition of fiduciary under both Title I of ERISA and the Internal Revenue Code. *Id.* section 102(a) (''all authority of the Secretary of the Treasury to issue [regulations, rulings opinions, and exemptions under section 4975 of the Code] is hereby transferred to the Secretary of Labor'').

[10] 29 CFR 2550.408b–2(e); 26 CFR 54.4975–6(a)(5).

transaction rules set forth in ERISA section 406(b) and Code section 4975(c)(1)(E).[11] Nevertheless, the Department recognizes that certain investment advice fiduciaries view the ability to execute principal transactions or riskless principal transaction as integral to the economically efficient distribution of fixed income securities. Therefore, in connection with the Regulation, the Department reviewed the existing legal framework to determine whether additional exemptions were needed for investment advice fiduciaries to engage in these transactions. In this regard, as further discussed below, fiduciaries who engage in such transactions under certain circumstances can avoid the ERISA and Code restrictions. Moreover, there are existing statutory and administrative exemptions, also discussed below, that already provide prohibited transaction relief for fiduciaries engaging in principal transactions and riskless principal transactions with plans and IRAs. Nevertheless, the Department determined that additional relief in this area is necessary and therefore, after reviewing the comments on the proposal, determined to grant this exemption for investment advice fiduciaries to engage in certain principal transactions and riskless principal transactions with plans and IRAs.

1. Blind Transactions

Certain principal transactions and riskless principal transactions between a plan or IRA and an investment advice fiduciary may not need exemptive relief because they are blind transactions executed on an exchange. The ERISA Conference Report states that a transaction will, generally, not be a prohibited transaction if the transaction is an ordinary ''blind'' purchase or sale of securities through an exchange where neither the buyer nor the seller (nor the agent of either) knows the identity of the other party involved.[12]

2. Principal Transactions Permitted Under an Exemption

As the prohibited transaction provisions demonstrate, ERISA and the Code strongly disfavor conflicts of interest. In appropriate cases, however, the statutes provide exemptions from their broad prohibitions on conflicts of interest. In addition, the Secretary of Labor has discretionary authority to grant administrative exemptions under ERISA and the Code on an individual or class basis, but only if the Secretary first finds that the exemptions are (1) administratively feasible, (2) in the interests of plans and their participants and beneficiaries and IRA owners, and (3) protective of the rights of the participants and beneficiaries of such plans and IRA owners. Accordingly, fiduciary advisers may always give advice without need of an exemption if they avoid the sorts of conflicts of interest that result in prohibited transactions. However, when they choose to give advice in which they have a conflict of interest, they must rely upon an exemption.

a. Statutory Exemptions

ERISA section 408(b)(14) provides a statutory exemption for transactions entered into in connection with the provision of fiduciary investment advice to a participant or beneficiary of an individual account plan or an IRA owner. The exemption provides relief for, among other things, the acquisition, holding, or sale of a security or other property as an investment under the plan pursuant to the investment advice. As set forth in ERISA section 408(g), the exemption is available if the advice is provided under an ''eligible investment advice arrangement'' which either (1) ''provides that any fees (including any commission or other compensation) received by the fiduciary adviser for investment advice or with respect to the sale, holding or acquisition of any security or other property for purposes of investment of plan assets do not vary depending on the basis of any investment option selected'' or (2) ''uses a computer model under an investment advice program meeting the requirements of [ERISA section 408(g)(3)].'' The ERISA section 408(g) exemptions include special conditions calibrated to insulate the fiduciary adviser from conflicts of interest. Code section 4975(d)(17) provides the same relief from the taxes imposed by Code section 4975(a) and (b).

ERISA section 408(b)(16) provides relief for transactions involving the purchase or sale of securities between a plan and a party in interest, including an investment advice fiduciary, if the transactions are executed through an electronic communication network, alternative trading system, or similar execution system or trading venue. Among other conditions, subparagraph (B) of the statutory exemption requires that either: (i) ''the transaction is effected pursuant to rules designed to match purchases and sales at the best price available through the execution system in accordance with applicable rules of the Securities and Exchange Commission or other relevant governmental authority,'' or (ii) ''neither the execution system nor the parties to the transaction take into account the identity of the parties in the execution of trades[.]'' The transactions covered by ERISA section 408(b)(16) include principal transactions between a plan and an investment advice fiduciary. Code section 4975(d)(19) provides the same relief from the taxes imposed by Code section 4975(a) and (b).

b. Administrative Exemptions

An administrative exemption for certain principal transactions will continue to be available through PTE 75–1.[13] Specifically, PTE 75–1, Part IV, provides an exemption that is available to investment advice fiduciaries who are ''market-makers.'' Relief is available from ERISA section 406 for the purchase or sale of securities by a plan or IRA, from or to a market-maker with respect to such securities who is also an investment advice fiduciary with respect to the plan or IRA, or an affiliate of such fiduciary. However, PTE 75–1, Part IV, is amended today in a Notice, published elsewhere in this issue of the **Federal Register**, to require fiduciaries relying on the exemption to comply with the Impartial Conduct Standards that are also incorporated in this exemption.

Further, Part II(1) of PTE 75–1 provides relief from ERISA section 406(a) and Code section 4975(c)(1)(A) through (D) for the purchase or sale of a security in a principal transaction between a plan or IRA and a broker-dealer registered under the Exchange Act or a bank supervised by the United States or a state. However, the exemption permits plans and IRAs to engage in principal transactions with broker-dealers and banks only if the broker-dealers and banks do not have or exercise any discretionary authority or control (except as a directed trustee) with respect to the investment of plan or IRA assets involved in the transaction, and *do not render investment advice (within the meaning of 29 CFR 2510.3–21(c)) with respect to the investment of those assets.* PTE 75–1, Part II(1) will continue to be available to parties in interest that are not fiduciaries and that satisfy its conditions. In this regard, the Regulation provides that parties will not be investment advice fiduciaries if they engage in arm's length transactions with

[11] The purchase or sale of an investment in a principal transaction or a riskless principal transaction between a plan or IRA and a fiduciary also is prohibited by ERISA section 406(a)(1)(A) and (D) and Code section 4975(c)(1)(A) and (D).

[12] *See* H.R. Rep. 93–1280, 93rd Cong., 2d Sess. 307 (1974); *see also* ERISA Advisory Opinion 2004–05A (May 24, 2004).

[13] 40 FR 50845 (Oct. 31, 1975), as amended, 71 FR 5883 (Feb. 3, 2006).

certain independent fiduciaries of a plan or IRA with financial expertise, including banks, insurance carriers, registered investment advisers, broker-dealers and persons holding, or possessing under management or control, total assets of at least $50 million, and who are capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies, and certain other conditions are satisfied. These non-fiduciary counterparties can continue to rely on PTE 75–1, Part II, for relief regarding principal transactions.

In connection with the proposed Regulation, the Department recognized the need for additional relief. Accordingly, the Department proposed this exemption for principal transactions in certain debt securities between a plan, participant or beneficiary account, or IRA, and an investment advice fiduciary. The proposed exemption was intended to facilitate continued access by plan and IRA investors to certain types of investments commonly sold in principal transactions.

The Department also proposed the Best Interest Contract Exemption, which is adopted elsewhere in this issue of the **Federal Register**. The Best Interest Contract Exemption provides broad relief for investment advice fiduciaries and their Affiliates and related entities to receive compensation as a result of investment advice to retail Retirement Investors (plan participants and beneficiaries, IRA owners, and certain plan fiduciaries, including small plan sponsors) under conditions specifically designed to address the conflicts of interest associated with the wide variety of payments advisers receive in connection with retail transactions involving plans and IRAs.

At the same time that the Department has granted these new exemptions, it has also amended existing exemptions to ensure uniform application of the Impartial Conduct Standards, which are fundamental obligations of fair dealing and fiduciary conduct, and include obligations to act in the customer's Best Interest, avoid misleading statements, and receive no more than reasonable compensation.[14] Taken together, the new exemptions and amendments to existing exemptions ensure that Retirement Investors are consistently protected by Impartial Conduct Standards, regardless of the particular exemption upon which the adviser relies.

The amendments also revoke certain existing exemptions, which provided little or no protections to IRA and non-ERISA plan participants, in favor of a more uniform application of the Best Interest Contract Exemption in the market for retail investments. With limited exceptions, it is the Department's intent that investment advice fiduciaries in the retail investment market rely on statutory exemptions, the Best Interest Contract Exemption, or this exemption to the extent that they receive conflicted forms of compensation that would otherwise be prohibited. The new and amended exemptions reflect the Department's view that Retirement Investors should be protected by a more consistent application of fundamental fiduciary standards across a wide range of investment products and advice relationships, and that retail investors, in particular, should be protected by the stringent protections set forth in the Best Interest Contract Exemption and this exemption. When fiduciaries have conflicts of interest, they will uniformly be expected to adhere to fiduciary norms and to make recommendations that are in their customer's Best Interest.

These new and amended exemptions follow a lengthy public notice and comment process, which gave interested persons an extensive opportunity to comment on this proposed exemption, proposed Regulation and other related exemption proposals. The proposals initially provided for 75-day comment periods, ending on July 6, 2015, but the Department extended the comment periods to July 21, 2015. The Department then held four days of public hearings on the new regulatory package, including the proposed exemptions, in Washington, DC from August 10 to 13, 2015, at which over 75 speakers testified. The transcript of the hearing was made available on September 8, 2015, and the Department provided additional opportunity for interested persons to comment on the proposals or hearing transcript until September 24, 2015. A total of over 3000 comment letters were received on the new proposals. There were also over 300,000 submissions made as part of 30 separate petitions submitted on the proposal. These comments and petitions came from consumer groups, plan sponsors, financial services companies, academics, elected government officials, trade and industry associations, and others, both in support and in opposition to the rule.[15] The Department has reviewed all comments, and after careful consideration of the comments, has decided to grant this exemption.

II. Exemption for Principal Transactions in Certain Assets

As finalized, this exemption for certain principal transactions and riskless principal transactions retains the core protections of the proposed exemption, but with revisions designed to facilitate implementation and compliance with the exemption's terms. In broadest outline, the exemption permits Advisers and the Financial Institutions that employ or otherwise retain them to enter into principal transactions and riskless principal transactions with plans and IRAs regarding certain investments, provided that they give advice regarding the transactions that is in their customers' Best Interest and the Financial Institution implements basic protections against the dangers posed by conflicts of interest. In particular, to rely on the exemption, Financial Institutions must:

- Acknowledge fiduciary status with respect to any investment advice regarding principal transactions or riskless principal transactions;
- Adhere to Impartial Conduct Standards requiring them to
  - Give advice that is in the Retirement Investor's Best Interest (*i.e.,* prudent advice that is based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to financial or other interests of the Adviser, Financial Institution or any Affiliates or other parties);
  - Seek to obtain the best execution reasonably available under the circumstances with respect to the transaction; and
  - Make no misleading statements about investment transactions, compensation, and conflicts of interest;
- Implement policies and procedures reasonably and prudently designed to prevent violations of the Impartial Conduct Standards;
- Refrain from giving or using incentives for Advisers to act contrary to the customer's Best Interest; and
- Make additional disclosures.

Advisers relying on the exemption must comply with the Impartial Conduct Standards when making investment recommendations regarding principal transactions and riskless principal transactions.

[14] The amended exemptions, published elsewhere in this **Federal Register**, include Prohibited Transaction Exemption (PTE) 75–1; PTE 77–4; PTE 80–83; PTE 83–1: PTE 84–24; and PTE 86–128.

[15] As used throughout this preamble, the term "comment" refers to information provided through these various sources, including written comments, petitions and witnesses at the public hearing.

The exemption takes a principles-based approach that permits Financial Institutions and Advisers to enter into transactions that would otherwise be prohibited. The exemption holds Financial Institutions and their Advisers responsible for adhering to fundamental standards of fiduciary conduct and fair dealing, while leaving them the flexibility and discretion necessary to determine how best to satisfy these basic standards in light of the unique attributes of their particular businesses. The exemption's principles-based conditions, which are rooted in the law of trust and agency, have the breadth and flexibility necessary to apply to a large range of investment and compensation practices, while ensuring that Advisers put the interests of Retirement Investors first. When Advisers choose to give advice regarding principal transactions and riskless principal transactions to Retirement Investors, they must protect their customers from the dangers posed by conflicts of interest.

In order to ensure compliance with the exemption's broad protective standards and purposes, the exemption gives special attention to the enforceability of the exemption's terms by Retirement Investors. When Financial Institutions and Advisers breach their obligations under the exemption and cause losses to Retirement Investors, it is generally critical that the investors have a remedy to redress the injury. The existence of enforceable rights and remedies gives Financial Institutions and Advisers a powerful incentive to comply with the exemption's standards, implement policies and procedures that are more than window-dressing, and carefully police conflicts of interest to ensure that the conflicts of interest do not taint the advice.

Thus, in the case of IRAs and non-ERISA plans, the exemption requires the Financial Institution to commit to the Impartial Conduct Standards in an enforceable contract with Retirement Investor customers. The exemption does not similarly require the Financial Institution to execute a separate contract with ERISA investors (plan participants, beneficiaries, and fiduciaries), but the Financial Institution must acknowledge its fiduciary status and that of its Advisers, and ERISA investors can directly enforce their rights to proper fiduciary conduct under ERISA section 502(a)(2) and (3). In addition, the exemption safeguards Retirement Investors' enforcement rights by providing that Financial Institutions and Advisers may not rely on the exemption if they include contractual provisions disclaiming liability for compensatory remedies or waiving or qualifying Retirement Investors' right to pursue a class action or other representative action in court. However, the exemption does permit Financial Institutions to include provisions waiving the right to punitive damages or rescission as contract remedies to the extent permitted by other applicable laws. In the Department's view, the availability of make-whole relief for such claims is sufficient to protect Retirement Investors and incentivize compliance with the exemption's conditions.

While the final exemption retains the proposed exemption's core protections, the Department has revised the exemption to ease implementation in response to commenters' concerns about the exemption's workability. Thus, for example, the final exemption eliminates the contract requirement altogether in the ERISA context and simplifies the mechanics of contract-formation for IRAs and plans not covered by Title I of ERISA. For new customers, the final exemption provides that the required contract terms may simply be incorporated in the Financial Institution's account opening documents and similar commonly-used agreements. The exemption additionally permits reliance on a negative consent process for existing contract holders. The Department recognizes that Retirement Investors may talk to numerous Advisors in numerous settings over the course of their relationship with a Financial Institution. Accordingly, the exemption also simplifies execution of the contract by simply requiring the Financial Institution to execute the contract, rather than each of the individual Advisers from whom the Retirement Investor receives advice. For similar reasons, the exemption does not require execution of the contract at the start of Retirement Investors' conversations with Advisers, as long as it is entered into prior to or at the same time as the recommended transaction.

As a means of facilitating use of the exemption, the Department also reduced compliance burdens by eliminating some of the conditions that were not critical to the exemption's protective purposes, and expanding the scope of the exemption's coverage (*e.g.,* by covering interests in unit investment trusts (UITs) and certificates of deposit (CDs)). The Department eliminated the requirement of adherence to other state and federal laws relating to advice as unduly expansive and duplicative of other laws; dropped a two-quote requirement; and eliminated a mark-up and mark-down disclosure requirement. In addition, the Department streamlined the disclosure conditions by simplifying the obligations. The Department also provided a mechanism for correcting good faith violations of the disclosure conditions, so that Financial Institutions would not lose the benefit of the exemption as a result of such good faith errors and would have an incentive to promptly correct them.

While making these changes to facilitate the implementation of the exemption, the Department emphasizes that the exemption is limited because of the severity of the conflicts of interest associated with principal transactions. When acting as a principal in a transaction involving a plan, participant or beneficiary account, or IRA, a fiduciary can have difficulty reconciling its duty to avoid conflicts of interest with its concern for its own financial interests as the Retirement Investor's counterparty. Of primary concern are issues involving liquidity, pricing, transparency, and the fiduciary's possible incentive to "dump" unwanted assets. The scope of this exemption balances the Department's significant concerns regarding principal transactions with the need to preserve market choice for plans, participants and beneficiary accounts, and IRAs.

The comments on this exemption, the Best Interest Contract Exemption, the Regulation, and related exemptions have helped the Department improve this exemption, while preserving and enhancing its protections. As described above, the Department has revised the exemption to facilitate implementation and compliance with the exemption, without diluting its core protections, which are critical to reducing the harm caused by conflicts of interest in the marketplace for advice. The tax-preferred investments covered by the exemption are critical to the financial security and physical health of investors. After consideration of the comments, the Department remains convinced of the importance of the exemption's core protections.

ERISA and the Code are rightly skeptical of the dangers posed by conflicts of interest, and generally prohibit conflicted advice. Before granting exemptive relief, the Department has a statutory obligation to ensure that the exemption is in the interests of plan and IRA investors and protective of their rights. Adherence to the fundamental fiduciary norms and basic protective conditions of this exemption helps ensure that investment recommendations are not driven by Adviser conflicts, but by the Best Interest of the Retirement Investor. The conditions of this exemption are carefully calibrated to permit principal transaction and riskless principal transactions in certain investments, while protecting Retirement Investors' interest in receiving sound advice on vitally important investments. Based upon these protective conditions, the Department finds that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners.

The preamble sections that follow provide a much more detailed discussion of the exemption's terms, comments on the exemption, and the Department's responses to those comments. After a discussion of the exemption's scope and limitations, the preamble discusses the conditions of the exemptions.

A. Scope of Relief in the Exemption

The exemption provides relief for "Advisers" and "Financial Institutions" to enter into "principal transactions" and "riskless principal transactions" in "principal traded assets" with plans and IRAs. For purposes of the exemption, a principal transaction is a transaction in which an Adviser or Financial Institution is purchasing from or selling to the plan, participant or beneficiary account, or IRA on behalf of the account of the Financial Institution or the account of any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Financial Institution. The term principal transaction does not include a riskless principal transaction as defined in the exemption. A riskless principal transaction is defined as a transaction in which a Financial Institution, after having received an order from a Retirement Investor to buy or sell a principal traded asset, purchases or sells the asset for the Financial Institution's own account to offset the contemporaneous transaction with the Retirement Investor.

The exemption uses the term "Retirement Investor" to describe the types of persons who can be investment advice recipients under the exemption, and the term "Affiliate" to describe people and entities with a connection to the Adviser or Financial Institution. These terms are defined in Section VI of this exemption. The following sections discuss the scope and conditions of the exemption as well as key definitional terms.

1. Principal Traded Assets

The exemption provides relief for principal transactions and riskless principal transactions involving certain investments, referred to as "principal traded assets," between a plan, participant or beneficiary account, or IRA, and an Adviser, Financial Institution or an entity in a control relationship with the Financial Institution, when the transaction is a result of an Adviser's or Financial Institution's provision of investment advice. Relief is provided from ERISA sections 406(a)(1)(A) and (D), and 406(b)(1) and (2), and the taxes imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A), (D) and (E). Relief has not been provided in this exemption from ERISA section 406(b)(3) and Code section 4975(c)(1)(F), which prohibit a fiduciary from receiving any consideration for its own personal account from any party dealing with the plan or IRA in connection with a transaction involving the assets of the plan or IRA.

The principal traded assets that are permitted to be *purchased* by plans, participant and beneficiary accounts, and IRAs, under the exemption include CDs, interests in UITs, and securities within the exemption's definition of "debt security." Debt securities are generally defined as corporate debt securities offered pursuant to a registration statement under the Securities Act of 1933; treasury securities; agency securities; and asset-backed securities that are guaranteed by an agency or government sponsored enterprise (GSE).

In addition, the final exemption includes a feature under which the definition of principal traded asset can be expanded without amending the class exemption. Under the definition of principal traded asset, investments can be added to the class exemption in the future based on an individual exemption granted by the Department. Accordingly, a principal traded asset for purposes of the class exemption also includes an investment that is permitted to be purchased under an individual exemption granted by the Department after the issuance date of this exemption, that provides relief for investment advice fiduciaries to engage in the purchase of the investment in a principal transaction or riskless principal transaction with a plan or IRA under the same conditions as this exemption. To the extent parties wish to expand the definition of principal traded asset in the future, they can submit a request for an individual exemption to the Department setting forth the specific attributes of the principal traded asset, the sales and compensation practices, and how conflicts of interest will be mitigated with respect to principal transactions and riskless principal transactions in that principal traded asset. If the exemption is granted, the class exemption will expand to include that investment within the definition of principal traded asset.

The exemption's definition of principal traded assets is more expansive with respect to the *sale* of principal traded assets by plans and IRAs. The definition extends to "securities or other investment property," which corresponds to the broad range of assets that can be recommended by fiduciary advisers under the Regulation. This permits trades that may be necessary, according to commenters, when a Retirement Investor seeks to sell an investment and cannot obtain a reasonable price from a third party. In addition, in response to commenters, the Department expanded the scope of the Best Interest Contract Exemption to cover riskless principal transactions involving all investment products.

As proposed, the exemption limited the types of assets that could be traded (both bought and sold) on a principal basis to corporate debt securities offered pursuant to a registration statement under the Securities Act of 1933, treasury securities, and agency securities. The Department received many comments regarding this limitation and the general intent of the exemption. Supporting comments emphasized that the exemption's limited scope and conditions were appropriate for the mitigation of conflicts of interest and the protection of plans and IRAs. One commenter particularly supported the exemption's approach of granting relief only to those securities least likely to be subject to principal trading abuses. The commenter supported, in particular, the exclusion of municipal securities.

Others urged the Department to broaden the scope of the exemption. Many of these commenters argued that principal transactions are necessary for the maintenance of inventory, liquidity, access to investments, and best execution. They contended that the failure to provide broader relief would drive up the cost to investors, and hinder normal transactions that are generally classified as facilitation trades or riskless principal transactions. Commenters took the position that the Department should not substitute its judgment for the judgment of investors and advisers. In particular, commenters urged the Department to: (a) Provide relief for riskless principal transactions, (b) add specific additional securities to the scope of the exemption, and (c) provide broad principal transaction relief for all securities and other property.

a. Riskless Principal Transactions

A number of comments noted that the proposal did not specifically address riskless principal transactions. In a riskless principal transaction, according to a commenter, a Financial Institution, after receiving an order to purchase or sell a security from a customer, purchases or sells the investment for its own account to offset the contemporaneous transaction with the customer. Commenters argued that riskless principal transactions are the functional equivalent of agency transactions. A commenter asserted that for this reason, riskless principal transactions would not involve the incentive to dump unwanted investments on Retirement Investors, which was one of the Department's concerns. Another commenter indicated that without wider availability of riskless principal transactions, many investments would not be available at all to plans and IRAs because it is typical for broker-dealers to engage in transactions with third parties on a riskless principal basis rather than a pure agency basis. One commenter stated that this is because counterparties may not want to assume settlement risk with an investor.

After consideration of these comments, the Department concurs with commenters that broader relief in this area is appropriate. The Department intended that the proposal cover riskless principal transactions within the general meaning of principal transactions, but the transactions would have been limited to the debt securities covered under the proposed exemption. The Department agrees with commenters that, to the extent a Financial Institution engages in a transaction based on an existing customer order, the riskless principal transaction can be viewed as functionally similar to an agency transaction, and the Department accepts the position of commenters that some investments may not be functionally available without this relief. For this reason, the Department expanded the scope of the companion Best Interest Contract Exemption to permit riskless principal transactions in all investments, and provide relief for compensation received in connection with such transactions, subject to the conditions of that exemption.

The Department also clarified that this exemption is available for riskless principal transactions involving principal traded assets. The definition of a principal transaction now explicitly excludes riskless principal transactions, and the exemption's scope specifically encompasses both principal transactions and separately-defined riskless principal transactions. In this manner, the exemption now clearly draws a distinction between principal transactions and riskless principal transactions and provides relief for both with respect to principal traded assets.

This approach results in some overlap between coverage of riskless principal transactions in the Best Interest Contract Exemption and this exemption. With respect to a recommended purchase of an investment that occurs in a riskless principal transaction, this exemption is available for principal traded assets. The Best Interest Contract Exemption, however, provides broader relief for all recommended purchases. In addition, *sales* from a plan or IRA in riskless principal transactions can occur under either exemption.

This approach is intended to provide flexibility to Financial Institutions relying on the exemptions. The Department believes that some Financial Institutions have business models that involve only riskless principal transactions. These Financial Institutions may not, as a general matter, hold investments in inventory to sell in principal transactions, but they may execute certain transactions as riskless principal transactions. Financial Institutions that do not engage in principal transactions, as defined in the exemptions, do not have to rely on this exemption at all, and can organize their practices to comply with the Best Interest Contract Exemption alone.

On the other hand, Financial Institutions that engage in both principal transactions and riskless principal transactions may want to organize their practices to comply with this exemption. They may not be certain at the outset whether a particular purchase by a plan or IRA will be executed as a principal transaction or a riskless principal transaction. Those Financial Institutions can rely on this exemption for principal traded assets that may be sold to plans and IRAs without concern for whether the transaction is, in fact a riskless principal transaction or principal transaction.

b. Adding to the Definition of Principal Traded Assets

Some commenters requested that this exemption extend to principal transactions in specific additional types of securities or investments, including municipal securities, currency, agency debt securities, CDs (including brokered CDs), asset backed securities, unit investment trusts (UITs), equities (including new issue and initial public offerings), new issue of debt securities, preferred securities, foreign corporate securities, foreign sovereign debt, debt of a charitable organization, derivatives, bank note offerings and wrap or other contracts that are not insurance products.

In response, the Department added to this final exemption CDs, UITs, and asset backed securities guaranteed by an agency or GSE. Both CDs and UITs were included as investments permitted to be sold under the proposed Best Interest Contract Exemption, and commenters informed us that these investments are typically sold in principal transactions. Without relief for CDs and UITs in this exemption, commenters asserted that Retirement Investors might lose access to such investments. Commenters indicated that these investments were common investments in ERISA plans, IRAs and non-ERISA plans. The Department therefore included them in this final exemption. As with the exemptive relief originally proposed regarding principal transactions in debt securities, the Department believes that the conflicts of interest created by principal transactions in CDs and UITs are effectively addressed by the conditions of this exemption so as to protect the interests of Retirement Investors while maintaining Retirement Investors' access to these investments.

Agency and GSE guaranteed asset backed securities were always intended to be included in the definition of debt security. The proposal provided that agency debt securities were defined by reference to the Financial Industry Regulatory Authority (FINRA) rule 6710(l).[16] Commenters informed us that the Department's definition omitted agency and GSE mortgage backed securities. Based on the Department's original intent to provide relief for these investments, and the view that the conditions are protective in these contexts, the Department included them in the final exemption.

Reflecting this expansion of relief to CDs, UITs and agency and GSE guaranteed asset backed securities, the final exemption uses the term "principal traded asset," rather than "debt security" to describe the

[16] FINRA is registered with the Securities and Exchange Commission (SEC) as a national securities association and is a self-regulatory organization, as those terms are defined in the Exchange Act, which operates under SEC oversight.

investments that can be purchased or sold.

As explained in greater detail below, the Department did not expand the purchase provisions of the exemption, as some commenters suggested, to include other investments such as municipal securities, currency, asset backed securities, equities (including new issue and initial public offerings), new issue of debt securities, preferred securities, foreign corporate securities, foreign sovereign debt, debt of a charitable organization, derivatives, bank note offerings and wrap or other contracts that are not insurance products. The Department determined that the conditions of this exemption may not be appropriately tailored to these types of investments. The Department invites interested parties to request an individual exemption for other investments that they would like to see included in this class exemption. This will provide the Department with the opportunity to gain additional information about those investments, their sales practices and associated conflicts of interest.

c. Principal Transaction Relief for All Securities and Other Property

Other commenters sought to more generally expand the scope of the exemption. Some commenters felt that unrestricted relief should be provided with respect to all principal transactions with few, if any, conditions. Some of these commenters took issue with the Department's decision to place any limitations at all on investments that can be purchased or sold in a principal transaction. The commenters expressed the view that the Department was substituting its judgment for those of individual investors and their advisers.

In support of their approach, a few commenters urged the Department to more closely hew to the approach taken under the securities laws, citing Temporary Rule 206(3)–3T issued by the Securities and Exchange Commission (SEC) under the Investment Advisers Act of 1940.[17] According to the commenters, Temporary Rule 206(3)–3T applies to institutions that are dually registered as investment advisers and broker-dealers and to transactions in non-discretionary accounts at such institutions, and it permits principal transactions involving all securities unless the investment adviser or Affiliate is the issuer of, or, at the time of the sale, an underwriter of, a security that is not an investment grade debt security. The rule generally requires written prospective consent by the customer to principal transactions; oral or written pre-transaction disclosure and customer consent; written confirmation to the customer; and written annual disclosure to the customer of transactions entered into in reliance on the rule.

Commenters also focused on principal transactions involving sales by plans and IRAs. Commenters indicated that broader relief was necessary to provide liquidity for Retirement Investors. They said that Financial Institutions serve an essential function in purchasing securities from their clients who need such liquidity.

The Department did not accept the commenters' call for relief for all principal transactions. The Department's approach in the proposal of this exemption was intentionally narrow, based on the potentially acute conflicts of interest associated with principal transactions that are recommended by fiduciaries. The Department believes that broad relief for all principal transactions, without tailored conditions, is inconsistent with longstanding principles that fiduciaries must act with loyalty to Retirement Investors. Because the fiduciary is on both sides of a principal transaction, the fiduciary duty of loyalty is sorely tested. In addition, the securities typically traded in principal transactions often lack objective market prices and Retirement Investors may have difficulty evaluating the fairness of a particular transaction. Principal traded investments also can be associated with low liquidity, low transparency and the possible incentive to dump unwanted investments.

Therefore, although the Department's approach harmonizes in many ways, as discussed below, with the disclosures required by the SEC's Temporary Rule 206(3)–3T, the Department did not adopt an exemption that is as broad in scope. The Department also notes in this respect that the SEC has not yet finalized its approach to rule 206(3)–3T, and the SEC has indicated the delay is related to the SEC's consideration of regulatory standards of care for broker-dealers and investment advisers under section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). In the most recent release proposing to extend the Temporary Rule, the SEC stated:

> As part of our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers, we intend to carefully consider principal trading by advisers, including whether rule 206(3)–3T should be substantively modified, supplanted, or permitted to sunset.[18]

Given the SEC's ongoing consideration of these issues, the Department does not believe there is a significant advantage to mirroring the scope of the Temporary Rule.

Although the Department retained the limited definition of principal traded asset, as discussed above, for recommendations that a plan or IRA *purchase* an investment, the Department did provide broader relief for recommended *sales* from a plan or IRA to a Financial Institution. The Department is persuaded by commenters that a broader exemption is necessary to provide liquidity to plans and IRAs.

The Department also notes that the final Regulation provides additional ways in which parties can engage in principal transactions and riskless principal transactions and avoid prohibited transactions. The Regulation provides that a person is not a fiduciary when the person engages in an arm's length transaction with an independent plan fiduciary with financial expertise, as defined in the Regulation. Financial professionals that engage in such transactions are not considered fiduciaries, and may rely on other exemptions such as PTE 75–1, Part II, or ERISA section 408(b)(17) and Code section 4975(d)(20), for a broader range of principal transactions and riskless principal transactions. Therefore, the concerns of commenters such as the Stable Value Investment Association, about principal transactions involving a stable value fund managed by a professional investment manager, should be addressed in that fashion.

Finally, this exemption does not affect the ability of a self-directed investor to obtain the services of a financial professional to effect or execute a transaction involving any type of investment, in the absence of investment advice. In that sense, the Department is not limiting investment opportunities for individual investors or substituting the Department's judgment for theirs. Instead, the exemption is aimed squarely at conflicted investment advice by fiduciaries and is intended to minimize the harms of such conflicts of interest.

In this regard, one commenter requested a clarification as to whether an exemption is necessary for the provision of principal transaction services where the services do not involve the provision of individual recommendations to a plan or IRA. In

[17] 17 CFR 275.206(3)–3T.

[18] See SEC's Release No. IA–3893, August 12, 2014.

response, the Department notes that relief from ERISA section 406(b) would only be necessary to the extent the service provider was acting as a fiduciary. To the extent the service provider does not make recommendations, it does not act as a fiduciary investment adviser. If the service provider is not a fiduciary, ERISA section 406(b) relief is not necessary, and the other exemptions referenced above, apply.

2. Exclusions

The exclusions set forth in Section I(c) of the proposal remain a part of the final exemption. First, under Section I(c)(1), Advisers who have or exercise discretionary authority or discretionary control with respect to management of the assets of a plan, participant or beneficiary account, or IRA or who exercise any discretionary authority or control respecting management or the disposition of the assets, or have any discretionary authority or discretionary responsibility in the administration of the plan, participant or beneficiary account, or IRA, may not take advantage of relief under the exemption to engage in principal transactions and riskless principal transactions with such investors.

A comment related to this provision asked that the limitation on investment managers be modified so that Financial Institutions that sponsor separately managed accounts that use independent, individual investment managers should be permitted to engage in principal transactions on behalf of their managed plans and IRAs with the sponsor. The Department did not adopt this suggestion. Instead, the Department notes that the Regulation was revised to provide that a person does not act as a fiduciary when engaged in an arm's length transaction with a plan fiduciary with financial expertise under the circumstances set forth in the Regulation. In such circumstances, the financial professionals may, therefore, rely on existing exemptions for non-fiduciary principal transactions and riskless principal transactions.

Second, under Section I(c)(2), the exemption is not available for a principal transaction involving a plan covered by Title I of ERISA if the Adviser or Financial Institution, or any Affiliate is the employer of employees covered by the plan. In accordance with this condition, the exemption is not available for a principal transaction entered into as part of a rollover from such a plan to an IRA, where the principal transaction is being executed by the plan, not the IRA. This restriction on employers does not apply in the case of an IRA or other similar plan that is not covered by Title I of ERISA. Accordingly, an Adviser or Financial Institution may provide advice to the beneficial owner of an IRA who is employed by the Adviser, its Financial Institution or an Affiliate, and receive compensation as a result, provided the IRA is not covered by Title I of ERISA.

No comments were received specific to the principal transactions exemption on proposed Section I(c)(2). Comments were received, however, on the same language, proposed in Section I(c)(1), of the Best Interest Contract Exemption. Specifically, industry commenters requested elimination of this exclusion in the Best Interest Contract Exemption. In particular, they said that Financial Institutions in the business of providing investment advice should not be compelled to hire a competitor to provide services to the Financial Institution's own plan. They warned that the exclusion could effectively prevent these Financial Institutions from providing any investment advice to their employees. Some commenters additionally stated that for compliance reasons, employees of a Financial Institution are often required to maintain their financial assets with that Financial Institution. As a result, they argued employees of Financial Institutions could be denied access to investment advice on their retirement savings.

As with the Best Interest Contract Exemption, the Department has not scaled back the exclusion. As noted above, the Department did not receive comments requesting that Financial Institutions be able to engage in principal transactions with their in-house plans. More generally, however, the Department continues to be concerned that the danger of abuse is compounded when the advice recipient receives recommendations from the employer, upon whom he or she depends for a job, to make investments in which the employer has a financial interest. To protect employees from abuse, employers generally should not be in a position to use their employees' retirement benefits as potential revenue or profit sources, without stringent safeguards. See, *e.g.,* ERISA section 403(c)(1) (generally providing that ''the assets of a plan shall never inure to the benefit of any employer''). Additionally, the exclusion of employers in Section I(c) does not apply in the case of an IRA or other similar plan that is not covered by Title I of ERISA. The decision to open an IRA account or obtain IRA services from the employer is much more likely to be entirely voluntary on the employees' part than would be true of their interactions with the retirement plan sponsored and designed by their employer for its employee benefit program. Accordingly, an Adviser or Financial Institution may provide advice to the beneficial owner of an IRA who is employed by the Adviser, its Financial Institution or an Affiliate regarding a principal transaction or riskless principal transaction, and engage in a principal transaction or riskless principal transaction as a result, provided the IRA is not covered by Title I of ERISA, and the conditions of this exemption are satisfied.

Section I(c)(2) further provides that the exemption is unavailable if the Adviser or Financial Institution is a named fiduciary or plan administrator, as defined in ERISA section 3(16)(A) with respect to an ERISA plan, or an Affiliate thereof, that was selected to provide advice to the plan by a fiduciary who is not independent of them. This provision is intended to disallow the selection of Advisers and Financial Institutions by named fiduciaries or plan administrators that have a significant financial stake in the selection and was adopted in the final exemption unchanged from the proposal.[19]

B. Conditions of the Exemption

Section I, discussed above, establishes the scope of relief provided by this Principal Transactions Exemption. Sections II–V set forth the conditions of the exemption. All applicable conditions must be satisfied in order to avoid application of the specified prohibited transaction provisions of ERISA and the Code. The Department finds that, subject to these conditions, the exemption is administratively feasible, in the interests of plans and of their participants and beneficiaries, and IRA owners and protective of the rights of the participants and beneficiaries of such plans and IRA owners. Under ERISA section 408(a), and Code section 4975(c)(2), the Secretary may not grant an exemption without making such findings. The conditions of the exemption, comments on those conditions, and the Department's responses, are described below.

1. Enforceable Right to Best Interest Advice (Section II)

Section II of the exemption sets forth the requirements that establish the Retirement Investor's enforceable right

[19] The definition of ''independent'' was adjusted in response to comments, as discussed below, to permit circumstances in which the person selecting the Adviser and Financial Institution could receive no more than 2% of its compensation from the Financial Institution.

to adherence to the Impartial Conduct Standards and related conditions. For advice to certain Retirement Investors—specifically, advice regarding transactions with IRAs, and plans that are not covered by Title I of ERISA (non-ERISA plans), such as Keogh plans—Section II(a) requires the Financial Institution and Retirement Investor to enter into a written contract that includes the provisions described in Section II(b)–(d) of the exemption and that also does not include any of the ineligible provisions described in Section II(f) of the exemption, and provide the disclosures set forth in Section II(e). As discussed further below, pursuant to Section II(g) of the exemption, advice to Retirement Investors regarding ERISA plans does not have to be subject to a written contract but Advisers and Financial Institutions must comply with the substantive standards established in Section II(b)–(e) to avoid liability for a non-exempt prohibited transaction.

The contract with Retirement Investors regarding IRAs and non-ERISA plans must include the Financial Institution's acknowledgment of its fiduciary status and that of its Advisers, as required by Section II(b); the Financial Institution's agreement that it and its Advisers will adhere to the Impartial Conduct Standards, including a Best Interest standard, as required by Section II(c); the Financial Institution's warranty that it has adopted and will comply with certain policies and procedures, including anti-conflict policies and procedures reasonably and prudently designed to ensure that Advisers adhere to the Impartial Conduct Standards, as required by Section II(d). The Financial Institution's disclosure of information about Material Conflicts of Interest associated with principal transactions and riskless principal transactions, as required by Section II(e), may be provided in the contract or in a separate single written disclosure. Section II(f) generally provides that the exemption is unavailable if the contract includes exculpatory provisions or provisions waiving the rights and remedies of the plan, IRA or Retirement Investor, including their right to participate in a class action in court. The contract may, however, provide for binding arbitration of individual claims, and may waive contractual rights to punitive damages or rescission.

The contract between the IRA or non-ERISA plan, and the Financial Institution, forms the basis of the IRA's or non-ERISA plan's enforcement rights. The Department intends that all the contractual obligations imposed on the Financial Institution (the Impartial Conduct Standards and warranties) will be actionable by the IRAs and non-ERISA plans. Because these standards are contractually imposed, an IRA or non-ERISA plan has a contract claim if, for example, its Adviser recommends an investment product that is not in the Best Interest of the IRA or other non-ERISA plan.

In the Department's view, these contractual rights serve a critical function for IRA owners and participants and beneficiaries of non-ERISA plans. Unlike participants and beneficiaries in plans covered by Title I of ERISA, IRA owners and participants and beneficiaries in non-ERISA plans do not have an independent statutory right to bring suit against fiduciaries for violation of the prohibited transaction rules. Nor can the Secretary of Labor bring suit to enforce the prohibited transactions rules on their behalf.[20] Thus, for investors in IRAs and non-ERISA plans, the contractual requirement creates a mechanism for investors to enforce their rights and ensures that they will have a remedy for misconduct. In this way, the exemption creates a powerful incentive for Financial Institutions and Advisers alike to oversee and adhere to basic fiduciary standards when engaging in principal transactions and riskless principal transactions, without requiring the imposition of unduly rigid and prescriptive rules and conditions.

Under Section II(g), however, the written contract requirement does not apply to advice to Retirement Investors regarding transactions with plans that are covered by Title I of ERISA (ERISA plans) in light of the existing statutory framework which provides a pre-existing enforcement mechanism for these investors and the Department. Instead, Advisers and Financial Institutions must satisfy the provisions in Section II(b)–(e) as conditions of the exemption when transacting with such Retirement Investors. Under the terms of the exemptions, the Financial Institution must provide a written acknowledgment of its and its Advisers' fiduciary status prior to or at the same time as the execution of the transaction, although it does not have to be part of a contract, as required by Section II(b); the Financial Institution and its Advisers must comply with the Impartial Conduct Standards, as required by Section II(c); the Financial Institutions must establish and comply with certain policies and procedures, as required by Section II(d); and they must provide the disclosures required by Section II(e).

If these conditions are not satisfied with respect to an ERISA plan engaging in a principal transaction or a riskless principal transaction, the Adviser and Financial Institution would be unable to rely on the exemption for relief from ERISA's prohibited transactions restrictions. An Adviser's failure to comply with the exemption would result in a non-exempt prohibited transaction under ERISA section 406 and would likely constitute a fiduciary breach under ERISA section 404. As a result, a plan, plan participant or beneficiary would be able to sue under ERISA section 502(a)(2) or (3) to recover any loss in value to the plan (including the loss in value to an individual account), or to obtain disgorgement of any wrongful profits or unjust enrichment. In addition, the Secretary of Labor can enforce ERISA's prohibited transaction and fiduciary duty provisions with respect to these ERISA plans, and an excise tax under the Code, as described above, applies.

In this regard, under Section II(g)(5) of the exemption, the Financial Institution and Adviser may not rely on the exemption if, in any contract, instrument, or communication they disclaim any responsibility or liability for any responsibility, obligation, or duty under Title I of ERISA to the extent the disclaimer would be prohibited by ERISA section 410, waive or qualify the right of the Retirement Investor to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution, or require arbitration or mediation of individual claims in locations that are distant or that otherwise unreasonably limit the ability of the Retirement Investors to assert the claims safeguarded by this exemption. The exemption's enforceability, and the potential for liability, is critical to ensuring adherence to the exemption's stringent standards and protections, notwithstanding the competing pull of the conflicts of interest associated with principal transactions and riskless principal transactions.

The Department expects claims of Retirement Investors regarding investments in ERISA plans to be brought under ERISA's enforcement provisions, discussed above. In general, ERISA section 410 invalidates

[20] An excise tax does apply in the case of a violation of the prohibited transaction provisions of the Code, generally equal to 15% of the amount involved. The excise tax is generally self-enforced; requiring parties not only to realize that they've engaged in a prohibited transaction but also to report it and pay the tax. Parties who have participated in a prohibited transaction for which an exemption is not available must pay the excise tax and file Form 5330 with the Internal Revenue Service.

instruments purporting to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under ERISA. Accordingly, provisions purporting to waive fiduciary obligations under ERISA serve only to mislead Retirement Investors about the scope of their rights. Additionally, the legislative intent of ERISA was, in part, to provide for ''ready access to federal courts.'' Accordingly, any recommended transaction covered by a contract or other instrument that waives or qualifies the right of the Retirement Investor to bring or participate in a class action or other representative action in court, will not be eligible for relief under this exemption.

A number of comments were received on the contract requirement as it was proposed. The comments, and the Department's responses, are discussed below. The Department notes that some of the commenters simply cross-referenced their comments, in the entirety, with respect to the same provisions in the proposed Best Interest Contract Exemption. Additionally, some commenters focused their comments solely on the Best Interest Contract Exemption. The Department determined it was important that the contract provisions in the Best Interest Contract Exemption be compatible with the contract provisions in this exemption, so that the two exemptions can easily be used together. For this reason, the Department considered all comments made on either exemption on a consolidated basis, and made corresponding changes in the two exemptions. For ease of use, the Department has included in this preamble the same general discussion of comments as in the Best Interest Contract Exemption, despite the fact that some comments discussed below were not made directly with respect to this exemption.

In this regard, one commenter inquired as to whether the contract required in this exemption could be combined with the contract required by the Best Interest Contract Exemption, or whether two contracts would be needed. It was the Department's intent in crafting this exemption that it could be used in connection with the Best Interest Contract Exemption, and it is the Department's view that there need only be one contract. If parties wish to give themselves flexibility to engage in principal transactions and riskless principal transactions with Retirement Investors, they can include the contract provisions that are specific to principal transactions and riskless principal transactions and obtain the Retirement Investor's consent to participate in such transactions.

a. Contract Requirement Applicable to IRAs and Non-ERISA Plans

A number of commenters took the position that the consumer protections afforded by the contract requirement are an essential feature of the exemption, particularly in the IRA market. Commenters indicated that enforceability is critical in the IRA market because of IRA owners' lack of a statutory right to enforce prohibited transactions provisions. Commenters said that, in order to achieve the goal of providing meaningful new protections to Retirement Investors, the exemption must provide a mechanism by which Advisers and Financial Institutions can be held legally accountable for the retirement recommendations they make.

Many other commenters, however, raised significant objections to the contract requirement. Commenters pointed to certain conditions of the exemption that they found ambiguous or subjective and indicated that these conditions could form the basis of class action lawsuits by disappointed investors. Some commenters said the contract requirement and associated litigation exposure will cause investment advice providers to cease serving Retirement Investors or provide only fee-based accounts that do not vary on the basis of the advice provided, resulting in the loss of services to retirement investors with smaller account balances. These commenters stated that investment advice fiduciaries would not risk the anticipated legal liability for Retirement Investors, or at least with respect to small accounts. Commenters also indicated that the SEC's Temporary Rule 206(3)–3T already addresses the issues regarding principal transactions that the Department is attempting to address.

In the final exemption, the Department retained the contract requirement with respect to IRAs and non-ERISA plans. The contractual commitment provides an administrable means of ensuring fiduciary conduct, eliminating ambiguity about the fiduciary nature of the relationship, and enforcing the exemption's conditions, thereby assuring compliance. The existence of enforceable rights and remedies gives Financial Institutions and Advisers a powerful incentive to comply with the exemption's standards, implement effective anti-conflict policies and procedures, and carefully police conflicts of interest. The enforceable contract gives clarity to the fiduciary nature of the undertaking, and ensures that Advisers and Financial Institutions do not subordinate the interests of the Retirement Investor to their own competing financial interests. The contract effectively aligns the interests of Retirement Investor, Advisers, and the Financial Institution, and gives the Retirement Investor the means to redress injury when violations occur.

Without a contract, the possible imposition of an excise tax provides an additional, but inadequate incentive to ensure compliance with the exemption's standards-based approach. This is particularly true because imposition of the excise tax critically depends on fiduciaries' self-reporting of violations, rather than independent investigations and litigation by the IRS. In contrast, contract enforcement does not rely on conflicted fiduciaries' assessment of their own adherence to fiduciary norms or require the creation and expansion of a government enforcement apparatus. The contract provides an administrable way of ensuring adherence to fiduciary standards, broadly applicable to an enormous range of investments and advice relationships.

The enforceability of the exemption's provisions enables the Department to grant exemptive relief based upon broad protective standards rather than rely exclusively upon highly proscriptive conditions. In the context of this exemption, the risk of litigation and enforcement serves many of the same functions that it has for hundreds of years under the law of trust and agency. It gives fiduciaries a powerful incentive to adhere to broad, flexible, and protective standards applicable to principal transactions and riskless principal transactions by imposing liability and providing a remedy when fiduciaries fail to comply with those standards.

In addition, a number of features of this final exemption, discussed more fully below, should temper commenters' concerns about the risk of excessive litigation. In particular, the exemption permits Advisers and Financial Institutions to require mandatory arbitration of individual claims, so that claims that do not involve systemic abuse or entire classes of participants can be resolved outside of court. Similarly, the exemption permits waivers of the right to obtain punitive damages or rescission based on violation of the contract. In the Department's view, make-whole compensatory relief is sufficient to incentivize compliance and redress injury caused by fiduciary misconduct. The Department has also clarified a number of the exemption's conditions and simplified the disclosure and compliance obligations to facilitate adherence to the exemption's terms.

The core principles of the exemption are well-established under trust law, ERISA and the Code, and have a long history of interpretations in court. Moreover, the Impartial Conduct Standards are measured based on the circumstances existing at the time of the recommendation, not based on the ultimate performance of the investment with the benefit of hindsight. It is well settled as a legal matter that fiduciary advisers are not guarantors of the success of investments under ERISA or the Code, and this exemption does nothing to change that fact. Finally, the Department added provisions enabling Advisers and Financial Institutions to correct good faith errors in disclosure, without facing loss of the exemption.

The Department did not rely solely on the approach in the SEC's Temporary Rule 206(3)–3T, or another primarily disclosure-based approach, as suggested by some commenters. In the Department's view, disclosure of conflicts is a necessary, but not sufficient, basis for relief in the context of fiduciary self-dealing involving tax-favored accounts.

One commenter asked the Department to address the interaction of the contract cause of action and state securities laws. In this connection, the Department confirms that it is not the Department's intent to preempt or supersede state securities law and enforcement, and the state securities laws remain subject to the ERISA section 514(b)(2)(A) savings clause.

b. No Contract Requirement Applicable to ERISA Plans

Under Section II(g) of the exemption, there is no contract requirement for transactions involving ERISA plans, but Financial Institutions and their Advisers must satisfy the conditions of Section II(b)–(e), including the conditions requiring written fiduciary acknowledgment, adherence to Impartial Conduct Standards, policies and procedures, and disclosures.

The Department eliminated the proposed contract requirement with respect to ERISA plans in this final exemption in response to public comment on this issue. A number of commenters indicated that the contract requirement was unnecessary for ERISA plans due to the statutory framework that already provides enforcement rights to such plans, their participants and beneficiaries, and the Secretary of Labor. Some commenters additionally questioned the extent to which the contract provided additional rights or remedies, and whether state-law contract claims would be pre-empted under ERISA's pre-emption provisions.

In the Department's view, the requirement that a Financial Institution provide written acknowledgement of fiduciary status for itself and its Advisers provides protections in the ERISA plan context that are comparable to the contract requirement for IRAs and non-ERISA plans. As a result of the written acknowledgment of fiduciary status, the fiduciary nature of the relationship will be clear to the parties both at the time of the investment transaction, and in the event of subsequent disputes over the conduct of the Advisers or Financial Institutions. There will be far less cause for the parties to litigate disputes over fiduciary status, as opposed to the substance of the fiduciaries' recommendations and conduct.

2. Contract Operational Issues—Section II(a)

Section II(a) specifies the mechanics of entering into the contract and provides that the contract must be enforceable against the Financial Institution. In addition, the section indicates that the contract may be a master contract covering multiple recommendations, and that it may cover advice that was rendered prior to the execution of the contract as long as the contract is entered into prior to or at the same time as the execution of the recommended transaction.

Section II(a)(1) further describes the methods for obtaining customer assent to the contract. For "new contracts," the Retirement Investor's assent must be demonstrated through a written or electronic signature. The exemption provides flexibility by permitting the contract terms to be set forth in a standalone document or in an investment advisory agreement, investment program agreement, account opening agreement, insurance or annuity contract or application, or similar document, or amendment thereto.

For Retirement Investors with "existing contracts," the exemption permits assent to be evidenced either by affirmative consent, as described above, or by a negative consent procedure. Under the negative consent procedure, the Financial Institution delivers a proposed contract amendment along with the disclosure required in Section II(e) to the Retirement Investor prior to January 1, 2018, and if the Retirement Investor does not terminate the amended contract within 30 days, the amended contract is effective. If the Retirement Investor does terminate the contract within that 30-day period, this exemption will provide relief for 14 days after the date on which the termination is received by the Financial Institution.[21] An existing contract is defined in the exemption as "an investment advisory agreement, investment program agreement, account opening agreement, insurance contract, annuity contract, or similar agreement or contract that was executed before January 1, 2018 and remains in effect." If the Financial Institution elects to use the negative consent procedure, it may deliver the proposed amendment by mail or electronically, but it may not impose any new contractual obligations, restrictions, or liabilities on the Retirement Investor by negative consent.

Finally, Section II(a)(2) of the exemption requires the Financial Institution to maintain an electronic copy of the Retirement Investor's contract on its Web site that is accessible by the Retirement Investor. This condition ensures that the Retirement Investor has ready access to the terms of the contract, and reinforces the exemption's goals of clearly establishing the fiduciary status of the Adviser and Financial Institution and ensuring their adherence to the exemption's conditions.

Comments on specific contract operational issues are discussed below.

a. Contract Timing

As proposed, Section II(a) required that, "[p]rior to recommending that the plan, participant or beneficiary account, or IRA purchase, sell or hold the Asset, the Adviser and Financial Institution enter into a written contract with the Retirement Investor that incorporates the terms required by Section II(b)–(e)." A large number of commenters responded to various aspects of this proposed requirement.

Many commenters objected to the timing of the contract requirement. They said that requiring execution of a contract "prior to" any recommendations would be contrary to existing industry practices. The commenters indicated that preliminary discussions may evolve into recommendations before a Retirement Investor has decided to work with a particular Adviser and Financial Institution. Requiring a contract upfront

[21] Alternatively, for purposes of this exemption, Advisers and Financial Institutions can provide the contractual terms required by the exemption and permit the Retirement Investor to specifically decline to authorize principal transactions and riskless principal transactions within 30 days but continue the existing contract. Of course, to the extent prohibited transaction relief is needed for transactions under the existing contract, the Adviser and Financial Institution would need to comply with another exemption.

could chill such preliminary discussions, unduly complicate the relationship between the Adviser and the Retirement Investor, and interfere with an investor's ability to shop around. Many commenters suggested that it would be better to time the requirement so that the contract would have to be entered into prior to the execution of the actual principal transaction, or even later, rather than before any advice was rendered. While some other commenters supported the proposed timing, noting the benefit of allowing Retirement Investors the chance to carefully review the contract prior to engaging in transactions, several commenters that strongly supported the contract requirement agreed that the timing could be adjusted without loss of protection to the Retirement Investor.

In the Department's view, the precise timing of the contract is not critical to the exemption, provided that the parties enter into a contract covering the advice. The Department did not intend to chill developing advice relationships or limit investors' ability to shop around. Therefore, the Department adjusted the exemption on this point by deleting the proposed requirement that the contract be entered into prior to the advice recommendation. Instead, the exemption generally provides that the advice must be subject to an enforceable written contract entered into prior to or at the same time as the execution of the recommended transaction. However, in order for the exemption to be available to recommendations made prior to the contract's formation, the contract's terms must cover the prior recommendations.

A few commenters suggested that the Department require the contract to be a separate document, not combined with any other document. However, other commenters requested that the Department allow Financial Institutions to incorporate the contract terms into other account documents. While the Department believes the contract is critical to IRA and non-ERISA plan investors, the Department recognizes the need for flexibility in its implementation. Therefore, the exemption contemplates that the contract may be incorporated into other documents to the extent desired by the Financial Institution. Additionally, as requested by commenters, the Department confirms that the contract requirement may be satisfied through a master contract covering multiple recommendations and does not require execution prior to each additional recommendation.

b. Contract Parties

A number of commenters questioned the necessity of the proposed requirement that Advisers be parties to the contract. These commenters indicated that the proposed requirement posed significant logistical challenges. For example, commenters stated that Advisers often work in teams and it would be difficult to obtain signatures from all such Advisers. Similarly, if call center representatives made recommendations that include principal transactions and riskless principal transactions, it could be hard to cover them under a contract. Over the course of a Retirement Investor's relationship with a Financial Institution, he or she could receive advice from a number of persons. Requiring that each such person execute a contract could prove difficult and unwieldy.

Based upon these objections, the Department deleted the requirement that individual Advisers be parties to the contract. The Financial Institution must be a party to the contract and take responsibility for satisfying the exemption's conditions, including the obligation to have policies and procedures reasonably and prudently designed to ensure that individual Advisers adhere to the Impartial Conduct Standards, and the obligation to insulate the Adviser from incentives to violate the Best Interest standard. Such Advisers include call center representatives who provide investment advice within the meaning of the Regulation.

Some commenters suggested that the Department provide additional flexibility and allow the individual Adviser to be obligated under the contract instead of the Financial Institution. The Department has not adopted that suggestion. To ensure operation of the exemption as intended, the Financial Institution should be a party to the contract. The supervisory responsibility and liability of the Financial Institution is important to the exemption's protections. In particular, the exemption contemplates that the Financial Institution will adopt and monitor stringent anti-conflict policies and procedures; avoid financial incentives that undermine the Impartial Conduct standards; and take appropriate measures to ensure that it and its representatives adhere to the exemption's conditions. The contract provides both a mechanism for imposing these obligations on the Financial Institution and creates a powerful incentive for the Financial Institution to take the obligations seriously in the management and supervision of investment recommendations.

c. Contract Signatures

Section II(a) of the exemption provides that the contract must be enforceable against the Financial Institution. As long as that is the case, the Financial Institution is not required to sign the contract. Section II(a) of the exemption further describes the methods through which customer assent may be achieved, and reflects commenters' requests for greater specificity on this point.

With respect to new contracts, a few commenters asked the Department to confirm that electronic execution by the Retirement Investor is sufficient. Another commenter asked about telephone assent. In the final exemption, the Department specifically permits electronic execution as a form of customer assent. The Department has not permitted telephone assent, however, because of the potential issues of proof regarding the existence and terms of a contract executed in that manner. It is the Department's goal that Retirement Investors obtain clear evidence of the contract terms and their applicability to the Retirement Investor's own account or contract. The exemption will best serve its purpose if the contractual commitments are clear to all the parties, and if ancillary disputes about the fiduciary nature of the advice relationship are avoided. For this same reason, the exemption requires that a copy of the applicable contract be maintained on a Web site accessible to the Retirement Investor.

Commenters also asked for the ability to use a negative consent procedure with respect to existing customers to avoid the expense and difficulty associated with obtaining a large number of client signatures. The Department adjusted the exemption on this point to permit amendment of existing contracts by negative consent, as discussed above. As this approach will still result in the Retirement Investor receiving clear evidence of the contract terms and their applicability to the Retirement Investor's own account or contract, the Department concurred with commenters on its use.

Treating the Retirement Investor's silence as consent after 30 days provides the Retirement Investor a reasonable opportunity to review the new terms and to reject them. The Financial Institution may not use the negative consent procedure, however, to impose new obligations, restrictions or liabilities on the Retirement Investor in connection with this exemption. Any attempt by the Financial Institution to impose additional obligations, restrictions or liabilities on the Retirement Investor must receive affirmative consent from the Retirement Investor, and cannot violate Section II(f).

A number of commenters also asked that the exemption authorize Financial Institutions to satisfy the contract requirement for all Retirement Investors—including new customers after the January 1, 2018—through unilateral contracts or implied or negative consent. Some commenters suggested that the Department should not require a contract at all, but only a ''customer bill of rights'' or similar disclosure, without any additional signature requirement. Some commenters suggested that the requirement of obtaining signatures could delay execution of time sensitive investment strategies.

Although the final exemption accommodates a wide variety of concerns regarding contract operational issues, the Department did not adopt the alternative approaches suggested by some commenters, such as merely requiring delivery of a customer bill of rights, broader reliance on a unilateral contract approach, or increased reliance on negative consent. The Department intends that Retirement Investors that are new customers of the Financial Institution should enter into an enforceable contract under Section II(a)(1)(i). Consistent with the Department's goal that Retirement Investors obtain clear evidence of the contract terms and their applicability to the Retirement Investor's own account or contract, the exemption limits the negative consent option to existing customers as a form of transitional relief, so that Financial Institutions can avoid the burdens associated with obtaining signatures from a large number of already-existing customers.

Apart from this transitional relief, the Department does not believe it is appropriate to dispense with the clarity, enforceability and legal protections associated with an affirmative contract. Contracts are commonplace in a wide range of commercial transactions occurring in person, on the web, and elsewhere. The Department has facilitated the process by providing that Financial Institutions can incorporate the contract terms into commonplace account opening or similar documents that they already use; by permitting electronic signatures; and by revising the timing rules, so that the contract's execution can follow the provision of advice, as long as it precedes or occurs at the same time as the execution of the recommended transaction.

3. Fiduciary Acknowledgment—Section II(b)

Section II(b) of the exemption requires the Financial Institution to affirmatively state in writing that the Financial Institution and the Adviser(s) act as fiduciaries under ERISA or the Code, or both, with respect to any investment advice regarding principal transactions and riskless principal transactions provided by the Financial Institution or the Adviser subject to the contract or, in the case of an ERISA plan, with respect to any investment advice regarding the principal transactions and riskless principal transactions between the Financial Institution and the Plan or participant or beneficiary account.

With respect to IRAs and non-ERISA plans, if this acknowledgment of fiduciary status does not appear in a contract with a Retirement Investor, the exemption is not satisfied with respect to transactions involving that Retirement Investor. With respect to ERISA plans, this acknowledgment must be provided to the Retirement Investor prior to or at the same time as the execution of the recommended transaction, but not as part of a contract. This fiduciary acknowledgment is critical to ensuring clarity and certainty with respect to fiduciary status of both the Adviser and Financial Institution under ERISA and the Code with respect to that advice.

The fiduciary acknowledgment provision received significant support from some commenters. Commenters described it as a necessary protection and noted that it would clarify the obligations of the Adviser. One commenter said that facilitating proof of fiduciary status should enhance investors' ability to obtain a remedy for Adviser misconduct in arbitration by eliminating ancillary litigation over fiduciary status. Rather than litigate over fiduciary status, the fiduciary acknowledgment would help ensure that the proceedings focused on the Advisers' compliance with fundamental fiduciary norms.

Some commenters opposed the fiduciary acknowledgment requirement in the proposal, as applicable to Financial Institutions, on the basis that it could force Financial Institutions to take on fiduciary responsibilities, even if they would not otherwise be functional fiduciaries under ERISA or the Code. The commenters pointed out that under the proposed Regulation, the acknowledgment of fiduciary status would have been a factor in imposing fiduciary status on a party. Therefore, Financial Institutions could become fiduciaries by virtue of the fiduciary acknowledgment. To address these concerns, a few commenters suggested language under which a Financial Institution would only be considered a fiduciary to the extent that it is ''an affiliate of the Adviser within the meaning of 29 CFR 2510.3–21(f)(7) that, with the Adviser, functions as a fiduciary.''

The Department has not adjusted the exemption as these commenters requested. The exemption requires as a condition of relief that a sponsoring Financial Institution accept fiduciary responsibility for the recommendations of its Adviser(s). The Financial Institution's role in supervising individual Advisers and overseeing their adherence to the Impartial Conduct Standards is a key safeguard of the exemption. The exemption's success critically depends on the Financial Institution's careful implementation of anti-conflict policies and procedures, avoidance of Adviser incentives to violate the Impartial Conduct Standards and broad oversight of Advisers. Accordingly, Financial Institutions that wish to engage in principal transactions and riskless principal transactions that would otherwise be prohibited under ERISA and the Code must agree to take on these responsibilities as a condition of relief under the exemption. To the extent Financial Institutions do not wish to take on this role with their associated responsibilities and liabilities, they may structure their operations to avoid prohibited transactions and the resultant need of the exemption.

Other commenters expressed the view that the fiduciary acknowledgement would potentially require broker-dealers to satisfy the requirements of the Investment Advisers Act of 1940. As described by commenters, the Act does not require broker-dealers to register as investment advisers if they provide advice that is solely incidental to their brokerage services. Commenters expressed concern that acknowledging fiduciary status and providing advice in satisfaction of the Impartial Conduct Standards could call into question whether the advice provided was solely incidental.

The Department does not, however, require the Adviser or Financial Institution to acknowledge fiduciary status under the securities laws, but rather under ERISA or the Code or both. Neither does the Department require Advisers to agree to provide investment advice on an ongoing, rather than transactional, basis. An Adviser's status as an ERISA fiduciary is not dispositive of its obligations under the securities laws, and compliance with the exemption does not trigger an automatic loss of the broker-dealer exception under the separate requirements of those laws. A broker-dealer who provides investment advice under the Regulation is an ERISA fiduciary; acknowledgment of ERISA fiduciary status would not, by itself, cause the Adviser to lose the broker-dealer exception. Under the Regulation and this exemption, the primary import of fiduciary status is that the broker has to act in the customer's Best Interest when making recommendations; seek to obtain the best execution reasonably available under the circumstances with respect to the transaction; and refrain from making misleading statements. Certainly, nothing in the securities laws precludes brokers from adhering to these basic standards, or forbids them from working for Financial Institutions that implement appropriate policies and procedures to ensure that these standards are met.

The Department changed the fiduciary acknowledgment provision in response to several comments requesting revisions to clarify the required extent of the fiduciary acknowledgment. Accordingly, the Department has clarified that the acknowledgment can be limited to investment recommendations subject to the contract or, in the case of an ERISA plan, any investment recommendations regarding the plan or beneficiary or participant account. As discussed in more detail below, the exemption (including the required fiduciary acknowledgment) does not in and of itself, impose an ongoing duty to monitor on the Adviser and Financial Institution. However, there may be some investments which cannot be prudently recommended for purchase to individual Retirement Investors, in the first place, without a mechanism in place for the ongoing monitoring of the investment.

4. Impartial Conduct Standards—Section II(c)

Section II(c) of the exemption requires that the Adviser and Financial Institution comply with fundamental Impartial Conduct Standards. Generally stated, the Impartial Conduct Standards require that Advisers and Financial Institutions provide investment advice regarding the principal transaction or riskless principal transaction that is in the Retirement Investor's Best Interest, seek to obtain the best execution reasonably available under the circumstances with respect to the transaction, and not make misleading statements to the Retirement Investor about the recommended transaction and Material Conflicts of Interest. As defined in the exemption, a Financial Institution and Adviser act in the Best Interest of a Retirement Investor when they provide investment advice that reflects "the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution, any Affiliate or other party."

The Impartial Conduct Standards represent fundamental obligations of fair dealing and fiduciary conduct. The concepts of prudence, undivided loyalty and reasonable compensation are all deeply rooted in ERISA and the common law of agency and trusts.[22] These longstanding concepts of law and equity were developed in significant part to deal with the issues that arise when agents and persons in a position of trust have conflicting loyalties, and accordingly, are well-suited to the problems posed by conflicted investment advice. The phrase "without regard to" is a concise expression of ERISA's duty of loyalty, as expressed in section 404(a)(1)(A) of ERISA and applied in the context of advice. It is consistent with the formulation stated in the common law, and it is consistent with the language used by Congress in Section 913(g)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act),[23] and cited in the Staff of the U.S. Securities and Exchange Commission "Study on Investment Advisers and Broker-Dealers as Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act" (Jan. 2011) (SEC staff Dodd-Frank Study).[24]

Under ERISA section 408(a) and Code section 4975(c)(2), the Department cannot grant an exemption unless it first finds that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners. An exemption permitting transactions that violate the Impartial Conduct Standards would fail these standards.

The Impartial Conduct Standards are conditions of the exemption for the provision of advice with respect to all Retirement Investors. For advice to Retirement Investors in IRAs and non-ERISA plans, the Impartial Conduct Standards must also be included as contractual commitments on the part of the Financial Institution and its Advisers. As noted above, there is no contract requirement for advice with respect Retirement Investors in ERISA plans.

Comments on each of the Impartial Conduct Standards are discussed below. Additionally, in response to commenters' assertion that the exemption is not administratively feasible due to uncertainty regarding some terms and requests for additional clarity, the Department has clarified some key terms in the text and provides additional interpretive guidance in the preamble discussion that follows. Finally, the Department discusses comments on the treatment of the Impartial Conduct Standards as both exemption conditions for all Retirement Investors as well as contractual representations with respect to IRAs and other non-ERISA Plans.

a. Best Interest Standard

Under Section II(c)(1), the Financial Institution must state that it and its Advisers will comply with a Best Interest standard when providing investment advice to the Retirement Investor with respect to principal transactions and riskless principal transactions, and, in fact, adhere to the standard. Advice in the Retirement Investor's Best Interest means advice that, at the time of the recommendation:

> reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, or other party.

The Best Interest standard set forth in the exemption is based on longstanding

[22] *See generally* ERISA sections 404(a), 408(b)(2); Restatement (Third) of Trusts section 78 (2007), and Restatement (Third) of Agency section 8.01.

[23] Section 913(g) of the Dodd-Frank Act governs "Standard of Conduct" and subsection (1) provides that "The Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice."

[24] SEC Staff Study on Investment Advisers and Broker-Dealers, January 2011, available at *https://www.sec.gov/news/studies/2011/913studyfinal.pdf*, pp. 109–110.

concepts derived from ERISA and the law of trusts. It is meant to express the concept, set forth in ERISA section 404, that a fiduciary is required to act "solely in the interest of the participants . . . 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 a like character and with like aims." Similarly, both ERISA section 404(a)(1)(A) and the trust-law duty of loyalty require fiduciaries to put the interests of trust beneficiaries first, without regard to the fiduciaries' own self-interest. Under this standard, for example, an Adviser, in choosing between two investments, could not select an investment because it is better for the Adviser's or Financial Institution's bottom line, even though it is a worse choice for the Retirement Investor.

A wide range of commenters indicated support for a broad Best Interest standard. Some comments indicated that the Best Interest standard is consistent with the way Advisers provide investment advice to clients today. However, a number of these commenters expressed misgivings as to the definition used in the proposed exemption, in particular, the "without regard to" formulation. The commenters indicated uncertainty as to the meaning of the phrase, including whether it effectively precluded an Adviser from receiving compensation if a particular investment would generate higher Adviser compensation.

Other commenters asked the Department to use a different definition of Best Interest, or simply use the exact language from ERISA's section 404 duty of loyalty. Others suggested definitional approaches that would require that the Adviser and Financial Institution "not subordinate" their customers' interests to their own interests, or that the Adviser and Financial Institution "put their customers' interests ahead of their own interests," or similar constructs.

FINRA suggested that the federal securities laws should form the foundation of the Best Interest standard. Specifically, FINRA urged that the Best Interest definition in the exemption incorporate the suitability standard applicable to investment advisers and broker dealers under federal securities laws. According to FINRA, this would facilitate customer enforcement of the Best Interest standard by providing adjudicators with a well-established basis on which to find a violation.

Other commenters found the Best Interest standard to be an appropriate statement of the obligations of a fiduciary investment advice provider and believed it would provide concrete protections against conflicted recommendations. These commenters asked the Department to maintain the Best Interest definition as proposed. One commenter wrote that the term "best interest" is commonly used in connection with a fiduciary's duty of loyalty and cautioned the Department against creating an exemption that failed to include the duty of loyalty. Others urged the Department to avoid definitional changes that would reduce current protections to Retirement Investors. Some commenters also noted that the "without regard to" language is consistent with the recommended standard in the SEC staff Dodd-Frank Study, and suggested that it has added benefit of potentially harmonizing with a future securities law standard for broker-dealers.

In the context of principal transactions, one commenter suggested that the Department make clear that both the advice and the execution of the transaction must be in the Retirement Investor's Best Interest. The Department agrees that the execution of the transaction is an important concern, and has incorporated in Section II(c)(2) of the exemption, a provision requiring Financial Institutions that are FINRA members to agree that they and their Advisers and Financial Institution will comply with the terms of FINRA rule 5310 (Best Execution and Interpositioning).

The final exemption retains the Best Interest definition as proposed, with minor adjustments. The first prong of the standard was revised to more closely track the statutory language of ERISA section 404(a), and, is consistent with the Department's intent to hold investment advice fiduciaries to a prudent investment professional standard. Accordingly, the definition of Best Interest now requires advice that "reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person *acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims,* based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor . . ." The exemption adopts the second prong of the proposed definition, "without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate or other party," without change. The Department continues to believe that the "without regard to" language sets forth the appropriate, protective standard under which a fiduciary investment adviser should act. The standard ensures that the advice will not be tainted by self-interest. Under this language, an Adviser and Financial Institution must make a recommendation with respect to the principal transaction or riskless principal transaction without considering their own financial or other interests, or those of their Affiliates, or others. They may not recommend such a transaction on the basis that it pays them more, or otherwise benefits them more than a transaction conducted on an agency basis. Many of the alternative approaches suggested by commenters pose their own ambiguities and interpretive challenges, and lower standards run the risk of undermining this regulatory initiative's goal of reducing the impact of conflicts of interest on Retirement Investors.

The Department has not specifically incorporated the suitability obligation as an element of the Best Interest standard, as suggested by FINRA but many aspects of suitability are also elements of the Best Interest standard. An investment recommendation that is not suitable under the securities laws would not meet the Best Interest standard. Under FINRA's rule 2111(a) on suitability, broker-dealers "must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer." The text of rule 2111(a), however, does not do any of the following: Reference a best interest standard, clearly require brokers to put their client's interests ahead of their own, expressly prohibit the selection of the least suitable (but more remunerative) of available investments, or require them to take the kind of measures to avoid or mitigate conflicts of interests that are required as conditions of this exemption.

The Department recognizes that FINRA issued guidance on rule 2111 in which it explains that "in interpreting the suitability rule, numerous cases explicitly state that a broker's recommendations must be consistent with his customers' best interests," and provided examples of conduct that would be prohibited under this standard, including conduct that this exemption would not allow.[25] The guidance goes on to state that "[t]he suitability requirement that a broker make only those recommendations that are consistent with the customer's best interests prohibits a broker from placing his or her interests ahead of the customer's interests." The Department, however is reluctant to adopt as an

[25] FINRA Regulatory Notice 12–25, p. 3 (2012).

express standard such guidance, which has not been formalized as a clear rule and that, in any case, may be subject to change. Additionally, FINRA's suitability rule may be subject to interpretations which could conflict with interpretations by the Department, and the cases cited in the FINRA guidance, as read by the Department, involved egregious fact patterns that one would have thought violated the suitability standard even without reference to the customer's best interest.

Moreover, suitability under SEC practice differs somewhat from the FINRA approach. According to the SEC staff Dodd-Frank Study, the SEC requirements are based on the anti-fraud provisions of the Securities Act Section 17(a), the Exchange Act Section 10(b) and Rule 10b–5 thereunder.[26] As a general matter, SEC Rule 10b–5 prohibits any person, directly or indirectly, from: (a) Employing any device, scheme, or artifice to defraud; (b) making untrue statements of material fact or omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances, not misleading; or (c) engaging in any act or practice or course of business which operates or that would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security. FINRA does not require scienter, but the weight of authority holds that violations of the Self-Regulatory Organization rules, standing alone, do not give right to a private cause of action. Courts, however, allow private claims for violations of SEC Rule 10b–5 for fraud claims, including, among others, unsuitable recommendations. The private plaintiff must establish that the broker's unsuitable recommendation involved a misrepresentation (or material omission) made with scienter. Accordingly, after review of the issue, the Department has decided not to accept the comment. The Department has concluded that its articulation of a clear loyalty standard within the exemption, rather than by reference to the FINRA guidance, will provide clarity and certainty to investors, and better protect their interests.

The Best Interest standard, as set forth in the exemption, is intended to effectively incorporate the objective standards of care and undivided loyalty that have been applied under ERISA for more than forty years. Under these objective standards, the Adviser must adhere to a professional standard of care in making investment recommendations regarding principal transactions and riskless principal transactions that are in the Retirement Investor's Best Interest. The Adviser may not base his or her recommendations on the Adviser's own financial interest in the transaction. Nor may the Adviser recommend a principal transaction or riskless principal transaction, unless it meets the objective prudent person standard of care. Additionally, the duties of loyalty and prudence embodied in ERISA are objective obligations that do not require proof of fraud or misrepresentation, and full disclosure is not a defense to making an imprudent recommendation or favoring one's own interests at the Retirement Investor's expense.

A few commenters also questioned the requirement in the Best Interest standard that recommendations be made without regard to the interests of the Adviser, Financial Institution, any Affiliate, or other party. The commenters indicated they did not know the purpose of the reference to "other party" and asked that it be deleted. The Department intends the reference to make clear that an Adviser and Financial Institution operating within the Impartial Conduct Standards should not take into account the interests of any party other than the Retirement Investor—whether the other party is related to the Adviser or Financial Institution or not—in making a recommendation regarding a principal transaction or riskless principal transaction. For example, an entity that may be unrelated to the Adviser or Financial Institution but could still constitute an "other party," for these purposes, is the manufacturer of the investment product being recommended.

Other commenters asked for confirmation that the Best Interest standard is applied based on the facts and circumstances as they existed at the time of the recommendation, and not based on hindsight. Consistent with the well-established legal principles that exist under ERISA today, the Department confirms that the Best Interest standard is not a hindsight standard, but rather is based on the facts as they existed at the time of the recommendation. Thus, the courts have evaluated the prudence of a fiduciary's actions under ERISA by focusing on the process the fiduciary used to reach its determination or recommendation—whether the fiduciary, "at the time they engaged in the challenged transactions, employed the proper procedures to investigate the merits of the investment and to structure the investment." [27] The standard does not measure compliance by reference to how investments subsequently performed or turn Advisers and Financial Institutions into guarantors of investment performance, even though they gave advice that was prudent and loyal at the time of transaction.[28]

This is not to suggest that the ERISA section 404 prudence standard, or Best Interest standard, are solely procedural standards. Thus, the prudence standard, as incorporated in the Best Interest standard, is an objective standard of care that requires investment advice fiduciaries to investigate and evaluate investments, make recommendations, and exercise sound judgment in the same way that knowledgeable and impartial professionals would. "[T]his is not a search for subjective good faith—a pure heart and an empty head are not enough." [29] Whether or not the fiduciary is actually familiar with the sound investment principles necessary to make particular recommendations, the fiduciary must adhere to an objective professional standard. Additionally, fiduciaries are held to a particularly stringent standard of prudence when they have a conflict of interest.[30] For this reason, the Department declines to provide a safe harbor based on "procedural prudence" as requested by a commenter.

The Department additionally confirms its intent that the phrase "without regard to" be given the same meaning as the language in ERISA section 404 that requires a fiduciary to act "solely in the interest of" participants and

[26] SEC staff Dodd-Frank Study at 61.

[27] *Donovan* v. *Mazzola,* 716 F.2d 1226, 1232 (9th Cir. 1983).

[28] One commenter requested an adjustment to the "prudence" component of the Best Interest standard, under which the standard would be that of a "prudent person serving clients with similar retirement needs and offering a similar array of products." In this way, the commenter sought to accommodate varying perspectives and opinions on particular investment products and business practices. The Department disagrees with the comment, which could be read as qualifying the stringency of the prudence obligation based on the Financial Institution's or Adviser's independent decisions on which products to offer, rather than on the needs of the particular Retirement Investor. Therefore, the Department did not adopt this suggestion.

[29] *Donovan* v. *Cunningham,* 716 F.2d 1455, 1467 (5th Cir. 1983), *cert. denied,* 467 U.S. 1251 (1984); *see also DiFelice* v. *U.S. Airways, Inc.,* 497 F.3d 410, 418 (4th Cir. 2007) ("Good faith does not provide a defense to a claim of a breach of these fiduciary duties; 'a pure heart and an empty head are not enough.'").

[30] *Donovan* v. *Bierwirth,* 680 F.2d 263, 271 (2d Cir. 1982) ("the[] decisions [of the fiduciary] must be made with an eye single to the interests of the participants and beneficiaries"); *see also Bussian* v. *RJR Nabisco, Inc.,* 223 F.3d 286, 298 (5th Cir. 2000); *Leigh* v. *Engle,* 727 F.2d 113, 126 (7th Cir. 1984).

beneficiaries, as such standard has been interpreted by the Department and the courts. Therefore, the standard would not, as some commenters suggested, foreclose the Adviser and Financial Institution from being paid. The Department confirms that the standard does not preclude the Financial Institution from receiving reasonable compensation or from recouping the cost of obtaining and carrying the security, assuming the investment remains prudent when all its costs are considered.

In response to commenter concerns, the Department also confirms that the Best Interest standard does not impose an unattainable obligation on Advisers and Financial Institutions to somehow identify the single "best" investment for the Retirement Investor out of all the investments in the national or international marketplace, assuming such advice or management were even possible. Instead, as discussed above, the Best Interest standard set out in the exemption, incorporates two fundamental and well-established fiduciary obligations: the duties of prudence and loyalty. Thus, the fiduciary's obligation under the Best Interest standard is to give advice or acquire or dispose of investments in a manner that adheres to professional standards of prudence, and to put the Retirement Investor's financial interests in the driver's seat, rather than the competing interests of the Adviser or other parties.

Finally, in response to questions regarding the extent to which this Best Interest standard or other provisions of the exemption impose an ongoing monitoring obligation on Advisers or Financial Institutions, the Department has added specific language in Section II(e) regarding monitoring. The text does not impose a monitoring requirement, but instead requires clarity. As suggested by FINRA, Section II(e) requires Advisers and Financial Institutions to disclose whether or not they will monitor the Retirement Investor's investments and alert the Retirement Investor to any recommended changes to those investments and, if so, the frequency with which the monitoring will occur and the reasons for which the Retirement Investor will be alerted. This is consistent with the Department's interpretation of an investment advice fiduciary's monitoring responsibility as articulated in the preamble to the Regulation.

The terms of the contract or disclosure along with other representations, agreements, or understandings between the Adviser, Financial Institution and Retirement Investor, will govern whether the nature of the relationship between the parties is ongoing or not. The preamble to the proposed Best Interest Contract Exemption stated that adherence to a Best Interest standard did not mandate an ongoing or long-term relationship, but instead left the determination of whether to enter into such a relationship to the parties.[31] This exemption builds upon this and requires that the contract clearly state the nature of the relationship and whether there is any duty to monitor on the part of the Adviser or Financial Institution. Whether the Adviser and Financial Institution, in fact, have an obligation to monitor the investment and provide long-term advice depends on the parties' reasonable understandings, arrangements, and agreements.

b. Best Execution

Section II(c)(2) of the exemption requires that the Adviser and Financial Institution seek to obtain the best execution reasonably available under the circumstances with respect to the principal transaction or riskless principal transaction with the plan, participant or beneficiary account or IRA.

Section II(c)(2)(i) further provides that Financial Institutions that are FINRA members may satisfy Section II(c)(2) by complying with the terms of FINRA rules 2121 (Fair Prices and Commissions) and 5310 (Best Execution and Interpositioning), or any successor rules in effect at the time of the transaction,[32] as interpreted by FINRA, with respect to the principal transaction or riskless principal transaction.

This provision is revised from the proposal, which provided that the purchase or sales price could not be unreasonable under the circumstances. Commenters on the proposal indicated that they were uncertain as to what an unreasonable price would be and requested additional clarification of the rule.

Further, some commenters indicated that FINRA rule 2121 (Fair Prices and Commissions) should be incorporated in the alternative. According to FINRA, rule 2121 "prohibits a broker-dealer from entering into a transaction with a customer 'at any price' that is not reasonably related to the current market price of the security." FINRA additionally recommended that the Department incorporate FINRA rule 5310 (Best Execution and Interpositioning) instead of its proposed two-quote requirement (discussed below). According to FINRA:

> [Rule 5310] uses a "facts and circumstances" analysis by requiring that a firm dedicate reasonable diligence to ascertain the best market for the security and to buy or sell in such market so that the price to the customer is as favorable as possible under the prevailing market conditions. A key determinant in assessing whether a firm has met this reasonable diligence standard is the character of the market for the security itself, which includes an analysis of price, volatility and relative liquidity.
>
> [The] Rule . . . also addresses instances in which there is limited quotation or pricing information available. The rule requires a broker-dealer to have written policies and procedures that address how the firm will determine the best inter-dealer market for such a security in the absence of pricing information or multiple quotations and to document its compliance with those policies and procedures.

After consideration of the comments received, the Department revised the proposed condition to focus on best execution, rather than an unreasonable price. The Department determined that a requirement that Advisers and Financial Institutions seek to obtain the best execution reasonably available under the circumstances with respect to the transaction, particularly as articulated by FINRA in rule 5310, would provide protections that are comparable to the Department's proposed condition but that are more familiar to the parties relying on the exemption.

The Department specifically incorporated FINRA rules 2121 and 5310 for FINRA members, as a method of satisfying this requirement, as suggested by some commenters. For Advisers and Financial Institutions that are not FINRA members, the best execution obligation under the exemption is satisfied if the Adviser and Financial Institution satisfies the best execution obligation as interpreted by their functional regulator. However, to the extent non-FINRA members wish for additional certainty as to their compliance obligations under this exemption, they may comply with the provisions of FINRA rules 2121 and 5310 to satisfy Section II(c)(2).

Under Section II(c)(2)(ii), if the Department expands the scope of this exemption to include additional principal traded assets by individual exemption,[33] the Department may

[31] 80 FR 21969 (Apr. 20, 2015).

[32] Accordingly, to the extent FINRA rules 2121 (Fair Prices and Commissions) or 5310 (Best Execution and Interpositioning) are amended, the Adviser and Financial Institution must comply with the requirements that are in effect at the time the transaction occurs.

[33] *See* Section VI(j)(1)(iv).

identify specific alternative best execution and fair pricing requirements imposed by another regulator or self-regulatory organization that must be complied with. This would potentially permit, for example, Financial Institutions to cite specific requirements of the Municipal Securities Rulemaking Board, if municipal securities become covered under the exemption.

c. Misleading Statements

The final Impartial Conduct Standard, set forth in Section II(c)(3), requires that statements by the Financial Institution and its Advisers 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 decision to engage in a principal transaction or a riskless principal transaction, may not be materially misleading at the time they are made. In response to commenters, the Department adjusted the text to clarify that the standard is measured at the time of the representations, *i.e.,* the statements must not be misleading ''at the time they are made.'' Similarly, the Department added a materiality standard in response to comments.

The Department did not accept certain other comments, however. One commenter requested that the Department add a qualifier providing that the standard is violated only if the statement was ''reasonably relied'' on by the Retirement Investor. The Department rejected the comment. The Department's aim is to ensure that Financial Institutions and Advisors uniformly adhere to the Impartial Conduct Standards, including the obligation to avoid materially misleading statements, when they give advice. Whether a Retirement Investor relied on a particular statement may be relevant to the question of damages in subsequent arbitration or court proceedings, but it is not and should not be relevant to the question of whether the fiduciary violated the exemption's standards in the first place. Moreover, inclusion of a reasonable reliance standard runs the risk of inviting boilerplate disclaimers of reliance in contracts and disclosure documents precisely so the Adviser can assert that any reliance is unreasonable.

One commenter asked the Department to require only that the Adviser ''reasonably believe'' the statements are not misleading. The Department is concerned that this standard too could undermine the protections of this condition, by requiring Retirement Investors or the Department to prove the Adviser's actual belief rather than focusing on whether the statement is objectively misleading. However, to address commenters' concerns about the risks of engaging in a prohibited transaction, as noted above, the Department has clarified that the standard is measured at the time of the representations and has added a materiality standard.

The Department believes that Retirement Investors are best served by statements and representations that are free from material misstatements. Financial Institutions and Advisers best avoid liability—and best promote the interests of Retirement Investors—by ensuring that accurate communications are a consistent standard in all their interactions with their customers.

A commenter suggested that the Department adopt FINRA's ''Frequently Asked Questions regarding Rule 2210'' in this connection.[34] FINRA's rule 2210, Communications with the Public, sets forth a number of procedural rules and standards that are designed to, among other things, prevent broker-dealer communications from being misleading. The Department agrees that adherence to FINRA's standards can promote materially accurate communications, and certainly believes that Financial Institutions and Advisers should pay careful attention to such guidance documents. After review of the rule and FAQs, however, the Department declines to simply adopt FINRA's guidance, which addresses written communications, since the condition of the exemption is broader in this respect. In the Department's view, the meaning of the standard is clear, and is already part of a plan fiduciary's obligations under ERISA. If, however, issues arise in implementation of the exemption, the Department will consider requests for additional guidance.

d. Contractual Representation Versus Exemption Condition

Commenters expressed a variety of views on whether violations of the Impartial Conduct Standards with respect to advice regarding principal transactions to Retirement Investors regarding IRAs and non-ERISA plans should result in loss of the exemption, violation of the contract, or both.[35] Some commenters objected to the incorporation of the Impartial Conduct Standards as contract terms, generally, on the basis that the requirement would contribute to litigation risk. Some commenters preferred that the Impartial Conduct Standards only be required as a condition of the exemption, and not give rise to contract claims.

Other commenters advocated for the opposite result, asserting that the Impartial Conduct Standards should be required for contractual promises only, and not treated as exemption conditions. These commenters asserted that the Impartial Conduct Standards are too vague and would result in uncertainty as to whether an excise tax under the Code, which is self-assessed, is owed. There were also suggestions to limit the contractual representation to the Best Interest standard alone. One commenter asserted that the favorable price requirement and the obligation not to make misleading statements fall within a Best Interest standard, and do not need to be stated separately. There were also suggestions that the Impartial Conduct Standards not apply to ERISA plans because fiduciaries to these plans already are required to adhere to similar statutory fiduciary obligations. In these commenters' views, requiring these standards in an exemption is redundant and inappropriately increases the consequences of any fiduciary breach by imposing an excise tax.

In response to comments, the Department has revised the language of the Impartial Conduct Standards and provided interpretive guidance to alleviate the commenters' concerns about uncertainty and litigation risk. However, the Department has concluded that, failure to adhere to the Impartial Conduct Standards should be both a violation of the contract (where required) and the exemption. Accordingly, the Department has not eliminated any of the conduct standards or, for IRAs and non-ERISA plans, restricted them just to conditions of the exemption for Retirement Investors investing in IRAs or non-ERISA plans. In the Department's view, all the Impartial Conduct Standards form the baseline standards that should be applicable to fiduciaries relying on the exemption; therefore, the Department has not accepted comments suggesting that the contract representation be limited to the Best Interest standard. Making all the Impartial Conduct Standards required contractual promises for dealings with IRAs and other non-ERISA plans creates the potential for contractual liability, incentivizes Financial Institutions to comply, and gives injured Retirement Investors a remedy if those Financial Institutions do not comply. This enforceability is critical to the safeguards afforded by the exemption.

[34] *Currently available at http://www.finra.org/industry/finra-rule-2210-questions-and-answers.*

[35] Commenters also asserted that the Department did not have the authority to condition the exemption on the Impartial Conduct Standards. Comments on the Department's jurisdiction are discussed in a separate Section D. of this preamble.

As previously discussed, the Impartial Conduct Standards will not unduly increase litigation risk. The standards are not unduly vague or unknown, but rather track longstanding concepts in law and equity. Also, the Department has simplified execution of the contract, streamlined disclosure, and made certain language changes to address legitimate concerns.

Similarly, the Department has not accepted the comment that the Impartial Conduct Standards should apply only to IRAs and non-ERISA plans. One of the Department's goals is to ensure equal footing for all Retirement Investors. The SEC staff Dodd-Frank Study found that investors were frequently confused by the differing standards of care applicable to broker-dealers and registered investment advisers. The Department hopes to minimize such confusion in the market for retirement advice by holding Advisers and Financial Institutions to similar standards, regardless of whether they are giving the advice to an ERISA plan, IRA, or a non-ERISA plan.

Moreover, inclusion of the standards in the exemption's conditions adds an important additional safeguard for ERISA and IRA investors alike because the party engaging in a prohibited transaction has the burden of showing compliance with an applicable exemption, when violations are alleged.[36] In the Department's view, this burden-shifting is appropriate because of the dangers posed by conflicts of interest, as reflected in the Department's Regulatory Impact Analysis and because of the difficulties Retirement Investors have in effectively policing such violations.[37] One important way for Financial Institutions to ensure that they can meet this burden is by implementing strong anti-conflict policies and procedures, and by refraining from creating incentives to violate the Impartial Conduct Standards. Thus, treating the Impartial Conduct Standards as exemption conditions creates an important incentive for Financial Institutions to carefully monitor and oversee their Advisers' conduct for adherence with fiduciary norms.

Moreover, as noted repeatedly, the language for the Impartial Conduct Standards borrows heavily from ERISA and the law of trusts, providing sufficient clarity to alleviate the commenters' concerns. Ensuring that fiduciary investment advisers adhere to the Impartial Conduct Standards and that all Retirement Investors have an effective legal mechanism to enforce the standards are central goals of this regulatory project.

[36] *See, e.g., Fish* v. *GreatBanc Trust Company,* 749 F.3d 671 (7th Cir. 2014).

[37] *See* Regulatory Impact Analysis.

5. Sales Incentives and Anti-Conflict Policies and Procedures

Under Section II(d)(1)–(3) of the exemption, the Financial Institution is required to adopt certain anti-conflict policies and procedures and to insulate Advisers from incentives to violate the Best Interest standard. In order for relief to be available under the exemption, a Financial Institution that meets the definition set forth in the exemption must provide oversight of Advisers' recommendations, as described in this section. The Financial Institution must prepare a written document describing the Financial Institution's policies and procedures, and make copies of the document readily available to Retirement Investors, free of charge, upon request as well as on the Financial Institution's Web site.[38] The written description must accurately describe or summarize key components of the policies and procedures relating to conflict-mitigation and incentive practices in a manner that permits Retirement Investors to make an informed judgment about the stringency of the Financial Institution's protections against conflicts of interest. The Department opted against requiring disclosure of the full policies and procedures to Retirement Investors to avoid giving them a potentially overwhelming amount of information that could run contrary to its purpose (*e.g.,* by alerting Advisers to the particular surveillance mechanisms employed by Financial Institutions). However, the exemption requires that the full policies and procedures must be made available to the Department upon request.

These obligations have several important components. First, the Financial Institution must adopt and comply with written policies and procedures reasonably and prudently designed to ensure that its individual Advisers adhere to the Impartial Conduct Standards set forth in Section II(c). Second, the Financial Institution in formulating its policies and procedures, must specifically identify and document its Material Conflicts of Interest associated with principal transactions and riskless principal transactions; adopt measures reasonably and prudently designed to prevent Material Conflicts of Interest from causing violations of the Impartial Conduct Standards set forth in Section II(c); and designate a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards. For purposes of the exemption, a Material Conflict of Interest exists when an Adviser or Financial Institution has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor.

[38] *See* Section IV(e).

Finally, the Financial Institution's policies and procedures must require that, neither the Financial Institution nor (to the best of its knowledge) any Affiliate uses or relies on 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 individual Advisers to make recommendations regarding principal transactions and riskless principal transactions that are not in the Best Interest of the Retirement Investor.

In this respect, however, the exemption makes clear that that requirement does not prevent the Financial Institution or its Affiliates from providing Advisers with differential compensation (whether in type or amount, and including, but not limited to, commissions) based on investment decisions by Plans, participant or beneficiary accounts, or IRAs, to the extent that the policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of Advisers with the interests of the Retirement Investors they serve as fiduciaries.

The anti-conflict policies and procedures will safeguard the interests of Retirement Investors by causing Financial Institutions to consider the conflicts of interest affecting their provision of advice to Retirement Investors regarding principal transactions and riskless principal transactions and to take action to mitigate the impact of such conflicts. In particular, under the final exemption, Financial Institutions must not use compensation and other employment incentives to the extent they are intended to or would reasonably be expected to cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. Financial Institutions must also establish a supervisory structure reasonably and prudently designed to ensure the Advisers will adhere to the

Impartial Conduct Standards. Mitigating conflicts of interest associated with principal transactions and riskless principal transactions by requiring greater alignment of the interests of the Adviser and Financial Institution, and the Retirement Investor, is necessary for the Department to make the findings under ERISA section 408(a) and Code section 4975(c)(2) that the exemption is in the interests of, and protective of, Retirement Investors. This warranty gives the Financial Institution a powerful incentive to ensure advice is provided in accordance with fiduciary norms, rather than risk litigation, including class litigation and liability.

Like the proposal, the exemption does not specify the precise content of the anti-conflict policies and procedures. This flexibility is intended to allow Financial Institutions to develop policies and procedures that are effective for their particular business models, while prudently ensuring compliance with their and their Advisers' fiduciary obligations and the Impartial Conduct Standards. The policies and procedures requirement, if taken seriously, can also reduce Financial Institutions' litigation risk by minimizing incentives for Advisers to provide advice that is not in Retirement Investors' Best Interest.

As adopted in the final exemption, the policies and procedures requirement is a condition of the exemption for all Retirement Investors—in ERISA plans, IRAs and non-ERISA plans. Failure to comply could result in liability under ERISA for engaging in a prohibited transaction and the imposition of an excise tax under the Code, payable to the Treasury. Additionally, with respect to Retirement Investors in IRAs and non-ERISA plans, the requirements take the form of a contractual warranty. The Financial Institution must warrant that it has adopted and will comply with the anti-conflict policies and procedures (including the obligation to avoid misaligned incentives). Failure to comply with the warranty could result in contractual liability.

Comments on the proposed policies and procedures requirement are discussed below. As stated above, for ease of use, the Department has included in this preamble the same general discussion of comments as in the Best Interest Contract Exemption, to the extent applicable to principal transactions and riskless principal transactions, despite the fact that some comments discussed below were not made directly with respect to this exemption.

a. Policies and Procedures Requirement Generally

Under the policies and procedures requirement, described in greater detail above, Financial Institutions must adopt and comply with anti-conflict policies and procedures. In addition, neither the Financial Institution nor (to the best of its knowledge) any Affiliates may use or rely on 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 Advisers to make recommendations that are not in the Best Interest of the Retirement Investor.

Some commenters were extremely supportive of the policies and procedures requirement as proposed. They expressed the view that the policies and procedures requirement, and in particular the restrictions on compensation and other employment incentives, was one of the most critical investor protections in the proposal because it would cause Financial Institutions to make specific and necessary changes to their compensation arrangements that would result in significant protections to Retirement Investors.

Some commenters believed that the Department did not go far enough. These commenters indicated that flat compensation arrangements should be required, or at least that the rules applicable to differential compensation should be more specific and stringent.

A few commenters also indicated that, in addition to focusing on the Adviser, the Financial Institution's policies and procedures need to consider the impact of compensation practices on branch managers. A commenter indicated that branch managers have responsibilities under FINRA's supervisory rules to ensure suitability and possibly approve individual transactions. The commenter asserted that branch managers financially benefit from Advisers' recommendations and have a variety of methods of influencing Adviser behavior.

Many others objected to the policies and procedures warranty and requested that it be eliminated in the final exemption. Some commenters believed that compliance would require drastic changes to current compensation arrangements or could possibly result in the complete prohibition of commissions and other transaction-based compensation. Other commenters suggested that the requirement should be eliminated as it would be unnecessary in light of the exemption's Best Interest standard, and because it would unnecessarily increase litigation risk to Financial Institutions. Alternatively, there were requests to clarify specific provisions and provide safe harbors in the policies and procedures requirement.

In the final exemption, the Department has retained the general approach of the proposal. The Department concurs with commenters who view the policies and procedures requirement as an important safeguard for Retirement Investors and as a necessary condition for the Department to make the findings under ERISA section 408(a) and Code section 4975(c)(2) that the exemption is in the interests of, and protective of, Retirement Investors. This provision will require Financial Institutions to take concrete and specific steps to ensure that its individual Advisers adhere to the Impartial Conduct Standards, and in particular, forego compensation practices and employment incentives (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 Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. Strong policies and procedures reduce the temptation (conscious or unconscious) to violate the Best Interest standard in the first place by ensuring that the Advisers' incentives are appropriately aligned with the interests of the customers they serve, and by ensuring appropriate monitoring and supervision of individual Advisers' conduct. While the Department views the Best Interest standard as critical to the protections of the exemption, the policies and procedures requirement is equally critical as a means of supporting Best Interest advice and protecting Retirement Investors from having to enforce the Best Interest standard after the advice has already been rendered and the damage done.

The Department has not made the requirements more stringent, as suggested by some commenters, so as to require completely level compensation. The Department designed the exemption to preserve mark-ups and mark-downs and other payments as applicable to the transaction in connection with principal transactions and riskless principal transactions, thereby preserving existing business models.

The Department also adopted the suggestion of one commenter that the exemption require the Financial

Institution to designate a specific person to address Material Conflicts of Interest and monitor Advisers' adherence to the Impartial Conduct Standards.[39] In the proposal, the Department had already suggested that Financial Institutions consider this approach; however, the commenter suggested that it should be a specific requirement and indicated that most Financial Institutions already have a designated compliance officer. The Department concurs with the commenter and has included that requirement in the final exemption, based on the view that formalizing the process for identifying and monitoring these issues will result in increased protections to Retirement Investors.

b. Specific Language of Policies and Procedures Requirement

There were also questions and comments on certain language in the proposed policies and procedures requirement. As proposed, the components of the policies and procedures requirement in Section II(d) read as follows:

- The Financial Institution has adopted written policies and procedures reasonably designed to mitigate the impact of Material Conflicts of Interest and to ensure that its individual Advisers adhere to the Impartial Conduct Standards set forth in Section II(c);
- In formulating its policies and procedures, the Financial Institution has specifically identified Material Conflicts of Interest and adopted measures to prevent the Material Conflicts of Interest from causing violations of the Impartial Conduct Standards set forth in Section II(c); and
- Neither the Financial Institution nor (to the best of its knowledge) any Affiliate uses quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives to the extent they would tend to encourage individual Advisers to make recommendations regarding principal transactions that are not in the Best Interest of the Retirement Investor.

A few commenters asked the Department to explain the difference between the first and second prongs of the policies and procedures requirement, as proposed. In response, the first prong of the requirement was intended to establish a general standard, while the second (and third) prongs provided specific rules regarding the policies and procedures requirement. This approach was also adopted in the final exemption. In addition, the language of Section II(d)(3) specifically provides that the third prong of the requirement, requiring Financial Institutions to insulate Advisers from incentives to violate the Best Interest standard, is part of the policies and procedures requirement.

There were also comments on (i) the definition and use of the term "Material Conflicts of Interest;" (ii) the language requiring the policies and procedures to be "reasonably designed" to mitigate the impact of such conflicts of interest, and (iii) the meaning of incentives that "tend to encourage" individual Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. These comments are discussed below.

i. Materiality

A number of commenters focused on the definition of Material Conflict of Interest used in the proposal. Under the definition as proposed, a Material Conflict of Interest exists when an Adviser or Financial Institution "has a financial interest that could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor." Some commenters took the position that the proposal did not adequately explain the term "material" or incorporate a materiality standard into the definition. A commenter wrote that the proposed definition was so broad that it would be difficult for Financial Institutions to comply with the various aspects of the exemption related to Material Conflicts of Interest, such as provisions requiring disclosure of Material Conflicts of Interest.

Another commenter indicated that the Department should not use the term "material" in defining conflicts of interest. The commenter believed that it could result in a standard that was too subjective from the perspective of the Adviser and Financial Institution, and could undermine the protectiveness of the exemption.

After consideration of the comments, the Department adjusted the definition of Material Conflict of Interest. In the final exemption, a Material Conflict of Interest exists when an Adviser or Financial Institution has a "financial interest that that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor." This language responds to concerns about the breadth and potential subjectivity of the standard. The Department did not, as some commenters suggested, include the word "material" in the definition of Material Conflict of Interest, to avoid the potential circularity of that approach.

ii. Reasonably Designed

One commenter asked that the Department more broadly use the modifier "reasonably designed" in describing the standard the policies and procedures must meet so as to avoid a construction that required standards that ensured perfect compliance, a potentially unattainable standard. The Department has accepted the comment and adjusted the language in Sections II(d)(1) and (2) to generally use the phrase "reasonably and prudently designed." Other commenters asked for guidance on the proposed phrasing "reasonably designed to mitigate" the impact of Material Conflicts of Interest. The Department provides additional guidance in this respect in the preamble of the Best Interest Contract Exemption published elsewhere in this issue of the **Federal Register**, which gives examples of some possible approaches to policies and procedures.

iii. Tend To Encourage

A number of commenters asked for clarification or revision of the proposed exemption's prohibition of incentives that "tend to encourage" violation of the Best Interest standard, generally to require a tight link between the incentives and the Advisers' recommendations. Commenters argued that the "tend to encourage" language established a standard that could be impossible to meet in the context of differential compensation. Accordingly, they requested that the Department use language such as "intended to encourage," "does encourage," "causes," or similar formulation.

In response to these commenters the Department has adjusted the condition's language as follows:

> [N]either the Financial Institution nor (to the best of the Financial Institution's knowledge) any Affiliate uses or relies on 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 individual Advisers to make recommendations regarding Principal Transactions and Riskless Principal Transactions that are not in the Best Interest of the Retirement Investor (emphasis added).

This language more accurately captures the Department's intent, which was to require that procedures reasonably address Advisers' incentives,

[39] One important consideration in addressing conflicts of interest is the Financial Institution's attentiveness to the qualifications and disciplinary history of the persons it employs to provide such advice. *See* Egan, Mark, Gregor Matvos and Amit Seru, *The Market for Financial Adviser Misconduct,* at 3 (February 26, 2016) ("Past offenders are five times more likely to engage in misconduct than the average adviser, even compared with other advisers in the same firm at the same point in time. The large presence of repeat offenders suggests that consumers could avoid a substantial amount of misconduct by avoiding advisers with misconduct records.").

not guarantee perfection. The Department disagrees, however, with the suggestion that Financial Institutions should be permitted to tolerate or create incentives that would ''reasonably be expected to cause such violations'' unless the Retirement Investor can actually prove the Financial Institution's intent to cause violations of the standard or the Adviser's improper motivation in making the recommendation. The aim of the policies and procedures requirement is to require the Financial Institution to take prophylactic measures to ensure that Retirement Advisers adhere to the Impartial Conduct Standards, a goal completely at odds with the creation of incentives to violate the Best Interest standard. In exchange for the receipt of compensation that would otherwise be prohibited by ERISA and the Code, the Financial Institution's responsibility under the exemption is to protect Retirement Investors from conflicts of interest, not to promote or continue to offer incentives to violate the Best Interest standard. Moreover, absent extensive discovery or the ability to prove the motivations of individual Advisers, Retirement Investors would generally be in a poor position to prove such ill intent.

However, the final exemption provides that the policies and procedures requirement does not:

> [P]revent the Financial Institution or its Affiliates from providing Advisers with differential compensation *(whether in type or amount, and including, but not limited to, commissions)* based on investment decisions by Plans, participant or beneficiary accounts, or IRAs, *to the extent that the policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of Advisers with the interests of the Retirement Investors they serve as fiduciaries* (emphasis added).

This language is designed to make clear that differential compensation is permitted, but only if the Financial Institution's policies and procedures, as a whole, are reasonably designed to avoid a misalignment of interests between Advisers and Retirement Investors.

For further guidance, the preamble to the Best Interest Contract Exemption, published in this same issue of the **Federal Register**, provides examples of the types of policies and procedures that may satisfy the warranty.

c. Contractual Warranty Versus Exemption Condition

In the proposal, both the Adviser and Financial Institution had to give a warranty to the Retirement Investor about the adoption and implementation of anti-conflict policies and procedures. A few commenters indicated that the Adviser should not be required to give the warranty, and questioned whether the Adviser would always be in a position to speak to the Financial Institution's incentive and compensation arrangements. The Department agrees that the Financial Institution has the primary responsibility for design and implementation of the policies and procedures requirement and, accordingly, has limited the warranty requirement to the Financial Institution.

Some commenters believed that even if the Department included a policies and procedure requirement in the exemption, it should not require a warranty on implementation and compliance with the requirement. According to some of these commenters the warranty was unnecessary in light of the Best Interest standard, and would unduly contribute to litigation risk. A few commenters also suggested that a Financial Institution's failure to comply with the contractual warranty could give rise to a cause of action to Retirement Investors who had suffered no injuries from failure to implement or comply with appropriate policies and procedures. A few other commenters expressed concern that the provision of a warranty could result in tort liability, rather than just contractual liability.

Other commenters argued that the Department should require Financial Institutions not only to make an enforceable warranty as a condition of the exemption, but also require actual compliance with the warranty as a condition of the exemption. One such commenter argued that it would be difficult for Retirement Investors to prove that policies and procedures were not ''reasonably designed'' to achieve the required purpose.

As noted above, the final exemption adopts the required policies and procedures as a condition of the exemption. The policies and procedures requirement is a critical part of the exemption's protections. The risk of liability associated with a non-exempt prohibited transaction gives Financial Institutions a strong incentive to design protective policies and procedures in a way that is consistent with the purposes and requirements of this exemption. Of course, the Department does not expect that successful contract claims will be brought by Retirement Investors without a showing of damages.

In addition, the final exemption requires the Financial Institution to make a warranty regarding the policies and procedures in contracts with Retirement Investors regarding IRAs and other non-ERISA plans. The warranty, and potential liability associated with that warranty, gives Financial Institutions both the obligation and the incentive to tamp down harmful conflicts of interest and protect Retirement Investors from misaligned incentives that encourage Advisers to violate the Best Interest standard and other fiduciary obligations and ensures that there is a means to redress the failure to do so. While the warranty exposes Financial Institutions and Advisers to litigation risk, these risks are circumscribed by the availability of binding arbitration for individual claims and the legal restrictions that courts generally use to police class actions.

The Department does not share a commenter's view that it would be too difficult for Retirement Investors to prove that the policies and procedures were not ''reasonably designed'' to achieve the required purpose. The final exemption requires the Financial Institution to disclose Material Conflicts of Interest associated with the principal transactions and riskless principal transactions to Retirement Investors and to describe its policies and procedures for safeguarding against those conflicts of interest. These disclosures should assist Retirement Investors in assessing the care with which Financial Institutions have designed their procedures, even if they are insufficient to fully convey how vigorously the Financial Institution implements the protections. In some cases, a systemic violation, or the possibility of such a violation, may be apparent on the face of the policies. In other cases, normal discovery in litigation may provide the information necessary. Certainly, if a Financial Institution were to provide significant prizes or bonuses for Advisers to push principal transactions and riskless principal transactions that were not in the Best Interest of Retirement Investors, Retirement Investors would often be in a position to pursue the claim. Most important, however, the enforceable obligation to adopt and comply with the policies and procedures as set forth herein, and to make relevant disclosures of the policies and procedures and of Material Conflicts of Interest, should create a powerful incentive for Financial Institutions to carefully police conflicts of interest, reducing the need for litigation in the first place.

In response to commenters that expressed concern about the specific use of the term ''warranty,'' the Department intends the term to have its standard meaning as a ''promise that something in furtherance of the contract is guaranteed by one of the contracting parties.'' [40] The Department merely requires that the contract with IRA and non-ERISA plan investors include an express enforceable promise of compliance with the policies and procedures condition. As previously discussed, the potential liability for violation of the warranty is cabined by the availability of non-binding arbitration in individual claims, and the ability to waive claims for punitive damages and rescission to the extent permitted by applicable law.

Additionally, although the policies and procedure requirement applies equally to ERISA plans, the final exemption does not require Financial Institutions to make a warranty with respect to ERISA plans, just as it does not require the execution of a contract with respect to ERISA plans. For these plans, a separate warranty is unnecessary because Title I of ERISA already provides an enforcement mechanism for failure to comply with the policies and procedures requirement. Under ERISA section 502(a), plan participants, fiduciaries, and the Secretary of Labor have ready means to enforce any failure to meet the conditions of the exemption, including a failure to comply with the policies and procedure requirement. A Financial Institution's failure to comply with the exemption's policies and procedure requirements would result in a non-exempt prohibited transaction under ERISA section 406 and would likely constitute a fiduciary breach under ERISA section 404. As a result, a plan participant or beneficiary, plan fiduciary, and the Secretary would be able to sue under ERISA section 502(a)(2), (3), or (5) to recover any loss in value to the plan (including the loss in value to an individual account), or to obtain disgorgement of any wrongful profits or unjust enrichment. Accordingly, the warranty is unnecessary in the context of ERISA plans.

d. Compliance With Laws Proposed Warranty

The proposed exemption also contained a requirement that the Adviser and Financial Institution would have had to warrant that they and their Affiliates would comply with all applicable federal and state laws regarding the rendering of the investment advice, the purchase, sale or holding of the Asset and the payment of compensation related to the purchase, sale and holding. While the Department did receive some support for this condition in comments, several commenters opposed this warranty proposal as being overly broad, and urged that it be deleted. The commenters argued that the warranty could create contract claims based on a wide variety of state and federal laws, without regard to the limitations imposed on individual actions under those laws. In addition, commenters suggested that many of the violations associated with these laws could be quite minor or unrelated to the Department's concerns about conflicts of interest. In response to these comments, the Department has eliminated this warranty from the final exemption.

6. Credit Standards and Liquidity

Section II(d)(4) provides that the Financial Institution's written policies and procedures regarding principal transactions and riskless principal transactions must address how the credit risk and liquidity assessments required by Section III(a)(3) of the exemption will be made. This requirement serves as an implementation tool for the exemption condition that a debt security that is purchased by a plan, participant or beneficiary account, or IRA, possess at the time of purchase no greater than moderate credit risk and sufficiently liquidity that it can be sold at or near its carrying value within a reasonably short period of time.

As discussed later in this preamble, when addressing the credit and liquidity conditions set forth in Section III(a) of the exemption, many commenters identified perceived compliance difficulties. Of those comments, one comment was applicable to Section II of the exemption. The commenter suggested that the Financial Institution be required to develop policies and procedures to assist Advisers by specifying how these assessments are to be made. This suggestion addressed some concerns expressed by commenters regarding the credit and liquidity conditions, and the Department concurs with the comment. The Department believes that Financial Institutions will be able to comply with the requirement, in part, by developing, if they do not already exist, policies and procedures to ensure that the credit worthiness and liquidity of debt securities are properly evaluated.

7. Contractual Disclosures

Section II(e) of the exemption obligates the Financial Institution to make specified contract disclosures to Retirement Investors in order to ensure that they have basic information about the scope of Adviser conflicts and that they appropriately authorize principal transactions and riskless principal transactions. For advice to Retirement Investors in IRAs and non-ERISA plans, the disclosures must be provided prior to or at the same time as the recommended transaction either as part of the contract or in a separate written disclosure provided to the Retirement Investor. For advice to Retirement Investors regarding investments in ERISA plans, the disclosures must be provided prior to or at the same time as the execution of the recommended transaction. The disclosure may be provided in person, electronically, or by mail. In the disclosures, the Financial Institution must clearly and prominently in a single written disclosure:

(1) Set forth in writing (i) the circumstances under which the Adviser and Financial Institution may engage in Principal Transactions and Riskless Principal Transactions with the Plan, participant or beneficiary account, or IRA, (ii) a description of the types of compensation that may be received by the Adviser and Financial Institution in connection with Principal Transactions and Riskless Principal Transactions, including any types of compensation that may be received from third parties, and (iii) identify and disclose the Material Conflicts of Interest associated with Principal Transactions and Riskless Principal Transactions;

(2) Except for existing contracts, document the Retirement Investor's affirmative written consent, on a prospective basis, to Principal Transactions and Riskless Principal Transactions between the Adviser or Financial Institution and the Plan, participant or beneficiary account, or IRA;

(3) Inform the Retirement Investor (i) that the consent set forth in Section II(e)(2) is terminable at will upon written notice by the Retirement Investor at any time, without penalty to the Plan or IRA, (ii) of the right to obtain, free of charge, copies of the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d), as well as information about the Principal Traded Asset, including its purchase or sales price, and other salient attributes, including, as applicable: The credit quality of the issuer; the effective yield; the call provisions; and the duration, provided that if the Retirement Investor's request is made prior to the transaction, the information must be provided prior to the transaction, and if the request is made after the transaction, the information must be provided within 30 business days after the request, (iii) that model contract disclosures or other model notice of the contractual terms which are reviewed for accuracy no less than quarterly and updated within 30 days as necessary are maintained on the Financial Institution's Web site, and (iv) that the Financial Institution's written description of its policies and procedures adopted in

[40] Black's Law Dictionary 10th ed. (2014).

accordance with Section II(d) is available free of charge on the Financial Institution's Web site; and

(4) Describe whether or not the Adviser and Financial Institution will monitor the Retirement Investor's investments that are acquired through a Principal Transaction or Riskless Principal Transaction and alert the Retirement Investor to any recommended change to those investments and, if so, the frequency with which the monitoring will occur and the reasons for which the Retirement Investor will be alerted.

By "clearly and prominently in a single written disclosure," the Department means that the Financial Institution may provide a document prepared for this purpose containing only the required information, or include the information in a specific section of the contract in which the disclosure information is provided, rather than requiring the Retirement Investor to locate the relevant information in several places throughout a larger disclosure or series of disclosures.

In addition, Section II(e)(5) of the exemption provides a mechanism for correcting disclosure errors, without losing the exemption. It provides that the Financial Institution will not fail to satisfy Section II(e), or violate a contractual provision based thereon, solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, or if the Web site is temporarily inaccessible, provided that (i) in the case of an error or omission on the web, the Financial Institution discloses the correct information as soon as practicable, but not later than 7 days after the date on which it discovers or reasonably should have discovered the error or omission, and (ii) in the case of other disclosures, the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. Section II(e)(5) further provides that to the extent compliance with the contract disclosure requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

Several commenters supported the proposed disclosures. Commenters recognized that well-designed disclosure can serve multiple purposes, including facilitating informed investment decisions. However, even if investors do not carefully review the disclosures they receive, commenters perceived a benefit to investors from the greater transparency of public disclosure. For example, Financial Institutions may change practices that run contrary to Retirement Investors' interests rather than disclose them publicly. One commenter suggested the disclosures should be strengthened and required for all retirement savings products, even beyond the scope of the Regulation and this exemption.

As proposed, the provision required disclosure of complete information about all the fees and other payments currently associated with the Retirement Investor's investments. Commenters objected to this as overly broad, given the exemption's limitation to principal transactions. The Department accepted this comment, and limited the disclosure to the information about the principal traded asset, including its purchase or sales price and other salient attributes, while still ensuring timely access by the Retirement Investor. By salient attributes, the Department means the credit quality of the issuer, the effective yield, the call provisions, and the duration, among other similar attributes, and the Department recognizes that the salient attributes will differ depending on the principal traded asset. In accepting this comment, the Department did not elect to modify the disclosure requirement further with qualifiers such as "reasonably" or "in the Financial Institution's possession." The Department believes that no additional limitation need be placed on the rights of the Retirement Investor to request information because, if a Financial Institution is advising a Retirement Investor to enter into a principal transaction or a riskless principal transaction, it should have all of the salient information available when providing that advice. The Department also made a clarification, requested by a commenter, that the Retirement Investor's consent must be withdrawn in writing. The Department concurs that this will provide additional certainty to the parties.

FINRA's suggestion that the parties agree on the extent of monitoring of the Retirement Investor's investments was adopted, in Section II(e)(4). In making this determination, Financial Institutions should carefully consider whether certain investments can be prudently recommended to the individual Retirement Investor, in the first place, without a mechanism in place for the ongoing monitoring of the investment. Finally, a number of commenters requested relief for good faith, inadvertent failure to comply with the exemption. A specific provision applicable to the Section II(e) disclosures is included in Section II(e)(5).

8. Ineligible Provisions

Under Section II(f) of the final exemption, relief is not available if a Financial Institution's contract with Retirement Investors regarding investments in IRAs and non-ERISA plans contains the following:

(1) Exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms;

(2) Except as provided in paragraph (f)(4), 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 Adviser or Financial Institution, or in an individual or class claim agrees to an amount representing liquidated damages for breach of the contract; provided that the parties may 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; or

(3) Agreements 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 this exemption.

Section II(f)(4) provides that, in the event the provision on pre-dispute arbitration agreements for class or representative claims in paragraph (f)(2) is ruled invalid by a court of competent jurisdiction, this provision shall not be a condition of the exemption with respect to contracts subject to the court's jurisdiction unless and until the court's decision is reversed, but all other terms of the exemption shall remain in effect.

The purpose of Section II(f) is to ensure that Retirement Investors receive the full benefit of the exemption's protections, by preventing them from being contracted away. If an Adviser makes a recommendation regarding a principal transaction or a riskless principal transaction, for compensation, within the meaning of the Regulation, he or she may not disclaim the duties or liabilities that flow from that recommendation. For similar reasons, the exemption is not available if the contract includes provisions that purport to waive a Retirement Investor's right to bring or participate in class actions. However, contract provisions in which Retirement Investors agree to arbitrate any individual disputes are allowed to the extent permitted by applicable state law. Moreover, Section II(f) does not prevent Retirement Investors from voluntarily agreeing to arbitrate class or representative claims after the dispute has arisen.

The Department's approach in this respect is consistent with FINRA's rules permitting mandatory pre-dispute arbitration for individual claims, but not for class action claims.[41] This rule was adopted in 1992, in response to a directive, articulated by former SEC Chairman David Ruder, that investors have access to courts in appropriate cases.[42] Section 12000 of the FINRA manual establishes a Code of Arbitration Procedure for Customer Disputes which sets forth rules on, *inter alia,* filing claims, amending pleadings, prehearing conferences, discovery, and sanctions for improper behavior.

A number of commenters addressed the proposed approach to arbitration and the other ineligible provisions of Section II(f). A discussion of the comments and the Department's responses follow.

a. Exculpatory Provisions

The Department included Section II(f)(1) in the final exemption without changes from the proposal. Commenters did, however, raise a few questions on the provision. In particular, commenters asked whether the contract could disclaim liability for acts or omissions of third parties, and whether there could be venue selection clauses. In addition, commenters asked whether the contract could require exhaustion of arbitration or mediation before filing in court. Section II(f)(1) does not prevent a Financial Institution's contract with IRA and non-ERISA plan investors from disclaiming liability for acts or omissions of third parties to the extent permissible under applicable law. In addition, for individual claims, reasonable arbitration and mediation requirements are not prohibited. In response to questions about venue selection, the final exemption includes a new Section II(f)(3), which provides that investors may not be required to arbitrate or mediate their individual claims in venues that are distant or that otherwise unreasonably limit their ability to assert the claims safeguarded by this exemption.

The Department has not revised Section II(f) to address every provision that may or may not be included in the contract. While some commenters submitted specific requests regarding specific contract language, and others suggested the Department provide model contracts for Financial Institutions to use, the Department has declined to make these changes in the exemption. The Department notes that Section II(f)(1) prohibits all exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms, and Section II(g)(5) prohibits Financial Institutions and Advisers from purporting to disclaim any responsibility or liability for any responsibility, obligation, or duty under Title I of ERISA to the extent the disclaimer would be prohibited by Section 410 of ERISA. Therefore, in response to comments regarding choice of law provisions, modifying ERISA's statute of limitations, and imposing obligations on the Retirement Investor, the Financial Institutions must determine whether their specific provisions are exculpatory and would disclaim or limit their liability under ERISA, or that of their Advisers. If so, they are not permitted. The Department will provide additional guidance in response to questions and enforcement proceedings

b. Arbitration

Section II(f)(2) of the final exemption adopts the approach, as proposed, that individual claims may be the subject of contractual pre-dispute binding arbitration. Class or other representative claims, however, must be allowed to proceed in court. The final exemption also provides that contract provisions may not limit recoveries to an amount representing liquidated damages for breach of the contract. However, the final exemption expressly permits Retirement Investors to knowingly waive their rights to obtain punitive damages or rescission of recommended transactions to the extent such waivers are permitted under applicable law. Commenters were divided on the approach taken in the proposal, as discussed below.

Some commenters objected to limiting Retirement Investors' right to sue in court on individual claims and specifically focused on the FINRA arbitration process. These commenters described FINRA's process as an unequal playing field, with insufficient protections for individual investors. They asserted that arbitrators are not required to follow federal or state laws, and so would not be required to enforce the terms of the contract. In addition, commenters complained that the decision of an arbitrator generally is not subject to appeal and cannot be overturned by any court. According to these commenters, even when the arbitrators find in favor of the consumer, the consumers often receive significantly smaller recoveries than they deserve. Moreover, some asserted that binding pre-dispute arbitration may be contrary to the legislative intent of ERISA, which provides for "ready access to federal courts."

Some commenters opposed to arbitration indicated that preserving the right to bring or participate in class actions in court would not give Retirement Investors sufficient access to courts. According to these commenters, allowing Financial Institutions to require resolution of individual claims by arbitration would impose additional and unnecessary hurdles on investors seeking to enforce the Best Interest standard. One commenter warned that the Regulation would make it more difficult for Retirement Investors to pursue class actions because the individualized requirements for proving fiduciary status could undermine any claims about commonality. Commenters said that class action lawsuits tend to be expensive and protracted, and even where successful, investors often recover only a small portion of their losses.

Other commenters just as forcefully supported pre-dispute binding arbitration agreements. Some asserted that arbitration is generally quicker and less costly than judicial proceedings. They argued that FINRA has well-developed protections in place to protect the interests of aggrieved investors. One commenter pointed out that FINRA requires that the arbitration provisions of a contract be highlighted and disclosed to the customer, and that customers be allowed to choose an "all-

[41] FINRA rule 12204(a) provides that class actions may not be arbitrated under the FINRA Code of Arbitration Procedures. FINRA rule 2268(d)(3) provides that no predispute arbitration agreement may limit the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement. The FINRA Board of Governors has ruled that a broker's predispute arbitration agreement with a customer may not include a waiver of the right to file or participate in a class action in court. *Department of Enforcement* v. *Charles Schwab & Co.* (Complaint 2011029760201) (Apr. 24, 2014).

[42] NASD Notice 92–65 SEC Approval of Amendments Concerning the Exclusion of Class-Action Matters from Arbitration Proceedings and Requiring that Predispute Arbitration Agreements Include a Notice That Class-Action Matters May Not Be Arbitrated, *available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=1660.*

public'' panel of arbitrators.[43] FINRA rules also impose larger filing fees on the industry party than on the investor. Commenters also cited evidence that investors are as likely to prevail in arbitration proceedings as they are in court, and even argued that permitting mandatory arbitration for all disputes would be in investors' best interest.

A number of commenters argued that arbitration should be available for *all* disputes that may arise under the exemption, including class or representative claims. Some of these commenters favored arbitration of class claims due to concerns about costs and potentially greater liability associated with class actions brought in court. Some commenters took the position that the ability of the Retirement Investor to participate in class actions could deter Financial Institutions from relying on the exemption at all.

After consideration of the comments on this subject, the Department has decided to adopt the general approach taken in the proposal. Accordingly, contracts with Retirement Investors may require pre-dispute binding arbitration of individual disputes with the Adviser or Financial Institution. The contract, however, must preserve the Retirement Investor's right to bring or participate in a class action or other representative action in court in such a dispute in order for the exemption to apply.

The Department recognizes that, for many claims, arbitration can be more cost-effective than litigation in court. Moreover, the exemption's requirement that Financial Institutions acknowledge their own and their Advisers' fiduciary status should eliminate an issue that frequently arises in disputes over investment advice. In addition, permitting individual matters to be resolved through arbitration tempers the litigation risk and expense for Financial Institutions, without sacrificing Retirement Investors' ability to secure judicial relief for systemic violations that affect numerous investors through class actions.

On the other hand, the option to pursue class actions in court is an important enforcement mechanism for Retirement Investors. Class actions address systemic violations affecting many different investors. Often the monetary effect on a particular investor is too small to justify the pursuit of an individual claim, even in arbitration. Exposure to class claims creates a powerful incentive for Financial Institutions to carefully supervise individual Advisers, and ensure adherence to the Impartial Conduct Standards. This incentive is enhanced by the transparent and public nature of class proceedings and judicial opinions, as opposed to arbitration decisions, which are less visible and pose less reputational risk to Financial Institutions or Advisers found to have violated their obligations.

The ability to bar investors from bringing or participating in such claims would undermine important investor rights and incentives for Advisers to act in accordance with the Best Interest standard. As one commenter asserted, courts impose significant hurdles for bringing class actions, but where investors can surmount theses hurdles, class actions are particularly well suited for addressing systemic breaches. Although by definition communications to a specific investor generally must have a degree of specificity in order to constitute fiduciary advice, a class of investors should be able to satisfy the requirements of commonality, typicality and numerosity where there is a systemic or wide-spread problem, such as the adoption or implementation of non-compliant policies and procedures applicable to numerous Retirement Investors, the systematic use of prohibited or misaligned financial incentives, or other violations affecting numerous Retirement Investors in a similar way. Moreover, the judicial system ensures that disputes involving numerous retirement investors and systemic issues will be resolved through a well-established framework characterized by impartiality, transparency, and adherence to precedent. The results and reasoning of court decisions serve as a guide for the consistent application of that law in future cases involving other Retirement Investors and Financial Institutions.

This is consistent with the approach long adopted by FINRA and its predecessor self-regulatory organizations. FINRA Arbitration rule 12204 specifically bars class actions from FINRA's arbitration process and requires that pre-dispute arbitration agreements between brokers and customers contain a notice that class action matters may not be arbitrated. In addition, it provides that a broker may not enforce any arbitration agreement against a member of certified or putative class action, until the certification is denied, the class action is decertified, the class member is excluded from, or elects not participate in, the class. This rule was adopted by the National Association of Securities Dealers and approved by the SEC in 1992.[44] In the release announcing this decision, the SEC stated:

> [T]he NASD believes, and the Commission agrees, that the judicial system has already developed the procedures to manage class action claims. Entertaining such claims through arbitration at the NASD would be difficult, duplicative and wasteful. . . . The Commission agrees with the NASD's position that, in all cases, class actions are better handled by the courts and that investors should have access to the courts to resolve class actions efficiently.[45]

In 2014, the FINRA Board of Governors upheld this rule in reviewing an enforcement action.[46]

Additional Protections

One commenter suggested that if the Department preserved the ability of a Financial Institution to require arbitration of claims, it should consider requiring a series of additional safeguards for arbitration proceedings permitted under the exemption. The commenter suggested that the conditions could state that (i) the arbitrator must be qualified and independent; (ii) the arbitration must be held in the location of the person challenging the action; (iii) the cost of the arbitration must be borne by the Financial Institution; (iv) the Financial Institution's attorneys' fees may not be shifted to the Retirement Investor, even if the challenge is unsuccessful; (v) statutory remedies may not be limited or altered by the contract; (vi) access to adequate discovery must be permitted; (vii) there must be a written record and a written decision; (viii) confidentiality requirements and protective orders which would prohibit the use of evidence in subsequent cases must be prohibited. The commenter said that some, but not all, of these procedures are currently required by FINRA.

The Department declines to mandate additional procedural safeguards for arbitration beyond those already mandated by other applicable federal and state law or self-regulatory organizations. In the Department's view, the FINRA arbitration rules, in particular, provide significant safeguards for fair dispute resolution, notwithstanding the concerns raised by some commenters. FINRA's Code of Arbitration Procedures for Customer Disputes applies when required by written agreement between the FINRA member and the customer, or if the

[43] The term ''Public Arbitrator'' is defined in FINRA rule 12100(u). According to FINRA, non-''Public Arbitrators'' are often referred to as ''industry'' arbitrators. *See* Final Report and Recommendations of the FINRA Dispute Resolution Task Force, released December 16, 2015.

[44] SEC Release No. 34–31371 (Oct. 28, 1992), 1992 WL 324491.

[45] *Id.*

[46] FINRA Decision, *Department of Enforcement* v. *Charles Schwab & Co.* (Complaint 2011029760201), p.14 (Apr. 24, 2014).

customer requests arbitration. The rules cover any dispute between the member and the customer that arises from the member's business activities, except for disputes involving insurance business activities of a member that is an insurance company.[47] FINRA's code of procedures also provide detailed instructions for initiating and pursuing an arbitration, including rules for selection of arbitrators (FINRA rule 12400), for discovery of evidence (FINRA rule 12505), and expungement of customer dispute information (FINRA rule 12805), which are designed to allow access by investors and preserve fairness for the parties. In addition, FINRA rule 12213 specifies that FINRA will generally select the hearing location closest to the customer. To the extent that the contracts provide for binding arbitration in individual claims, the Department defers to the judgment of FINRA and other regulatory bodies, such as state insurance regulators, responsible for determining the safeguards applicable to arbitration proceedings.

Federal Arbitration Act

Some commenters asserted that the Department does not have the authority to include the exemption's provisions on class action waivers under the Federal Arbitration Act (FAA), which they said protects enforceable arbitration agreements and expresses a federal policy in favor of arbitration over litigation. Without clear statutory authority to restrict arbitration, these commenters said, the Department cannot include the provisions on class action waivers.

These comments misconstrue the effect of the FAA on the Department's authority to grant exemptions from prohibited transactions. The FAA protects the validity and enforceability of arbitration agreements. Section 2 of the FAA states: ''[a] written provision in any . . . contract . . . to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.'' [48] This Act was intended to reverse judicial hostility to arbitration and to put arbitration agreements on an equal footing with other contracts.[49]

Section II(f)(2) of the exemption is fully consistent with the FAA. The exemption does not purport to render an arbitration provision in a contract between a Financial Institution and a Retirement Investor invalid, revocable, or unenforceable. Nor, contrary to the concerns of one commenter, does Section II(f)(2) prohibit such waivers. Both Institutions and Advisers remain free to invoke and enforce arbitration provisions, including provisions that waive or qualify the right to bring a class action or any representative action in court. Instead, such a contract simply does not meet the conditions for relief from the prohibited transaction provisions of ERISA and the Code. As a result, the Financial Institution and Adviser would remain fully obligated under both ERISA and the Code to refrain from engaging in prohibited transactions. In short, Section II(f)(2) does not affect the validity, revocability, or enforceability of a class-action waiver in favor of individual arbitration. This regulatory scheme is thus a far cry from the State judicially created rules that the Supreme Court has held preempted by the FAA,[50] and the National Labor Relations Board's attempt to prohibit class-action waivers as an ''unfair labor practice.'' [51]

The Department has broad discretion to craft exemptions subject to the Department's overarching obligation to ensure that the exemptions are administratively feasible, in the interests of plan participants, beneficiaries, and IRA owners, and protective of their interests. In this instance, the Department has concluded that the enforcement rights and protections associated with class action litigation are important to safeguarding the Impartial Conduct Standards and other anti-conflict provisions of the exemption. If a Financial Institution enters into a contract requiring binding arbitration of class claims, the Department would not purport to invalidate the provision, but rather would insist that the Financial Institution fully comply with statutory provisions prohibiting conflicted fiduciary transactions in its dealings with its Retirement Investment customers. The FAA is not to the contrary. It neither limits the Department's express grant of discretionary authority over exemptions, nor entitles parties that enter into arbitration agreements to a pass from the prohibited transaction rules.

While the Department is confident that its approach in the exemption does not violate the FAA, it has carefully considered the position taken by several commenters that the Department exceeded the Department's authority in including provisions in the exemption on class and representative claims, and the possibility that a court might rule that the condition regarding arbitration of class claims in Section II(f)(2) of the exemption is invalid based on the FAA. Accordingly, in an abundance of caution, the Department has specifically provided that Section II(f)(2) can be severable if a court finds it invalid based on the FAA. Specifically, Section II(f)(4) provides that:

> In the event that the provision on pre-dispute arbitration agreements for class or representative claims in paragraph (f)(2) of this Section is ruled invalid by a court of competent jurisdiction, this provision shall not be a condition of this exemption with respect to contracts subject to the court's jurisdiction unless and until the court's decision is reversed, but all other terms of the exemption shall remain in effect.

The Department is required to find that the provisions of an exemption are administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of participants and beneficiaries and IRA owners. The Department finds that the exemption with paragraph (f)(2) satisfies these requirements. The Department believes, consistent with the position of the SEC and FINRA, that the courts are generally better equipped to handle class claims than arbitration procedures and that the prohibition on contractual provisions mandating arbitration of such claims helps the Department make the requisite statutory findings for granting an exemption.

Nevertheless, the Department has determined that, based on all the exemption's other conditions, it can still make the necessary findings to grant the exemption even without the condition prohibiting pre-dispute agreements to arbitrate class claims. In particular, if a court were to invalidate the condition, the Department would still find that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries, and protective of the rights of the participants and beneficiaries. It would be less protective, but still sufficient to grant the exemption.

The Department's adoption of the specific severability provision in Section II(f)(4) of the exemption should not be viewed as evidence of the Department's intent that no other conditions of this or the other exemptions granted today are severable if a court were to invalidate them.

[47] FINRA rule 12200.

[48] 9 U.S.C. 2.

[49] *See AT&T Mobility LLC* v. *Concepcion,* 563 U.S. 333, 342 (2011).

[50] *See American Express Co.* v. *Italian Colors Restaurant,* 133 S. Ct. 2304 (2013); *AT&T Mobility LLC* v. *Concepcion,* 563 U.S. 333 (2011).

[51] *See D.R. Horton, Inc.* v. *NLRB,* 737 F.3d 344 (5th Cir. 2013).

Instead, the Department intends that invalidated provisions of the rule and exemptions may be severed when the remainder of the rule and exemptions can function sensibly without them.[52]

c. Remedies

Some commenters asked whether the proposal's prohibition of exculpatory clauses would affect the parties' ability to limit remedies under the contract, particularly regarding liquidated damages, punitive damages, consequential damages and rescission. In response, the Department has added text to Section II(f)(2) in the final exemption clarifying that the parties, in an individual or class claim, may not agree to an amount representing liquidated damages for breach of the contract. However, the exemption, as finalized, expressly permits the parties to 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.

In the Department's view, it is sufficient to the exemptions' protective purposes to permit recovery of actual losses. The availability of such a remedy should ensure that plaintiffs can be made whole for any losses caused by misconduct, and provide an important deterrent for future misconduct. Accordingly, the exemption does not permit the contract to include liquidated damages provisions, which could limit Retirement Investors' ability to obtain make-whole relief.

On the other hand, the exemption permits waiver of punitive damages to the extent permissible under governing law. Similarly, rescission can result in a remedy that is disproportionate to the injury. In cases where an advice fiduciary breached its obligations, but there was no injury to the participant, a rescission remedy can effectively make the fiduciary liable for losses caused by market changes, rather than its misconduct. These new provisions in section II(f)(2) only apply to waiver of the contract claims; they do not qualify or limit statutory enforcement rights under ERISA. Those statutory remedies generally provide for make-whole relief and to rescission in appropriate cases, but they do not provide for punitive damages.

[52] *See Davis County Solid Waste Management* v. *United States Environmental Protection Agency,* 108 F.3d 1454, 1459 (D.C. Cir. 1997) (finding that severability depends on an agency's intent and whether the provisions can operate independently of one another).

9. General Conditions Applicable to Each Transaction (Section III)

Section III of the exemption sets forth conditions that apply to the terms of each principal transaction or a riskless principal transaction entered into under the exemption. Section III(a) applies only to *purchases* by a Plan, participant or beneficiary account, or IRA, of principal traded assets that are debt securities, as defined in the exemption. Section III(b) and (c) apply to both purchase and sale transactions, involving all principal traded assets. Many comments were received with respect to the proposed conditions, and the Department has revised the proposed language to address these comments.

a. Issuer/Underwriter Restrictions

Section III(a)(1) and (2) of the exemption provides that the debt security being bought by the Plan, participant or beneficiary account, or IRA must not have been issued or, at the time of the transaction, underwritten by the Financial Institution or any Affiliate. The Department received comments generally objecting to these conditions as unduly limiting investment opportunities to Retirement Investors. Commenters argued that many debt securities will only be available for purchase by a Retirement Investor on a principal basis as part of the initial issuance or underwriting since the debt securities are not frequently resold in small lots to retail investors on either a principal or an agency basis.

The Department is sympathetic to the commenters' position, but has determined to adopt the language without modification. This reflects the Department's concerns that additional conflicts of interest are inherent in transactions where the issuer or underwriter of a security (whether debt or equity) is a fiduciary to a plan or IRA. In such instances, the Financial Institution generally has either been retained by a third party to sell securities as part of an underwriting and has made guarantees as to such sales and will likely profit from such sales more than in a traditional principal transaction or is issuing securities on its own behalf for the specific purposes of benefiting itself. Further, since generally the issued or underwritten securities are being issued or underwritten by the Financial Institution for the first time, heightened issues regarding pricing and liquidity result. Since these unique conflicts exist with respect to both issuance and underwriting transactions, they would require conditions unique to issuance and underwriter principal transactions, respectively. This exemption was not designed to address such conflicts. The Department believes that permitting such transactions without applying additional conditions would not be protective of participants and beneficiaries of plans and IRA owners. Parties seeking relief for such transactions are encouraged to seek an individual exemption from the Department.

b. Credit Standards and Liquidity

Section III(a)(3) of the exemption requires that, using information reasonably available to the Adviser at the time of the transaction, the Adviser must determine that the debt security being purchased by the Plan, participant or beneficiary account, or IRA, possesses no greater than a moderate credit risk and is sufficiently liquid that the debt security could be sold at or near its carrying value within a reasonably short period of time. Debt securities subject to a moderate credit risk should possess at least average credit-worthiness relative to other similar debt issues. Moderate credit risk would denote current low expectations of default risk, with an adequate capacity for payment of principal and interest.

This condition is intended to identify investment grade securities, and avoid the circumstance in which an investment advice fiduciary can recommend speculative debt securities and then sell them to the Plan, participant or beneficiary account, or IRA, from its own inventory. The SEC used similar provisions in setting credit standards in its regulations, including its Rule 6a–5 issued under the Investment Company Act.[53]

Some commenters on this aspect of the proposal generally objected to the condition's lack of objectivity. Some requested that the Department instead specifically condition the exemption on the security's being "investment grade," rather than the proposed credit and liquidity standards. While the Department generally intends the exemption to be limited to securities that a reasonable investor would treat as investment grade securities, Section 939A of the Dodd-Frank Act provides that the Department may not "reference or rely on" credit ratings—including "investment grade"—in the exemption's conditions. Accordingly, Advisers and Financial Institutions wishing to rely on the exemption must make a reasonable determination of creditworthiness,

[53] 17 CFR 270.6a–5, 77 FR 70117 (November 23, 2012).

without automatic adherence to specified credit ratings.

Another commenter suggested that the Department replace the liquidity component of the standard with the provision of two quotes or a requirement that the Financial Institution reasonably believe a principal transaction provides a better price than would be available in the absence of a principal transaction. The Department agrees that it is important that the price of the principal transaction or a riskless principal transaction is reasonable and has conditioned the exemption on the Adviser and Financial Institution's commitment to seek to obtain the best execution reasonably available under the circumstances with respect to the transaction (and for FINRA members, specifically on satisfaction of FINRA rules 2121 (Fair Prices and Commissions) and 5310 (Best Execution and Interpositioning)). However, the Department determined not to replace the liquidity component with the two quote requirement in light of commenters' views that the requirement was unlikely to be workable or effective in achieving the Department's aims.

Other commenters focused on the timing associated with the liquidity component of the condition. They expressed concern that the condition may apply throughout the time period in which the security is held by the Retirement Investor. The Department revised the operative text to make clear that the standard must be satisfied based on the information reasonably available to the Adviser at the time of the transaction and not thereafter. Nevertheless, the Department notes that the Adviser's consideration of whether the recommendation is in the Retirement Investor's Best Interest may also need to include consideration of information that is reasonably available regarding restrictions or near term expected performance of the debt security, in light of the Retirement Investor's needs and objectives. The Department additionally eliminated the credit standards with respect to sales from a plan, participant or beneficiary account, or IRA; accordingly, this condition will not stand in the way of a plan or IRA selling a security that no longer meets the credit standards to a Financial Institution in a principal transaction. The purpose of the liquidity condition was to protect Retirement Investors from the dangers associated with a conflicted Adviser saddling them with low-quality securities, not to prevent them from disposing of such securities.

Commenters also argued that although the Department cited the similar credit standards set forth in the SEC's Rule 6a–5 issued under the Investment Company Act, the Department's reliance on SEC language as a template for the credit risk language is not necessarily appropriate because the SEC uses the language for a different purpose unrelated to retail accounts. While in a different context, the SEC's adoption of similar language supports the Department's view that Financial Institutions are capable of implementing the standard. For that reason, the SEC language remains relevant. Further, the Department itself has previously proposed the use of the same language in multiple class exemptions without material objections by the financial services industry to the workability of the language.[54]

Some commenters also indicated that the Department's use of the term "fair market value" in the proposal, in place of the term "carrying value," that is used in the SEC standard, was confusing. In response, the Department revised the final exemption to use the term "carrying value" rather than "fair market value." In addition, the Department adopted the suggestion of a commenter that Financial Institutions be required to establish policies and procedures to determine how credit risk and liquidity assessments will be made and to develop standards for such assessments. This requirement is in Section II(d), discussed above, and is intended to provide a mechanism for Financial Institutions to operationalize this requirement. As revised, the Department believes that the credit standards condition can serve a protective role without being too vague or operationally difficult.

In addition to operational concerns, commenters addressed whether credit standards should be part of the exemption at all. Some commenters opposed both the credit and liquidity conditions on the grounds that the Department was substituting the Department's judgment for the judgment of Retirement Investors. Other commenters, however, supported the Department's approach as imposing appropriate safeguards against the added risk associated with investment advice fiduciaries recommending principal transactions and riskless principal transactions involving securities that possess substantial credit risk or are thinly traded.

The Department has decided to retain the credit standards. First, the exemption addresses only those principal transactions and riskless principal transactions that are the result of the provision of fiduciary investment advice. To the extent that a Retirement Investor is truly acting on his or her own without the advice of an investment advice fiduciary, the necessary exemptive relief already exists. As discussed above, Part II of PTE 75–1 currently provides relief from ERISA section 406(a) for principal transactions so long as the broker-dealer or bank does not render investment advice with respect to the assets involved in the principal transaction. Second, the most commonly held categories of debt securities will continue to be available to plans and IRAs.

Most importantly, with respect to investment advice that is being provided by an investment advice fiduciary, the Department believes that inherent conflicts of interest justify the credit and liquidity conditions. As discussed elsewhere in this preamble, principal transactions in particular raise significant conflicts of interest, and are often associated with substantial pricing, transparency and liquidity issues. These concerns are magnified when a debt security is of lesser quality. Further, beyond the Department's heightened concerns regarding pricing, transparency and liquidity, Financial Institutions may generate higher levels of compensation with respect to lower quality debt securities, generating additional conflicts that would otherwise be absent from principal transactions and riskless principal transactions. Finally, the Department notes that other prohibited transaction exemptions granted by the Department permitting principal transactions between plans and plan fiduciaries also contain similar credit standards.[55]

c. Agreement, Arrangement or Understanding

Section III(b) provides that a principal transaction or a riskless principal transaction may not be part of an agreement, arrangement, or understanding designed to evade compliance with ERISA or the Code, or to otherwise impact the value of the principal traded asset. Such a condition protects against the Adviser or Financial Institution manipulating the terms of the principal transaction or a riskless principal transaction, either as an isolated transaction or as a part of a

[54] *See,* 78 FR 37572 (June 21, 2013).

[55] *See* PTE 75–1, Part IV, Exemptions from Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks, 40 FR 50845 (Oct. 31, 2006), proposed amendment pending, 78 FR 37572 (Friday, June 21, 2013).

series of transactions, to benefit themselves or their Affiliates. Further, this condition would also prohibit an Adviser or Financial Institution from engaging in principal transactions with Retirement Investors for the purpose of ridding inventory of unwanted or poorly performing principal traded assets. The Department did not receive comments on this condition, and it has been adopted as proposed, with the substitution of the term ''principal traded asset'' for ''debt security.''

d. Cash

Section III(c) requires that the purchase or sale of the principal traded asset must be for no consideration other than cash. By limiting a purchase or sale to cash consideration, the Department intends that relief will not be provided for a principal transaction or a riskless principal transaction that is executed on an in-kind basis. The limitation to cash reflects the Department's concern that in-kind transactions create complexity and additional conflicts of interest because of the need to value the in-kind asset involved in the transaction. The Department did not receive comments on this condition, and it was adopted as proposed.

e. Proposed Pricing Condition

Section III(d) of the proposal addressed the pricing of the principal transaction by proposing that the purchase or sale occur at a price that (1) the Adviser and Financial Institution reasonably believe is at least as favorable to the plan, participant or beneficiary account, or IRA, as the price available in a transaction that is not a principal transaction, and (2) is at least as favorable to the plan, participant or beneficiary account, or IRA, as the contemporaneous price for the security, or a similar security if a price is not available for the same security, offered by two ready and willing counterparties that are not Affiliates of the Adviser or Financial Institution. The proposal further provided that when comparing the prices, the Adviser and Financial Institution could take into account commissions and mark-ups/mark-downs.

Many commenters raised concerns regarding the practicality of the two quote process outlined in proposed Section III(d)(2). A number of commenters did not believe that the two quote process would be workable. They said that two quotes may not be available on all securities, particularly corporate debt securities. They further expressed uncertainty about the meaning of the ''similar securities'' that could be substituted. In addition, commenters indicated that the time needed to go through the two quote process could interfere with a Financial Institution's duty of best execution under FINRA rule 5310, or in any event could slow the execution of a transaction, to the detriment of the Retirement Investor. FINRA suggested the exemption should be conditioned on FINRA rule 5310 instead of the proposed two quote requirement.

Further, the Department has come to believe that the quotes themselves may not be reliable measure of fair price because they are solicited as comparisons rather than with the intent to purchase or sell. A Financial Institution might be less than rigorous in its solicitation of the two quotes, perhaps seeking quotes that simply validate the Financial Institution's opinion of the appropriate price for the principal transaction. In light of such comments and concerns, the Department did not adopt the two quote requirement.

However, in order to address the Department's concern about the price of the transaction, as discussed in more detail above, the exemption requires that Advisers and Financial Institutions engaging in the transactions seek to obtain the best execution reasonably available under the circumstances. For FINRA members, the final exemption provides that they must comply with FINRA rules 2121 and 5310. These rules provide for best execution and fair pricing, and they will ensure that the Financial Institution does not use its relationship with a plan or IRA to benefit financially to the detriment of the plan or IRA.

One commenter expressed strong support for the intent behind the pricing conditions to protect Retirement Investors. The commenter expressed concern, however, that Financial Institutions could work around the proposed pricing conditions, resulting in the conditions failing to provide the anticipated protections to Retirement Investors. The commenter suggested that Financial Institutions be required to articulate why the principal transaction is in the Retirement Investor's Best Interest and provide current market data, available from FINRA's TRACE system, for example, to back up such articulation. Another commenter also suggested that specific pricing information could be made available on request.

The Department believes that the Department's approach in Section II(c)(2) of the final exemption Impartial Conduct Standards implements the intent of the pricing condition proposed in Section III(d)(1). The Department did not adopt the suggestion to require the provision of current market data based upon its concern that the additional costs would likely outweigh the benefits, particularly for retail investors. Because of the nature of the marketplace for principal traded assets, current market data is often difficult to analyze and apply to an individual transaction involving the same asset. Such difficulties are particularly problematic with respect to less sophisticated Retirement Investors who will not have the analytic tools at their disposal to interpret any market data that could be provided to them. Consequently, disclosure of such data would likely be of limited value to retail investors. To the extent that the information would be useful to more sophisticated Retirement Investors, such Retirement Investors typically have the information and necessary analytic tools already available.

10. Disclosure Requirement (Section IV)

a. Pre-Transaction Disclosure

Section IV(a) of the exemption requires that, prior to or at the same time as the execution of the transaction, the Adviser or Financial Institution must provide the Retirement Investor, orally or in writing, a disclosure of the capacity in which the Financial Institution may act with respect to the transaction. By ''capacity in which the Financial Institution may act,'' the Department means that the Financial Institution must notify the Retirement Investor if it may act as principal in the transaction. This requirement is intended to harmonize with the SEC's Temporary Rule 206(3)–3T, which has a similar pre-transaction requirement. Such a harmonization allows for a streamlined disclosure requirement, which places less burden on the Financial Institutions.

In the proposal, Section IV(a) would have required the Adviser or Financial Institution to provide a statement, prior to engaging in the principal transaction, that the purchase or sale would be executed as a principal transaction. A few commenters indicated that they would not always know if the transaction would be executed as a principal transaction prior to the transaction. These commenters suggested that the Department adopt the approach in the SEC's Temporary Rule 206(3)–3T, which a commenter said, requires that an investment adviser inform the client ''of the capacity in which it may act with respect to such transaction.'' A commenter said this formulation recognized that the investment adviser may not know at that time whether the transaction would be executed as a principal transaction. The Department concurs with this comment and has revised the pre-transaction disclosure to more closely match the language in the SEC's Temporary Rule.

Some commenters indicated that the Department's requirement in Section IV(a) was burdensome in that they perceived it to require the Retirement Investor's affirmative consent to the specific terms of the transaction in advance of the execution. In response, the Department notes that the proposal did not, and the final exemption does not, contemplate such consent. However, the Department notes that the exemption is limited to Advisers and Financial Institutions that act in a non-discretionary capacity.

The proposed pre-transaction disclosure also would have required disclosure of the two quotes received from unrelated counterparties and the mark-up, mark-down or other payment to be applied to the principal transaction.[56] Commenters pointed to logistical problems involved in determining a true mark-up/mark-down amount when multiple, unrelated brokers facilitate the principal transaction. They asserted that, in the absence of contextual information, the disclosure of the mark-up/mark-down may not be useful to Retirement Investors. A few commenters suggested that the Department require the disclosure of the maximum and minimum possible mark-up or mark-down, with one commenter suggesting that more specific information could be made available upon request. The preamble to the proposed exemption discussed the possibility of defining the mark-up/mark-down by reference to FINRA rule 2121 and the related guidance, and asked for comment on the approach. One commenter, however, said the Department did not provide any methodology for the mark-up/mark-down disclosure requirement and, as a result, the Department's approach would lead to confusion and inconsistent application of the pricing condition. Other commenters suggested that the Department defer to other regulatory and legislative initiatives regarding mark-up/mark-down disclosure—in particular, FINRA's proposed disclosures in FINRA Regulatory Notice 14–52.

The Department was persuaded by the commenters that required disclosure of the mark-up or mark-down might introduce significant complexity to compliance with the exemption, in particular with respect to transactions that could be covered by FINRA's pending disclosure requirement, and therefore has not adopted the mark-up/mark-down disclosure requirement in the final exemption. Commenters' suggestions to require disclosure of the minimum and maximum mark-up/mark-down were not adopted because the Department believes that this disclosure would not be specific enough to benefit Retirement Investors.

b. Confirmation

Section IV(b) of the proposal would have required a written confirmation in accordance with Rule 10b–10 under the Exchange Act, that also includes disclosure of the mark-up, mark-down or other payment to be applied to the principal transaction. A number of comments noted that Rule 10b–10 does not currently include disclosure of the mark-up or mark-down, and making the change would be costly. There were also significant comments, discussed elsewhere, as to the practicality of the mark-up or mark-down disclosure, such that the Department determined not to require the disclosure as discussed above. As a result, the requirement to include a mark-up or mark-down as part of the confirmation has been eliminated. Section IV(b) now simply requires the issuance of a confirmation of the transaction. The requirement to provide a confirmation may be met by compliance with the existing Rule 10b–10, or any successor rule in effect at the time of the transaction, or for Advisers and Financial Institutions not subject to the Exchange Act, similar requirements imposed by another regulator or self-regulatory organization.

c. Annual Disclosure

Section IV(c) sets forth a requirement under which the Adviser or Financial Institution must provide certain written information clearly and prominently in a single written disclosure to the Retirement Investor on an annual basis. The annual disclosure must include: (1) A list identifying each principal transaction and riskless principal transaction executed in the Retirement Investor's account in reliance on this exemption during the applicable period and the date and price at which the transaction occurred; and (2) a statement that (i) the consent required pursuant to Section II(e)(2) is terminable at will upon written notice, without penalty to the Plan or IRA, (ii) the right of a Retirement Investor in accordance with Section II(e)(3)(ii) to obtain, free of charge, information about the Principal Traded Asset, including its salient attributes, (iii) model contract disclosures or other model notice of the contractual terms which are reviewed for accuracy no less than quarterly updated within 30 days as necessary are maintained on the Financial Institution's Web site, and (iv) the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d) are available free of charge on the Financial Institution's Web site.

With respect to this requirement, Section IV(d) of the exemption includes a good faith compliance provision, under which the Financial Institution will not fail to satisfy Section IV solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information or if the Web site is temporarily inaccessible, provided that (i) in the case of an error or omission on the web, the Financial Institution discloses the correct information as soon as practicable, but not later than 7 days after the date on which it discovers or reasonably should have discovered the error or omission, and (ii) in the case of other disclosures, the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after that date on which it discovers or reasonably should have discovered the error or omission. In addition, to the extent compliance with the annual disclosure requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, the exemption provides that they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

The proposal included an annual disclosure requirement in Section IV(c) that would have included the following elements:

(1) A list identifying each principal transaction engaged in during the applicable period, the prevailing market price at which the Debt Security was purchased or sold, and

[56] As discussed above, the proposed two quote requirement was not adopted in the final exemption.

the applicable mark-up or mark-down or other payment for each Debt Security; and

(2) A statement that the consent required pursuant to Section II(e)(2) is terminable at will, without penalty to the Plan or IRA.

The disclosure would have been required to be made within 45 days after the end of the applicable year.

As finalized, the annual disclosure now includes a list of the principal transactions and riskless principal transactions entered into in reliance on this exemption, and the date and price at which they occurred. As discussed elsewhere in this preamble, the final exemption does not include the disclosure of the mark-up or mark-down in this final exemption. However, the disclosure in the final exemption includes a reminder of the Retirement Investor's right (in accordance with Section II(e)(3)(ii) of the exemption) to obtain, free of charge, information about the principal traded asset, including its salient attributes.

The final exemption also more closely harmonizes with the SEC's Temporary Rule 206(3)–3T, as requested by some commenters. First, the Department removed the proposed condition that the annual disclosure be provided within 45 days after the end of the applicable year, in favor of the language used in the Temporary Rule that the disclosure be provided ''no less frequently than annually.'' Second, the Department added the requirement that the annual disclosure provide the date on which the transaction occurred, and a clarification that the disclosure is only required with respect to principal transactions and riskless principal transactions entered into pursuant to this exemption. These elements also harmonize with the SEC's Temporary Rule. As with the pre-transaction disclosure, the harmonization of the annual disclosure should ease compliance for Financial Institutions.

The Department adopted the annual disclosure, despite comments indicating it was unnecessary and duplicative of other disclosures. The annual disclosure provides a summary of the principal transactions and riskless principal transactions entered into during the reporting period and serves a unique purpose in collecting the information provided in the other disclosures. The annual disclosure provides Retirement Investors with the opportunity to review and evaluate all of the principal transactions and riskless principal transactions that occurred under the terms of the exemption during that period. The information provided may give Retirement Investors perspective that they do not gain from the individual confirmations.

Finally, a few commenters objected to Section IV(d) of the proposal, which would have required disclosure of information about the debt security and its purchase or sale, upon reasonable request of the Retirement Investor. Such right of request was viewed as unbounded. The Department concurs with the commenters and has deleted Section IV(d). The Department believes the provision in Section IV(c)(2), that a notice must be provided of the Retirement Investor's right to obtain, free of charge, information about the Principal Traded Asset, including its salient attributes, serves the same function. As discussed above, one commenter requested that the information must be reasonably available and in the Financial Institution's possession. The Department believes that no additional limitation need be placed on the rights of the Retirement Investor to request information because, if a Financial Institution is advising a Retirement Investor to enter into a principal transaction or a riskless principal transaction, it should have all of the salient information available when providing that advice.

11. Recordkeeping (Section V)

Under Section V(a) and (b) of the exemption, the Financial Institution must maintain for six years records necessary for the Department and certain other entities, including plan fiduciaries, participants, beneficiaries and IRA owners, to determine whether the conditions of the exemption have been satisfied. Some commenters stated that they were unsure what information would have to be saved for six years. The Department notes that the language requires that records necessary to demonstrate compliance with the exemption's conditions must be maintained.

The final exemption includes changes to the recordkeeping provision made in accordance with comments on other exemption proposals in connection with the Regulation. First, the text was revised to make clear that the records must be ''reasonably accessible for examination,'' to remove the subjective views of the person requesting to examine or audit the records. The section also clarifies that fiduciaries, employers, employee organizations, participants and their employees and representatives only have access to information concerning their own plans. In addition, Financial Institutions are not required to disclose privileged trade secrets or privileged commercial or financial information to any of the parties other than the Department, as was also true of the proposal. Financial Institutions are also not required to disclose records if such disclosure would be precluded by 12 U.S.C. 484, relating to visitorial powers over national banks and federal savings associations.[57] As revised, the exemption requires the records be ''reasonably'' available, rather than ''unconditionally available.'' Finally, additional language was added to clarify that any failure to maintain the required records with respect to a given transaction or set of transactions does not affect the relief for other transactions.

The recordkeeping provision in the exemption is necessary to demonstrate compliance with the terms of the exemption and therefore should represent prudent business practices in any event. The Department notes that similar language is used in many other exemptions and has been the Department's standard recordkeeping requirement for exemptions for some time.

12. Definitions (Section VI)

Section VI of the exemption provides definitions of the terms used in the exemption. Most of the definitions received no comment, and they are finalized as proposed. Those terms that have been revised or received comment are below. Additional comments on definitions, such as ''Best Interest,'' ''Principal Transaction'' and ''Material Conflict of Interest,'' are discussed above in their respective sections.

a. Adviser

The exemption contemplates that an individual person, an Adviser, will provide advice to the Retirement Investor. An Adviser must be an investment advice fiduciary of a plan or IRA who is an employee, independent contractor, agent, or registered representative of a Financial Institution, and the Adviser must satisfy the applicable federal and state regulatory and licensing requirements of banking and securities laws with respect to the covered transaction.[58] Advisers may be, for example, registered representatives

[57] A commenter with respect to the Best Interest Contract Exemption raised concerns that the Department's right to review a bank's records under that exemption could conflict with federal banking laws that prohibit agencies other than the Office of the Comptroller of the Currency (OCC) from exercising ''visitorial'' powers over national banks and federal savings associations. To address the comment, Financial Institutions are not required to disclose records if the disclosure would be precluded by 12 U.S.C. 484. A corresponding change was made in this exemption.

[58] *See* Section VI(a) of the exemption.

of broker-dealers registered under the Exchange Act.

One commenter suggested that applicable federal and state regulatory and licensing language, similar to that in the Best Interest Contract Exemption proposal, be added to the definition. The Department agrees with the commenter, and the exemption contains the suggested language.

b. Financial Institutions

A Financial Institution is the entity that employs an Adviser or otherwise retains the Adviser as an independent contractor, agent or registered representative and customarily purchases or sells Principal Traded Assets for its own account in the ordinary course of its business.[59] Financial Institutions must be investment advisers registered under the Investment Advisers Act of 1940 or state law, banks, or registered broker-dealers.

The Department specifically requested comment on whether there are other types of Financial Institutions that should be included in the definition. No comments were received regarding the need for additional entities to be included. The only comments regarding the definition that were received addressed the language in the proposal that would have required that advice by a bank be delivered through the bank's trust department. Commenters indicated that the language serves no material purpose. As a result, the definition is finalized as proposed with the exception of the removal of the trust requirement.

c. Debt Securities and Principal Traded Assets

As discussed in detail above with respect to the scope of the exemption, the Department heard from many commenters that wanted to expand the scope of the assets that would be eligible to participate in principal transactions under the exemption. After a review of individual investments, the Department revised the proposal to include asset backed securities, CDs, UITs and additional investments later determined to be added through individual exemptions. Further, with respect to *sales* by a plan or IRA in a principal transaction or a riskless principal transaction, all securities or other property are provided exemptive relief. The Department operationalized these additions by revising the proposed definition of a debt security to include asset backed securities guaranteed by an agency or a government sponsored enterprise, both within the meaning of FINRA rule 6710. Further, in order to capture the remaining investments, the new defined term "principal traded asset" was included in Section VI. The definition of a principal traded asset encompasses both the definition of "debt security" and the other investments listed herein.

In addition to the comments discussed above, one commenter stated that requiring that a debt security be offered pursuant to a registration statement under the Securities Act of 1933 was difficult to comply with operationally in the secondary market. The commenter argued that the requirement could be eliminated in reliance on the Best Interest standard. The Department does not agree, and the language is finalized as proposed. Requiring that a security be registered is a straightforward mechanism by which the Department can ensure a base level of regulatory compliance and quality. An Adviser or Financial Institution should be able to verify the registration of a particular debt security by using a variety of sources.

d. Affiliate

Section VI(b) defines "Affiliate" of an Adviser or Financial Institution as:

(1) Any person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution. For this purpose, the term "control" means the power to exercise a controlling influence over the management or policies of a person other than an individual;

(2) Any officer, director, partner, employee, or relative (as defined in ERISA section 3(15)), of the Adviser or Financial Institution; or

(3) Any corporation or partnership of which the Adviser or Financial Institution is an officer, director, or partner of the Adviser or Financial Institution.

The Department received a comment requesting that this definition adopt a securities law definition. The commenter expressed the view that use of a separate definition would make compliance more difficult for broker-dealers. The Department did not accept this comment. Instead, the Department made minor adjustments so that the definition is identical to the affiliate definition incorporated in prior exemptions under ERISA and the Code, that are applicable to broker dealers,[60] as well as the definition that is used in the Regulation. Therefore, the definition should not be new to the broker-dealer community, and is consistent with other applicable laws.

e. Independent

The term Independent is used in Section I(c)(2)(ii), which precludes Financial Institutions and Advisers from relying on the exemption if they are the named fiduciary or plan administrator, as defined in ERISA section 3(16)(A), with respect to an ERISA-covered plan, unless such Financial Institutions or Advisers are selected to provide advice to the plan by a plan fiduciary that is Independent of the Financial Institutions or Advisers.

In the proposed exemption, the definition of Independent provided that the person (*e.g.,* the independent fiduciary appointing the Adviser or Financial Institution under Section I(c)(2)(ii)) could not receive any compensation or other consideration for his or her own account from the Adviser, the Financial Institution or an Affiliate. A commenter indicated that as a result, a number of parties providing services to the Financial Institution, and receiving compensation in return, could not satisfy the Independence requirement. The commenter suggested defining entities that receive less than 5% of their gross income from the fiduciary as Independent.

In response, the Department revised the definition of Independent so that it provides that the person's compensation from the Financial Institution may not be in excess of 2% of the person's annual revenues based on the prior year. This approach is consistent with the Department's general approach to fiduciary independence. For example, the prohibited transaction exemption procedures provide a presumption of independence for appraisers and fiduciaries if the revenue they receive from a party is not more than 2% of their total annual revenue.[61] The Department has revised the definition accordingly.[62]

C. Good Faith

Commenters requested that the exemption continue to apply in the event of a Financial Institution's or Adviser's good faith failure to comply with one or more of the conditions. In the commenters' views, the exemption was sufficiently complex and the implementation timeline sufficiently short to justify such a provision. For example, FINRA suggested that the Department include a provision for continued application of the exemption

[59] *See* Section VI(e) of the exemption.

[60] *See, e.g.,* PTE 75–1, Part II, 40 FR 50845 (Oct. 31, 1975), as amended at 71 FR 5883 (Feb. 3, 2006).

[61] 29 CFR 2570.31(j).

[62] The same commenter also requested clarification that an IRA owner will not be deemed to fail the Independence requirement simply because he or she is an employee of the Financial Institution. However, the Independence is not applicable to IRA owners.

despite a failure to comply with "any term, condition or requirement of this exemption . . . if the failure to comply was insignificant and a good faith and reasonable attempt was made to comply with all applicable terms, conditions and requirements." Several commenters specifically supported FINRA's suggestion.

The Department has reviewed the exemption's requirements with these comments in mind and has included a good faith correction mechanism for the disclosure requirements in the exemption. These provisions take a similar approach to the provisions in the Department's regulations under ERISA sections 404 and 408(b)(2). In addition, as discussed above, the Department has eliminated a condition requiring compliance with other federal and state laws, which many commenters had argued could expose them to loss of the exemption based on small or technical violations. The Department has also facilitated compliance by streamlining the contracting process (and eliminating the contract requirement for ERISA plans), reducing the disclosure burden, and extending the time for compliance with many of the exemption's conditions. These and other changes should reduce the need for a self-correction process for excusing violations.

The Department declines to permanently adopt a broader unilateral good faith provision for Financial Institutions and their Advisers that could undermine fiduciaries' incentive to comply with the fundamental standards imposed by the exemption. The exemption's primary purpose is to combat harmful conflict of interest. If the exemption is too forgiving of abusive conduct, however, it runs the risk of permitting those same conflicts of interest to play a role in the design of policies and procedures, the use and oversight of adviser-incentives, the supervision of Adviser conduct, and the substance of investment recommendations. At the very least, it could encourage Financial Institutions and Advisers to resolve doubts on such questions in favor of their own financial interests rather than the interests of the Retirement Investor. Given the dangers posed by conflicts, the Department has deliberately structured this exemption to provide a strong counter-incentive to such conduct.

Additionally, many of the exemption's standards, such as the Best Interest standard and the pricing condition, already have a built-in reasonableness or prudence standard governing compliance. It would be inappropriate, in the Department's view, to create a self-correction mechanism for conduct that was imprudent or unreasonable. For example, the Best Interest standard requires that the Adviser 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. Similarly, the policies and procedures requirement under Section II(d) turns to a significant degree on adherence to standards of prudence and reasonableness. Thus, under Section II(d)(1), the Financial Institution is required to adopted and comply with written policies and procedures *reasonably and prudently designed* to ensure that its individual Advisers adhere to the Impartial Conduct Standards set forth in Section II(c).

Additionally, the provision allowing mandatory arbitration of individual claims is also responsive to the practicalities of resolving disputes over small claims. The Department also stresses that violations of the exemption's conditions with respect to a particular Retirement Investor or transaction, eliminates the availability of the exemption for that investor or transaction. Such violations do not render the exemption unavailable with respect to other Retirement Investors or other transactions.

D. Jurisdiction

The Department received a number of comments questioning the Department's jurisdiction and legal authority to proceed with the proposal. A number of commenters focused on the Department's authority to impose certain conditions as part of this exemption, specifically including the contract requirement and the Impartial Conduct Standards. Some commenters asserted that by requiring a contract for all Retirement Investors, and thereby facilitating contract claims by such parties, the proposal would expand upon the remedies established by Congress under ERISA and the Code. Commenters stated that ERISA preempts state law actions, including breach-of-contract actions. With respect to IRAs and non-ERISA plans, commenters stated that Congress provided that the enforcement of the prohibited transaction rules should be carried out by the Internal Revenue Service, not private plaintiffs. These commenters argued that the Department's proposal would impermissibly create a private right of action in violation of Congressional intent.

Commenters' arguments regarding the Impartial Conduct Standards were based generally on the fact that the standards, as noted above, are consistent with longstanding principles of prudence and loyalty set forth in ERISA section 404, but which have no counterpart in the Code. Commenters took the position that because Congress did not choose to impose the standards of prudence and loyalty on fiduciaries with respect to IRAs and non-ERISA plans, the Department exceeded its authority in proposing similar standards as a condition of relief in a prohibited transaction exemption.

With respect to ERISA plans, commenters stated that Congress' separation of the duties of prudence and loyalty (in ERISA section 404) from the prohibited transaction provisions (in ERISA section 406), showed an intent that the two should remain separate. Commenters additionally questioned why the conduct standards were necessary for ERISA plans, when such plans already have an enforceable right to fiduciary conduct that is both prudent and loyal. Commenters asserted that imposing the Impartial Conduct Standards as conditions of the exemption improperly created strict liability for prudence violations.

Some commenters additionally took the position that Congress, in the Dodd-Frank Act, gave the SEC the authority to establish standards for broker-dealers and investment advisers and therefore, the Department did not have the authority to act in that area.

The Department disagrees that the exemption exceeds its authority. The Department has clear authority under ERISA section 408(a) and the Reorganization Plan [63] to grant administrative exemptions from the prohibited transaction provisions of both ERISA and the Code. Congress gave the Department broad discretion to grant or deny exemptions and to craft conditions for those exemptions, subject only to the overarching requirement that the exemption be administratively feasible, in the interests of plans, plan participants and beneficiaries and IRA owners, and protective of their rights.[64] Nothing in ERISA or the Code suggests

[63] *See* fn. 1, *supra,* discussing of Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)).

[64] *See* ERISA section 408(a) and Code section 4975(c)(2).

that, in exercising its express discretion to fashion appropriate conditions, the Department cannot condition exemptions on contractual terms or commitments, or that, in crafting exemptions applicable to fiduciaries, the Department is forbidden to borrow from time-honored trust-law standards and principles developed by the courts to ensure proper fiduciary conduct.

In addition, this exemption does not create a cause of action for plan fiduciaries, participants or IRA owners to directly enforce the prohibited transaction provisions of ERISA and the Code in a federal or state-law contract action. Instead, with respect to ERISA plans and participants and beneficiaries, the exemption facilitates the existing statutory enforcement framework by requiring Financial Institutions to acknowledge in writing their fiduciary status and the fiduciary status of their Advisers. With respect to IRAs and non-ERISA plans, the exemption requires Advisers and Financial Institutions to make certain enforceable commitments to the advice recipient. Violation of the commitments can result in contractual liability to the Adviser and Financial Institution separate and apart from the legal consequences of a non-exempt prohibited transaction (*e.g.,* an excise tax).

There is nothing new about a prohibited transaction exemption requiring certain written documentation between the parties. The Department's widely-used exemption for Qualified Professional Asset Managers (QPAM), requires that an entity acting as a QPAM acknowledge in a written management agreement that it is a fiduciary with respect to each plan that has retained it.[65] Likewise, PTE 2006–16, an exemption applicable to compensation received by fiduciaries in securities lending transactions, requires the compensation to be paid in accordance with the terms of a written instrument.[66] Surely, the terms of these documents can be enforced by the parties. In this regard, the statutory authority permits, and in fact requires, that the Department incorporate conditions in administrative exemptions designed to protect the interests of plans, participants and beneficiaries, and IRA owners. The Department has determined that the contract requirement in the final exemption serves a critical protective function.

Likewise, the Impartial Conduct Standards represent, in the Department's view, baseline standards of fundamental fair dealing that must be present when fiduciaries make conflicted investment recommendations to Retirement Investors. After careful consideration, the Department determined that broad relief could be provided to investment advice fiduciaries receiving conflicted compensation only if such fiduciaries provided advice in accordance with the Impartial Conduct Standards—*i.e.,* if they provided prudent advice without regard to the interests of such fiduciaries and their Affiliates and Related Entities, in exchange for reasonable compensation and without misleading investors. These Impartial Conduct Standards are necessary to ensure that Advisers' recommendations reflect the Best interest of their Retirement Investor customers, rather than the conflicting financial interests of the Advisers and their Financial Institutions. As a result, Advisers and Financial Institutions bear the burden of showing compliance with the exemption and face liability for engaging in a non-exempt prohibited transaction if they fail to provide advice that is prudent or otherwise in violation of the standards. The Department does not view this as a flaw in the exemption, as commenters suggested, but rather as a significant deterrent to violations of important conditions under an exemption that accommodates a wide variety of potentially dangerous compensation practices.

The Department similarly disagrees that Congress' directive to the SEC in the Dodd-Frank Act limits its authority to establish appropriate and protective conditions in the context of a prohibited transaction exemption. Section 913 of the Dodd-Frank Act directs the SEC to conduct a study on the standards of care applicable to brokers-dealers and investment advisers, and issue a report containing, among other things:

> an analysis of whether [sic] any identified legal or regulatory gaps, shortcomings, or overlap in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers.[67]

Section 913 of the Dodd-Frank Act authorizes, but does not require, the SEC to issue rules addressing standards of care for broker-dealers and investment advisers for providing personalized investment advice about securities to retail customers.[68] Nothing in the Dodd-Frank Act indicates that Congress meant to preclude the Department's regulation of fiduciary investment advice under ERISA or its application of such a regulation to securities brokers or dealers. To the contrary, the Dodd-Frank Act in directing the SEC study specifically directed the SEC to consider the effectiveness of existing legal and regulatory standard of care under other federal and state authorities.[69] The Dodd-Frank Act did not take away the Department's responsibility with respect to the definition of fiduciary under ERISA and in the Code; nor did it qualify the Department's authority to issue exemptions that are administratively feasible, in the interests of plans, participants and beneficiaries, and IRA owners, and protective of the rights of participants and beneficiaries of the plans and IRA owners. If the Department were unable to rely on contract conditions and trust-law principles, it would be unable to grant broad relief under this exemption from the rigid application of the prohibited transaction rules. This enforceable standards-based approach enabled the Department to grant relief to a much broader range of practices and compensation structures than would otherwise have been possible.

Additionally, the Department notes that nothing in ERISA or the Code requires any Adviser or Financial Institution to use this exemption. Exemptions, including this class exemption, simply provide a means to engage in a transaction otherwise prohibited by the statutes. The conditions to an exemption are not equivalent to a regulatory mandate that conflicts with or changes the statutory remedial scheme. If Advisers or Financial Institutions do not want to be subject to contract claims, they can (1) change their trading practices and avoid committing a prohibited transaction, (2) use the statutory exemptions in ERISA section 408(b)(14) and section 408(g), or Code section 4975(d)(17) and (f)(8), or (3) apply to the Department for individual exemptions tailored to their particular situations.

E. Defer to the Securities and Exchange Commission

Many commenters suggested that a uniform standard applicable to all retail accounts would be preferable to the Department's proposal, and that the Department should work with other

[65] *See* Section VI(a) of PTE 84–14, 49 FR 9494, March 13, 1984, as amended at 70 FR 49305 (August 23, 2005) and as amended at 75 FR 38837 (July 6, 2010).

[66] *See* Section IV(c) of PTE 2006–16, 71 FR 63786 (Oct. 31, 2006).

[67] Dodd-Frank Act, sec. 913(d)(2)(B).

[68] 15 U.S.C. 80b–11(g)(1).

[69] Dodd-Frank Act, sec. 913(b)(1) and (c)(1).

regulators, such as the SEC and FINRA, to fashion such an approach. Others suggested that the Department should wait and defer to the SEC's determination of an appropriate standard for broker-dealers under the Dodd-Frank Act. Still others suggested that the Department should provide exemptions based on fiduciary status under securities laws, or based on compliance with other applicable laws or regulations. FINRA indicated that the proposal should be based on existing principles in federal securities laws and FINRA rules but acknowledged that additional rulemaking would be required.

The Department disagrees with the commenters, and believes it is important to move forward with this proposal to remedy the ongoing injury to Retirement Investors as a result of conflicted advice arrangements. ERISA and the Code create special protections applicable to investors in tax qualified plans. The fiduciary duties established under ERISA and the Code are different from those applicable under securities laws, and would continue to differ even if both regimes were interpreted to attach fiduciary status to exactly the same parties and activities. Reflecting the special importance of plan and IRA investments to retirement and health security, this statutory regime flatly prohibits fiduciaries from engaging in transactions involving self-dealing and conflicts of interest unless an exemption applies. Under ERISA and the Code, the Department of Labor has the authority to craft exemptions from these stringent statutory prohibitions, and the Department is specifically charged with ensuring that any exemptions it grants are in the interests of Retirement Investors and protective of these interests. Moreover, the fiduciary provisions of ERISA and the Code broadly protect all investments by Retirement Investors, not just those regulated by the SEC. As a consequence, the Department uniquely has the ability to assure that these fiduciary rules work in harmony for all Retirement Investors, regardless of whether they are investing in securities, insurance products that are not securities, or other types of investments.

The Department has taken very seriously its obligation to harmonize the Department's regulation with other applicable laws, including the securities laws. In pursuing its consultations with other regulators, the Department aimed to coordinate and minimize conflicting or duplicative provisions between ERISA, the Code and federal securities laws. The Department has coordinated—and will continue to coordinate—its efforts with other federal agencies to ensure that the various legal regimes are harmonized to the fullest extent possible. The resulting exemption provides Advisers and Financial Institutions with a choice to provide advice on an unconflicted basis or comply with this exemption or another exemption, which now all require advice to be provided in accordance with basic fiduciary norms. Far from confusing investors, the standards set forth in the exemption ensure that Retirement Investors can uniformly expect to receive advice that is in their best interest with respect to their retirement investments. Moreover, the best interest standard reflects what many investors have believed they were entitled to all along, even though it was not legally required.

In this regard, waiting for the SEC to act, as some commenters suggested, would delay the implementation of these important, updated safeguards to plan and IRA investors, and impose substantial costs on them as current harms from conflicted advice would continue.

F. Applicability Date and Transition Rules

The Regulation will become effective June 7, 2016 and this exemption is issued on this same date. The Regulation is effective at the earliest possible date under the Congressional Review Act. For the exemption, the issuance date serves as the date on which the exemption is intended to take effect for purposes of the Congressional Review Act. This date was selected to provide certainty to plans, plan fiduciaries, plan participants and beneficiaries, IRAs, and IRA owners that the new protections afforded by the final rule are now officially part of the law and regulations governing their investment advice providers, and to inform financial services providers and other affected service providers that the rule and exemption are final and not subject to further amendment or modification without additional public notice and comment. The Department expects that this effective date will remove uncertainty as an obstacle to regulated firms allocating capital and other resources toward transition and longer term compliance adjustments to systems and business practices.

The Department has also determined that, in light of the importance of the Regulation's consumer protections and the significance of the continuing monetary harm to retirement investors without the rule's changes, an Applicability Date of April 10, 2017, is appropriate for plans and their affected service providers to adjust to the basic change from non-fiduciary to fiduciary status. This exemption has the same Applicability Date; parties may rely on it as of the Applicability Date.

Section VII provides a transition period under which relief from the prohibited transaction provisions of ERISA and the Code is available for Financial Institutions and Advisers during the period between the Applicability Date and January 1, 2018 (the "Transition Period"). For the Transition Period, full relief under the exemption will be available for Financial Institutions and Advisers subject to more limited conditions than the full set of conditions described above. This period is intended to provide Financial Institutions and Advisers time to prepare for compliance with the conditions of Section II–IV set forth above, while safeguarding the interests of Retirement Investors. The Transition Period conditions set forth in Section VII are subject to the same exclusions in Section I(c), for advice from fiduciaries with discretionary authority over the customer's investments and specified advice concerning in-house plans.

The transitional conditions of Section VII require the Financial Institution and its Advisers to comply with the Impartial Conduct Standards when making recommendations regarding principal transactions and riskless principal transactions to Retirement Investors. The Impartial Conduct Standards required in Section VII are the same as required in Section II(c) but are repeated for ease of use.

During the Transition Period, the Financial Institution must additionally provide a written notice to the Retirement Investor prior to or at the same time as the execution of the principal transaction or riskless principal transaction, which may cover multiple transactions or all transactions taking place within the Transition Period, affirmatively stating its and its Adviser(s) fiduciary status under ERISA or the Code or both with respect to the recommendation. The Financial Institution must also state in writing that it and its Advisers will comply with the Impartial Conduct Standards. Further, the Financial Institution's notice must disclose the circumstances under which the Adviser and Financial Institution may engage in principal transactions and riskless principal transactions with the Plan, participant or beneficiary account or IRA, and its Material Conflicts of Interest. The disclosure may be provided in person, electronically or by mail, and it may be provided in the same document as the notice required in the transition period for exemption in Section IX of the Best Interest Contract Exemption.

Similar to the disclosure provisions of Section II(e), the transitional exemption in Section VII provides for exemptive relief to continue despite errors and omissions in the disclosures, if the Financial Institution acts in good faith and with reasonable diligence.

In addition, the Financial Institution must designate a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards.

Finally, the Financial Institution must comply with the recordkeeping provision of Section V(a) and (b) of the exemption regarding the transactions entered into during the Transition Period.

After the Transition Period, however, the exemption provided in Section VII will no longer be available. After that date, Financial Institutions and Advisers must satisfy all of the applicable conditions described in Sections II–V for the relief in Section I(b) to be available for any prohibited transactions occurring after that date. This includes the requirement to enter into a contract with a Retirement Investor, where required. Financial Institutions relying on the negative consent procedure set forth in Section II(a)(1)(ii) must provide the contractual provisions to Retirement Investors with Existing Contracts prior to January 1, 2018, and allow those Retirement Investors 30 days to terminate the contract. If the Retirement Investor does terminate the contract within that 30-day period, this exemption will provide relief for 14 days after the date on which the termination is received by the Financial Institution.

The proposed exemption, with the proposed Best Interest Contract Exemption, the proposed Regulation and other exemption proposals, generally set forth an Applicability Date of eight months, although the proposals sought comment on a phase in of conditions. As with other sections of this preamble, the Department is addressing comments regarding the Applicability Date as a cohesive whole. Some commenters, concerned about the ongoing harm to Retirement Investors, urged the Department to implement the Regulation and related exemptions quickly. However, the majority of industry commenters requested a two- to three-year transition period. These commenters requested time to enter into contracts with Retirement Investors (including developing and implementing the policies and procedures and incentive practices that meet the terms of Section II(d)). Some commenters requested the Department allow good faith compliance during the transition period. Others requested the Department phase in the requirements over time. One commenter requested the Best Interest standard become effective immediately, with the other conditions becoming effective within one year. Another comment expressed concern about phasing in the conditions over time, referring to this as a "piecemeal" approach, which would not be helpful to implementing a system to protect Retirement Investors. Other commenters wrote that the Department should re-propose the exemption or adopt it as an interim final exemption and seek additional comments.

The transition provisions in Section VII of the final exemption respond to commenters' concerns about ongoing economic harm to Retirement Investors during the period in which Financial Institutions develop systems to comply with the exemption. The provisions require prompt implementation of certain core protections of the exemption in the form of the acknowledgment of fiduciary status, compliance with the Impartial Conduct Standards, and certain important disclosures, to safeguard Retirement Investors' interests. The provisions recognize, however, that the Financial Institutions will need time to develop policies and procedures and supervisory structures that fully comport with the requirements of the final exemption. Accordingly, during the Transition Period, Financial Institutions are not required to execute the contract or give Retirement Investors warranties or disclosures on their anti-conflict policies and procedures. While the Department expects that Advisers and Financial Institutions will, in fact, adopt prudent supervisory mechanisms to prevent violations of the Impartial Conduct Standards (and potential liability for such violations), the exemption will not require the Financial Institutions to make specific representations on the nature or quality of the policies and procedures during this Transition Period. The Department will be available to respond to Financial Institutions' request for guidance during this period, as they develop the systems necessary to comply with the exemption's conditions.

The transition provisions also accommodate Financial Institutions' need for time to prepare for full compliance with the exemption, and therefore full compliance with all the final exemption's applicable conditions is delayed until January 1, 2018. The Department selected that period, rather than two to three years, as requested by some commenters, in light of the significant adjustments in the final exemption that significantly eased compliance burdens. Although the Department believes that the conditions of the exemption set forth in Section II–V are required to support the Department's findings required under ERISA section 408(a), and Code section 4975(c)(2) over the long term, the Department recognizes that Financial Institutions may need time to achieve full compliance with these conditions. The Department therefore finds that the provisions set forth in Section VII satisfy the criteria of ERISA section 408(a) and Code section 4975(c)(2) for the transition period because they provide the significant protections to Retirement Investors while providing Financial Institutions with time necessary to achieve full compliance. A similar transition period is provided for the companion Best Interest Contract Exemption due to the corresponding provisions in that exemption that may require time for Financial Institutions to begin compliance.

The Department considered, but did not elect, delaying the application of the rule defining fiduciary investment advice until such time as Financial Institutions could make the changes to their practices and compensation structures necessary to comply with Sections II through V of this exemption. The Department believed that delaying the application of the new fiduciary rule would inordinately delay the basic protections of loyalty and prudence that the rule provides. Moreover, a long period of delay could incentivize Financial Institutions to increase efforts to provide conflicted advice to Retirement Investors before it becomes subject to the new rule. The Department understands that many of the concerns regarding the applicability date of the rule are related to the prohibited transaction provisions of ERISA and the Code rather than the basic fiduciary standards. This transition period exemption addresses these concerns by giving Financial Institutions and Advisers necessary time to fully comply with Sections II–V of the exemption.

The Department also considered the views of commenters that requested re-proposal of the Regulation and exemptions, or issuing the rule and exemptions as interim final rules with requests for additional comment. After reviewing all the comments on the 2015 proposal, which was itself a re-proposal, the Department has concluded that it is in a position to publish a final rule and exemptions. It has carefully considered and responded to the significant issues raised in the comments in drafting the final rule and exemptions. Moreover, the Department has concluded that the difference between the final documents and the proposals are also responsive to the commenters' concerns and could be reasonably foreseen by affected parties.

No Relief From ERISA Section 406(a)(1)(C) or Code Section 4975(c)(1)(C) for the Provision of Services

This exemption will not provide relief from a transaction prohibited by ERISA section 406(a)(1)(C), or from the taxes imposed by Code section 4975(a) and (b) by reason of Code section 4975(c)(1)(C), regarding the furnishing of goods, services or facilities between a plan and a party in interest. The provision of investment advice to a plan under a contract with a fiduciary is a service to the plan and compliance with this exemption will not relieve an Adviser or Financial Institution of the need to comply with ERISA section 408(b)(2), Code section 4975(d)(2), and applicable regulations thereunder.

Paperwork Reduction Act Statement

In accordance with the requirements of the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506(c)(2)), the Department solicited comments on the information collections included in the proposed Exemption for Principal Transactions in Certain Debt Securities Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs. 80 FR 21989 (Apr. 20, 2015). The Department also submitted an information collection request (ICR) to OMB in accordance with 44 U.S.C. 3507(d), contemporaneously with the publication of the proposal, for OMB's review. The Department received two comments from one commenter that specifically addressed the paperwork burden analysis of the information collections. Additionally many comments were submitted, described elsewhere in this preamble and in the preamble to the accompanying final rule, which contained information relevant to the costs and administrative burdens attendant to the proposals. The Department took into account such public comments in connection with making changes to the prohibited transaction exemption, analyzing the economic impact of the proposals, and developing the revised paperwork burden analysis summarized below.

In connection with publication of this prohibited transaction exemption, the Department is submitting an ICR to OMB requesting approval of a new collection of information under OMB Control Number 1210–0157. The Department will notify the public when OMB approves the ICR.

A copy of the ICR may be obtained by contacting the PRA addressee shown below or at *http://www.RegInfo.gov.* PRA ADDRESSEE: G. Christopher Cosby, Office of Policy and Research, U.S. Department of Labor, Employee Benefits Security Administration, 200 Constitution Avenue NW., Room N–5718, Washington, DC 20210. Telephone: (202) 693–8410; Fax: (202) 219–4745. These are not toll-free numbers.

As discussed in detail below, the class exemption will permit principal transactions and riskless principal transactions in certain principal traded assets between a plan, participant or beneficiary account, or an IRA, and an Adviser or Financial Institution, and the receipt of a mark-up or mark-down or other payment by the Adviser or Financial Institution for themselves or Affiliates as a result of investment advice. The class exemption will require Financial Institutions to enter into a contractual arrangement with Retirement Investors regarding principal transactions and riskless principal transactions with IRAs and plans not subject to Title I of ERISA (non-ERISA plans), adopt written policies and procedures, make disclosures to Retirement Investors (including with respect to ERISA plans), and on a publicly available Web site, and maintain records necessary to prove that the conditions of the exemption have been met for a period of six (6) years from the date of each principal transaction or riskless principal transaction. In addition, the exemption provides a transition period from the Applicability Date, to January 1, 2018. As a condition of relief during the transition period, Financial Institutions must make a disclosure (transition disclosure) to all Retirement Investors (in ERISA plans, IRAs, and non-ERISA plans) prior to or at the same time as the execution of recommended transactions. These requirements are ICRs subject to the PRA.

The Department has made the following assumptions in order to establish a reasonable estimate of the paperwork burden associated with these ICRs:

- 51.8 percent of disclosures to Retirement Investors with respect to ERISA plans [70] and 44.1 percent of contracts with and disclosures to Retirement Investors with respect to IRAs and non-ERISA plans [71] will be distributed electronically via means already used by respondents in the normal course of business and the costs arising from electronic distribution will be negligible, while the remaining contracts and disclosures will be distributed on paper and mailed at a cost of $0.05 per page for materials and $0.49 for first class postage;
- Financial Institutions will use existing in-house resources to distribute required contracts and disclosures;
- Tasks associated with the ICRs performed by in-house personnel will be performed by clerical personnel at an hourly wage rate of $55.21;[72]
- Financial Institutions will hire outside service providers to assist with nearly all other compliance costs;
- Outsourced legal assistance will be billed at an hourly rate of $335.00;[73]
- Approximately 6,000 Financial Institutions [74] will utilize the exemption

[70] According to data from the National Telecommunications and Information Agency (NTIA), 33.4 percent of individuals age 25 and over have access to the internet at work. According to a Greenwald & Associates survey, 84 percent of plan participants find it acceptable to make electronic delivery the default option, which is used as the proxy for the number of participants who will not opt out that are automatically enrolled (for a total of 28.1 percent receiving electronic disclosure at work). Additionally, the NTIA reports that 38.9 percent of individuals age 25 and over have access to the internet outside of work. According to a Pew Research Center survey, 61 percent of internet users use online banking, which is used as the proxy for the number of internet users who will opt in for electronic disclosure (for a total of 23.7 percent receiving electronic disclosure outside of work). Combining the 28.1 percent who receive electronic disclosure at work with the 23.7 percent who receive electronic disclosure outside of work produces a total of 51.8 percent who will receive electronic disclosure overall.

[71] According to data from the NTIA, 72.4 percent of individuals age 25 and older have access to the internet. According to a Pew Research Center survey, 61 percent of internet users use online banking, which is used as the proxy for the number of internet users who will opt in for electronic disclosure. Combining these data produces an estimate of 44.1 percent of individuals who will receive electronic disclosures.

[72] For a description of the Department's methodology for calculating wage rates, see *http://www.dol.gov/ebsa/pdf/labor-cost-inputs-used-in-ebsa-opr-ria-and-pra-burden-calculations-march-2016.pdf.* The Department's methodology for calculating the overhead cost input of its wage rates was adjusted from the proposed PTE to the final PTE. In the proposed PTE, the Department based its overhead cost estimates on longstanding internal EBSA calculations for the cost of overhead. In response to a public comment stating that the overhead cost estimates were too low and without any supporting evidence, the Department incorporated published U.S. Census Bureau survey data on overhead costs into its wage rate estimates.

[73] This rate is the average of the hourly rate of an attorney with 4–7 years of experience and an attorney with 8–10 years of experience, taken from the Laffey Matrix. See *http://www.justice.gov/sites/default/files/usao-dc/legacy/2014/07/14/Laffey%20Matrix_2014-2015.pdf*

[74] One commenter questioned the basis for the Department's assumption regarding the number of

Continued

to engage in principal transactions and riskless principal transactions.

Compliance Costs for Financial Institutions

The Department believes that nearly all Financial Institutions will contract with outside service providers to implement the various compliance requirements of this exemption. As described in the regulatory impact analysis, per-Financial Institution costs for broker-dealers (BDs) were calculated by allocating the total cost reductions in the medium assumptions scenario across the Financial Institution size categories, and then subtracting the cost reductions from the per-Financial Institution average costs derived from the Oxford Economics study. The methodology for calculating the per-Financial Institution costs for registered investment advisers (RIAs) is described in detail in the regulatory impact analysis. The Department is attributing 50 percent of the compliance costs for BDs and RIAs to this Exemption and 50 percent of the compliance costs for BDs and RIAs to the Best Interest Contract Exemption, published elsewhere in today's **Federal Register**. With the above assumptions, the per-Financial Institution costs are as follows:

- Start-Up Costs for Large BDs: $3.7 million
- Start-Up Costs for Large RIAs: $3.2 million
- Start-Up Costs for Medium BDs: $889,000
- Start-Up Costs for Medium RIAs: $662,000
- Start-Up Costs for Small BDs: $278,000
- Start-Up Costs for Small RIAs: $219,000
- Ongoing Costs for Large BDs: $918,000
- Ongoing Costs for Large RIAs: $803,000
- Ongoing Costs for Medium BDs: $192,000
- Ongoing Costs for Medium RIAs: $143,000
- Ongoing Costs for Small BDs: $60,000
- Ongoing Costs for Small RIAs: $47,000

In order to engage in transactions and receive compensation covered under this exemption, Section II requires Financial Institutions to acknowledge, in writing, their fiduciary status and adopt written policies and procedures designed to ensure compliance with the Impartial Conduct Standards. Financial Institutions must make certain disclosures to Retirement Investors. Financial institutions must generally enter into a written contract with Retirement Investors with respect to principal transactions and riskless principal transactions with IRAs and non-ERISA plans with certain required provisions, including affirmative agreement to adhere to the Impartial Conduct Standards and, if they are FINRA members, to comply with FINRA rules 2121 and 5310.

Section IV requires Financial Institutions and Advisers to make certain disclosures to the Retirement Investor. These disclosures include: (1) A pre-transaction disclosure; (2) a disclosure, on demand, of information regarding the principal traded asset, including its salient attributes; (3) an annual disclosure; (4) transaction confirmations; and (5) a web-based disclosure.

Section VII requires Financial Institutions to make a transition disclosure, acknowledging their fiduciary status and that of their Advisers with respect to the Advice, stating the Best Interest standard of care, and describing the circumstances under which principal transactions and riskless principal transactions may occur and the associated Material Conflicts of Interest, prior to engaging in any transactions during the transition period from the Applicability Date to January 1, 2018. The transition disclosure can cover multiple transactions, or all transactions occurring in the transition period.

The Department is able to disaggregate an estimate of many of the legal costs from the costs above; however, it is unable to disaggregate any of the other costs. The Department received a comment on the proposed PTE stating that the estimates for legal professional time to draft disclosures were not supported by any empirical evidence. The Department also received multiple comments on the proposed PTE stating that its estimate of 60 hours of legal professional time during the first year a financial institution used the exemption and then no legal professional time in subsequent years was too low.

In response to a recommendation made during the Department's August 2015, public hearing on the proposed rule and exemptions, and in an attempt to create estimates with a clearer empirical evidentiary basis, the Department drafted certain portions of the required disclosures, including a sample contract, the one-time disclosure to the Department, and the transition disclosure. The Department believes that the time spent updating existing contracts and disclosures in future years would be no longer than the time necessary to create the original contracts and disclosures. The Department did not attempt to draft the complete set of required disclosures because it expects that the amount of time necessary to draft such disclosures will vary greatly among firms. For example, the Department did not attempt to draft sample policies and procedures, pre-transaction disclosures, disclosures regarding the principal traded assets, or confirmation slips. The Department expects the amount of time necessary to complete these disclosures will vary significantly based on a variety of factors including the nature of a firm's compensation structure, and the extent to which a firm's policies and procedures require review and signatures by different individuals. The Department further believes that pre-transaction disclosures will be provided orally at de minimis cost, facts and circumstances will vary too widely to accurately depict the disclosures regarding the principal traded assets, and providing confirmation slips is a regular and customary business practice

Financial Institutions likely to use the exemption. According to the "2015 Investment Management Compliance Testing Survey," Investment Adviser Association, cited in the regulatory impact analysis for the accompanying rule, 63 percent of Registered Investment Advisers service ERISA-covered plans and IRAs. The Department conservatively interprets this to mean that all of the 113 large Registered Investment Advisers (RIAs), 63 percent of the 3,021 medium RIAs (1,903), and 63 percent of the 24,475 small RIAs (15,419) work with ERISA-covered plans and IRAs. The Department assumes that all of the 42 large broker-dealers, and similar shares of the 233 medium broker-dealers (147) and the 3,682 small broker-dealers (2,320) work with ERISA-covered plans and IRAs. According to SEC and FINRA data, cited in the regulatory impact analysis, 18 percent of broker-dealers are also registered as RIAs. Removing these firms from the RIA counts produces counts of 105 large RIAs, 1,877 medium RIAs, and 15,001 small RIAs that work with ERISA-covered plans and IRAs and are not also registered as broker-dealers. Further, according to Hung et al. (2008) (see Regulatory Impact Analysis for complete citation), approximately 13 percent of RIAs report receiving commissions. Additionally, 20 percent of RIAs report receiving performance based fees; however, at least 60 percent of these RIAs are likely to be hedge funds. Thus, as much as 8 percent of RIAs providing investment advice receive performance based fees. Combining the 8 percent of RIAs receiving performance based fees with the 13 percent of RIAs receiving commissions creates a conservative estimate of 21 percent of RIAs that might need exemptive relief. Although the Department believes that very few RIAs that are not also broker-dealers engage in principal transactions and riskless principal transactions, its data to support this belief is limited, so the Department is conservatively assuming that the same RIAs that receive performance-based fees and commissions are the types of RIAs that might engage in principal transactions and riskless principal transactions. In total, the Department estimates that 2,509 broker-dealers and 3,566 RIAs receiving performance-based fees and commissions will use this exemption. As described in detail in the regulatory impact analysis, the Department believes a de minimis number of banks may also use the exemption.

producing de minimis additional burden.

Considered in conjunction with the estimates provided in the proposal, the Department estimates that outsourced legal assistance to draft standard contracts, contract disclosures, annual disclosures, and transition disclosures will cost an average of $3,676 per Financial Institution for a total of $22.3 million during the first year. In subsequent years, it will cost an average of $2,978 per Financial Institution for a total of $18.1 million annually to update the contracts, contract disclosures, and annual disclosures.

The legal costs of these disclosures were disaggregated from the total compliance costs because these disclosures are expected to be relatively uniform. Although the tested disclosures generally took less time than many of the commenters said they would, the Department acknowledges that the disclosures that were not tested are those that are expected to be the most time consuming. Importantly, as explained in greater detail in section 5.3 of the regulatory impact analysis, the Department is primarily relying on cost data provided by the Securities Industry and Financial Markets Association (SIFMA) and the Financial Services Institute (FSI) to calculate the total cost of the legal disclosures, rather than its own internal drafting of disclosures. Accordingly, in the event that any of the Department's estimates understate the time necessary to create and update the disclosures, it does not impact the total burden estimates. The total burden estimates were derived from SIFMA and FSI's all-inclusive costs. Therefore, in the event that legal costs are understated, other cost estimates in this analysis would be overstated in an equal manner.

In addition to legal costs for creating the contracts and disclosures, the start-up cost estimates include the costs of implementing and updating the IT infrastructure, creating the web disclosures, gathering and maintaining the records necessary to produce the various disclosures, developing policies and procedures, addressing material conflicts of interest, monitoring Advisers' adherence to the Impartial Conduct Standards, and any other steps necessary to ensure compliance with the conditions of the Exemption not described elsewhere. In addition to legal costs for updating the contracts and disclosures, the ongoing cost estimates include the costs of updating the IT infrastructure, updating the web disclosures, reviewing processes for gathering and maintaining the records necessary to produce the various disclosures, reviewing the policies and procedures, producing the detailed disclosures regarding principal traded assets on request, monitoring investments as agreed upon with the Retirement Investor, addressing material conflicts of interest, monitoring Advisers' adherence to the Impartial Conduct Standards, and any other steps necessary to ensure compliance with the conditions of the exemption not described elsewhere. These costs total $1.9 billion during the first year and $412.2 million in subsequent years. These costs do not include the costs of producing of distributing disclosures and contracts, which are discussed below.

Distribution of Disclosures and Contracts

The Department estimates that 14,000 Retirement Investors with respect to ERISA plans and 2.4 million Retirement Investors with respect to IRAs and non-ERISA plans will receive a three-page transition disclosure during the first year. Additionally, 14,000 Retirement Investors with respect to ERISA plans will receive a fifteen-page contract disclosure, and 2.4 million Retirement Investors with respect to IRAs and non-ERISA plans will receive a fifteen-page contract during the first year. In subsequent years, 4,000 Retirement Investors with respect to ERISA plans will receive a fifteen-page contract disclosure and 490,000 Retirement Investors with respect to IRAs and non-ERISA plans will receive a fifteen-page contract. To the extent that Financial Institutions use both the Best Interest Contract Exemption and the Principal Transactions Exemption, these estimates may represent overestimates because significant overlap exists between the requirements of the transition disclosure and the contract for both exemptions. If Financial Institutions choose to use both exemptions with the same clients, they will probably combine the documents.

The transition disclosure will be distributed electronically to 51.8 percent of ERISA plan investors and 44.1 percent of IRAs and non-ERISA plan investors during the first year. Paper disclosures will be mailed to the remaining 48.2 percent of ERISA plan investors and 55.9 percent of IRAs and non-ERISA plan investors. The contract disclosure will be distributed electronically to 51.8 percent of the ERISA plan investors during the first year or during any subsequent year in which the plan investor begins a new advisory relationship. Paper contract disclosures will be mailed to 48.2 percent of ERISA plan investors. The contract will be distributed electronically to 44.1 percent of IRAs and non-ERISA plan participants during the first year or during any subsequent year in which the investor begins a new advisory relationship. Paper contracts will be mailed to 55.9 percent of IRAs and non-ERISA plan investors. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution will cost approximately $2.5 million during the first year and $342,000 during subsequent years. Paper distribution will also require two minutes of clerical time to print and mail the disclosure or contract,[75] resulting in 85,000 hours at an equivalent cost of $4.7 million during the first year and 9,000 hours at an equivalent cost of $508,000 during subsequent years.

The Department estimates that 2.5 million Retirement Investors for ERISA plans, IRAs and non-ERISA plans will receive a two-page annual disclosure during the second year and all subsequent years. The disclosure will be distributed electronically to 51.8 percent of ERISA plan investors and 44.1 percent of IRA holders and non-ERISA plan investors. Paper statements will be mailed to 48.2 percent of ERISA plan investors and 55.9 percent of IRA owners and non-ERISA plan participants. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution will cost approximately $812,000.[76] Paper distribution will also require two minutes of clerical time to print and mail the statement, resulting in 46,000 hours at an equivalent cost of $2.5 million annually.

The Department estimates that Financial Institutions will receive ten requests per year for more detailed principal traded asset information during the second year and all subsequent years. The detailed disclosures will be distributed electronically for 51.8 percent of the ERISA plan investors and 44.1 percent of the IRA holders and non-ERISA plan participants. The Department believes that requests for additional information will be proportionally likely with each Retirement Investor type. Therefore, approximately 34,000 detailed disclosures will be distributed on paper. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution

[75] One commenter questioned the basis for this estimate. The Department worked with clerical staff to determine that most notices and disclosures can be printed and prepared for mailing in less than one minute per disclosure. Therefore, an estimate of two minutes per disclosure is a conservative estimate.

[76] This cost includes $0.05 per page for materials and $0.49 per mailing for postage.

will cost approximately $25,000. Paper distribution will also require two minutes of clerical time to print and mail the statement, resulting in 1,000 hours at an equivalent cost of $62,000 annually.

Overall Summary

Overall, the Department estimates that in order to meet the conditions of this Exemption, Financial Institutions and Advisers will distribute approximately 4.9 million disclosures and contracts during the first year and 3.0 million disclosures and contracts during subsequent years. Distributing these disclosures and contracts will result in a total of 85,000 hours of burden during the first year and 56,000 hours of burden in subsequent years. The equivalent cost of this burden is $4.7 million during the first year and $3.1 million in subsequent years. This exemption will result in an outsourced labor, materials, and postage cost burden of $2.0 billion during the first year and $431.5 million during subsequent years.

These paperwork burden estimates are summarized as follows:

Type of Review: New collection.

Agency: Employee Benefits Security Administration, Department of Labor.

Titles: (1) Prohibited Transaction Exemption for Principal Transactions in Certain Assets between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs and (2) Final Investment Advice Regulation.

OMB Control Number: 1210–0157.

Affected Public: Businesses or other for-profits; not for profit institutions.

Estimated Number of Respondents: 6,075.

Estimated Number of Annual Responses: 4,927,605 during the first year and 3,018,574 during subsequent years.

Frequency of Response: When engaging in exempted transaction; Annually.

Estimated Total Annual Burden Hours: 85,457 hours during the first year and 56,197 hours in subsequent years.

Estimated Total Annual Burden Cost: $1,956,129,694 during the first year and $431,468,619 in subsequent years.

Regulatory Flexibility Act

This exemption, which is issued pursuant to ERISA section 408(a) and Code section 4975(c)(2), is part of a broader rulemaking that includes other exemptions and a final regulation published in today's **Federal Register**. The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) imposes certain requirements with respect to Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act (5 U.S.C. 551 *et seq.*), or any other laws. Unless the head of an agency certifies that a final rule is not likely to have a significant economic impact on a substantial number of small entities, section 604 of the RFA requires that the agency present a final regulatory flexibility analysis (FRFA) describing the rule's impact on small entities and explaining how the agency made its decisions with respect to the application of the rule to small entities.

The Secretary has determined that this rulemaking, including this exemption, will have a significant economic impact on a substantial number of small entities. The Secretary has separately published a Regulatory Impact Analysis (RIA) which contains the complete economic analysis for this rulemaking including the Department's FRFA for the rule and the related prohibited transaction exemptions. This section of this preamble sets forth a summary of the FRFA. The RIA is available at *www.dol.gov/ebsa.*

As noted in section 6.1 of the RIA, the Department has determined that regulatory action is needed to mitigate conflicts of interest in connection with investment advice to Retirement Investors. The Regulation is intended to improve plan and IRA investing to the benefit of retirement security. In response to the proposed rulemaking, organizations representing small businesses submitted comments expressing particular concern with three issues: the carve-out for investment education, the Best Interest Contract Exemption, and the carve-out for persons acting in the capacity of counterparties to plan fiduciaries with financial expertise. Section 2 of the RIA contains an extensive discussion of these concerns and the Department's response.

As discussed in section 6.2 of the RIA, the Small Business Administration (SBA) defines a small business in the Financial Investments and Related Activities Sector as a business with up to $38.5 million in annual receipts. In response to a comment received from the SBA's Office of Advocacy on our Initial Regulatory Flexibility Analysis, the Department contacted the SBA, and received from them a dataset containing data on the number of Financial Institutions by NAICS codes, including the number of Financial Institutions in given revenue categories. This dataset would allow the estimation of the number of Financial Institutions with a given NAICS code that fall below the $38.5 million threshold and therefore be considered small entities by the SBA. However, this dataset alone does not provide a sufficient basis for the Department to estimate the number of small entities affected by the rule. Not all Financial Institutions within a given NAICS code would be affected by this rule, because being an ERISA fiduciary relies on a functional test and is not based on industry status as defined by a NAICS code. Further, not all Financial Institutions within a given NAICS code work with ERISA-covered plans and IRAs.

Over 90 percent of broker-dealers, registered investment advisers, insurance companies, agents, and consultants are small businesses according to the SBA size standards (13 CFR 121.201). Applying the ratio of entities that meet the SBA size standards to the number of affected entities, based on the methodology described at greater length in the RIA, the Department estimates that the number of small entities affected by this rule is 2,438 BDs, 16,521 RIAs, 496 Insurers, and 3,358 other ERISA service providers.

For purposes of the RFA, the Department continues to consider an employee benefit plan with fewer than 100 participants to be a small entity. Further, while some large employers may have small plans, in general small employers maintain most small plans. The definition of small entity considered appropriate for this purpose differs, however, from a definition of small business that is based on size standards promulgated by the SBA. These small pension plans will benefit from the rule, because as a result of the rule, they will receive non-conflicted advice from their fiduciary service providers. The 2013 Form 5500 filings show nearly 595,000 ERISA covered retirement plans with less than 100 participants.

Section 6.5 of the RIA summarizes the projected reporting, recordkeeping, and other compliance costs of the rule and exemptions, which are discussed in detail in section 5 of the RIA. Among other things, the Department concludes that it is likely that some small service providers may find that the increased costs associated with ERISA fiduciary status outweigh the benefits of continuing to service the ERISA plan market or the IRA market. The Department does not believe that this outcome will be widespread or that it will result in a diminution of the amount or quality of advice available to small or other retirement savers, because some Financial Institutions will fill the void and provide services the ERISA plan and IRA market. It is also possible that the economic impact of the rule and exemptions on small entities would not be as significant as it would be for large entities, because anecdotal evidence indicates that small entities do not have as many business arrangements that give rise to conflicts of interest. Therefore, they would not be confronted with the same costs to restructure transactions that would be faced by large entities.

Section 5.3.1 of the RIA includes a discussion of the changes to the proposed rule and exemptions that are intended to reduce the costs affecting both small and large business. These include elimination of data collection and annual disclosure requirements in the Best Interest Contract Exemption, and changes to the implementation of the contract requirement in the exemption. Section 7 of the RIA discusses significant regulatory alternatives considered by the Department and the reasons why they were rejected.

Congressional Review Act

This exemption, along with related exemptions and a final rule published elsewhere in this issue of the **Federal Register**, is part of a rulemaking that is subject to the Congressional Review Act provisions of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801, *et seq.*) and, will be transmitted to Congress and the Comptroller General for review. This rulemaking, including this exemption is treated as a ''major rule'' as that term is defined in 5 U.S.C. 804, because it is likely to result in an annual effect on the economy of $100 million or more.

General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under ERISA section 408(a) and Code section 4975(c)(2) does not relieve a fiduciary or other party in interest or disqualified person with respect to a plan or IRA from certain other provisions of ERISA and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of ERISA section 404 which require, among other things, that a fiduciary act prudently and discharge his or her duties respecting the plan solely in the interests of the participants and beneficiaries of the plan. Additionally, the fact that a transaction is the subject of an exemption does not affect the requirement of Code section 401(a) that the plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries;

(2) The Department finds 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 the plan;

(3) The exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the exemption; and

(4) The exemption is supplemental to, and not in derogation of, any other provisions of ERISA and the Code, including statutory or administrative exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

Exemption

Section I—Exemption

(a) In general. ERISA and the Internal Revenue Code prohibit fiduciary advisers to employee benefit plans (Plans) and individual retirement plans (IRAs) from self-dealing, including receiving compensation that varies based on their investment recommendations. ERISA and the Code also prohibit fiduciaries from engaging in securities purchases and sales with Plans or IRAs on behalf of their own accounts (Principal Transactions). This exemption permits certain persons who provide investment advice to Retirement Investors (*i.e.,* fiduciaries of Plans, Plan participants or beneficiaries, or IRA owners) to engage in certain Principal Transactions and Riskless Principal Transactions as described below.

(b) Exemption. This exemption permits an Adviser or Financial Institution to engage in the purchase or sale of a Principal Traded Asset in a Principal Transaction or Riskless Principal Transaction with a Plan, participant or beneficiary account, or IRA, and receive a mark-up, mark-down or other similar payment as applicable to the transaction for themselves or any Affiliate, as a result of the Adviser's and Financial Institution's advice regarding the Principal Transaction or Riskless Principal Transaction. As detailed below, Financial Institutions and Advisers seeking to rely on the exemption must acknowledge fiduciary status, adhere to Impartial Conduct Standards in rendering advice, disclose Material Conflicts of Interest associated with Principal Transactions and Riskless Principal Transactions and obtain the consent of the Plan or IRA. In addition, Financial Institutions must adopt certain policies and procedures, including policies and procedures reasonably designed to ensure that individual Advisers adhere to the Impartial Conduct Standards; and retain certain records. This exemption provides relief from ERISA section 406(a)(1)(A) and (D) and section 406(b)(1) and (2), and the taxes imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A), (D), and (E). The Adviser and Financial Institution must comply with the conditions of Sections II–V.

(c) Scope of this exemption: This exemption does not apply if:

(1) The Adviser: (i) Has or exercises any discretionary authority or discretionary control respecting management of the assets of the Plan, participant or beneficiary account, or IRA involved in the transaction or exercises any discretionary authority or control respecting management or the disposition of the assets; or (ii) has any discretionary authority or discretionary responsibility in the administration of the Plan, participant or beneficiary account, or IRA; or

(2) The Plan is covered by Title I of ERISA and (i) the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the Plan, or (ii) the Adviser 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 investment advice to the plan by a fiduciary who is not Independent.

Section II—Contract, Impartial Conduct, and Other Conditions

The conditions set forth in this section include certain Impartial Conduct Standards, such as a Best Interest standard, that Advisers and Financial Institutions must satisfy to rely on the exemption. In addition, this section requires Financial Institutions to adopt anti-conflict policies and procedures that are reasonably designed to ensure that Advisers adhere to the Impartial Conduct Standards, and requires disclosure of important information about the Principal Transaction or Riskless Principal Transaction. With respect to IRAs and Plans not covered by Title I of ERISA, the Financial Institutions must agree that they and their Advisers will adhere to the exemption's standards in a written contract that is enforceable by the Retirement Investors. To minimize compliance burdens, the exemption provides that the contract terms may be incorporated into account opening documents and similar commonly-used agreements with new customers, and the exemption permits reliance on a negative consent process with respect to existing contract holders. The contract does not need to be executed before the provision of advice to the Retirement Investor to engage in a Principal Transaction or Riskless Principal Transaction. However, the contract must cover any advice given prior to the contract date in order for the exemption to apply to such advice. There is no contract requirement for recommendations to Retirement Investors about investments in Plans covered by Title I of ERISA, but the Impartial Conduct Standards and other requirements of Section II(b)–(e) must be satisfied in order for relief to be available under the exemption, as set forth in Section II(g). Section II(a) imposes the following conditions on Financial Institutions and Advisers:

(a) Contracts with Respect to Principal Transactions and Riskless Principal Transactions Involving IRAs and Plans Not Covered by Title I of ERISA. If the investment advice resulting in the Principal Transaction or Riskless Principal Transaction concerns an IRA or a Plan that is not covered by Title I, the advice is subject to an enforceable written contract on the part of the Financial Institution, which may be a master contract covering multiple recommendations, that is entered into in accordance with this Section II(a) and incorporates the terms set forth in Section II(b)–(d). The Financial Institution additionally must provide the disclosures required by Section II(e). The contract must cover advice rendered prior to the execution of the contract in order for the exemption to apply to such advice and related compensation.

(1) Contract Execution and Assent.

(i) New Contracts. Prior to or at the same time as the execution of the Principal Transaction or Riskless Principal Transaction, the Financial Institution enters into a written contract with the Retirement Investor acting on behalf of the Plan, participant or beneficiary account, or IRA, incorporating the terms required by Section II(b)–(d). The terms of the contract may appear in a standalone document or they may be incorporated into an investment advisory agreement, investment program agreement, account opening agreement, insurance or annuity contract or application, or similar document, or amendment thereto. The contract must be enforceable against the Financial Institution. The Retirement Investor's assent to the contract may be evidenced by handwritten or electronic signatures.

(ii) Amendment of Existing Contracts by Negative Consent. As an alternative to executing a contract in the manner set forth in the preceding paragraph, the Financial Institution may amend Existing Contracts to include the terms required in Section II(b)–(d) by delivering the proposed amendment and the disclosure required by Section II(e) to the Retirement Investor prior to January 1, 2018, and considering the failure to terminate the amended contract within 30 days as assent. An Existing Contract is an investment advisory agreement, investment program agreement, account opening agreement, insurance contract, annuity contract, or similar agreement or contract that was executed before January 1, 2018, and remains in effect. If the Financial Institution elects to use the negative consent procedure, it may deliver the proposed amendment by mail or electronically, provided such means is reasonably calculated to result in the Retirement Investor's receipt of the proposed amendment, but it may not impose any new contractual obligations, restrictions, or liabilities on the Retirement Investor by negative consent.

(2) Notice. The Financial Institution maintains an electronic copy of the Retirement Investor's contract on the Financial Institution's Web site that is accessible by the Retirement Investor.

(b) Fiduciary. The Financial Institution affirmatively states in writing that the Financial Institution and the Adviser(s) act as fiduciaries under ERISA or the Code, or both, with respect to any investment advice regarding Principal Transactions and Riskless Principal Transactions provided by the Financial Institution or the Adviser subject to the contract, or in the case of an ERISA Plan, with respect to any investment advice regarding Principal Transactions and Riskless Principal Transactions between the Financial Institution and the Plan or participant or beneficiary account.

(c) Impartial Conduct Standards. The Financial Institution states that it and its Advisers agree to adhere to the following standards and, they in fact, comply with the standards:

(1) When providing investment advice to a Retirement Investor regarding the Principal Transaction or Riskless Principal Transaction, the Financial Institution and Adviser provide investment advice that is, at the time of the recommendation, in the Best Interest of the Retirement Investor. As further defined in Section VI(c), 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 Adviser, Financial Institution, or any Affiliate or other party;

(2) The Adviser and Financial Institution seek to obtain the best execution reasonably available under the circumstances with respect to the Principal Transaction or Riskless Principal Transaction.

(i) Financial Institutions that are FINRA members shall satisfy this Section II(c)(2) if they comply with the terms of FINRA rules 2121 (Fair Prices and Commissions) and 5310 (Best Execution and Interpositioning), or any successor rules in effect at the time of the transaction, as interpreted by FINRA, with respect to the Principal Transaction or Riskless Principal Transaction.

(ii) The Department may identify specific requirements regarding best execution and/or fair prices imposed by another regulator or self-regulatory organization relating to additional Principal Traded Assets pursuant to Section VI(j)(1)(iv) in an individual exemption that may be satisfied as an alternative to the standard set forth in Section II(c)(2) above.

(3) Statements by the Financial Institution and its Advisers to the Retirement Investor about the Principal Transaction or Riskless Principal Transaction, fees and compensation related to the Principal Transaction or Riskless Principal Transaction, Material Conflicts of Interest, and any other matters relevant to a Retirement Investor's decision to engage in the Principal Transaction or Riskless Principal Transaction, will not be materially misleading at the time they are made.

(d) Warranty. The Financial Institution affirmatively warrants, and in fact complies with, the following:

(1) The Financial Institution has adopted and will comply with written policies and procedures reasonably and prudently designed to ensure that its individual Advisers adhere to the Impartial Conduct Standards set forth in Section II(c);

(2) In formulating its policies and procedures, the Financial Institution has specifically identified and documented its Material Conflicts of Interest associated with Principal Transactions and Riskless Principal Transactions;

adopted measures reasonably and prudently designed to prevent Material Conflicts of Interest from causing violations of the Impartial Conduct Standards set forth in Section II(c); and designated a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards;

(3) The Financial Institution's policies and procedures require that neither the Financial Institution nor (to the best of the Financial Institution's knowledge) any Affiliate uses or relies on 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 individual Advisers to make recommendations regarding Principal Transactions and Riskless Principal Transactions that are not in the Best Interest of the Retirement Investor. Notwithstanding the foregoing, the requirement of this Section II(d)(3) does not prevent the Financial Institution or its Affiliates from providing Advisers with differential compensation (whether in type or amount, and including, but not limited to, commissions) based on investment decisions by Plans, participant or beneficiary accounts, or IRAs, to the extent that the policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of Advisers with the interests of the Retirement Investors they serve as fiduciaries;

(4) The Financial Institution's written policies and procedures regarding Principal Transactions and Riskless Principal Transactions address how credit risk and liquidity assessments for Debt Securities, as required by Section III(a)(3), will be made.

(e) Transaction Disclosures. In the contract, or in a separate single written disclosure provided to the Retirement Investor or Plan prior to or at the same time as the execution of the Principal Transaction or Riskless Principal Transaction, the Financial Institution clearly and prominently:

(1) Sets forth in writing (i) the circumstances under which the Adviser and Financial Institution may engage in Principal Transactions and Riskless Principal Transactions with the Plan, participant or beneficiary account, or IRA, (ii) a description of the types of compensation that may be received by the Adviser and Financial Institution in connection with Principal Transactions and Riskless Principal Transactions, including any types of compensation that may be received from third parties, and (iii) identifies and discloses the Material Conflicts of Interest associated with Principal Transactions and Riskless Principal Transactions;

(2) Except for Existing Contracts, documents the Retirement Investor's affirmative written consent, on a prospective basis, to Principal Transactions and Riskless Principal Transactions between the Adviser or Financial Institution and the Plan, participant or beneficiary account, or IRA;

(3) Informs the Retirement Investor (i) that the consent set forth in Section II(e)(2) is terminable at will upon written notice by the Retirement Investor at any time, without penalty to the Plan or IRA, (ii) of the right to obtain, free of charge, copies of the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d), as well as information about the Principal Traded Asset, including its purchase or sales price, and other salient attributes, including, as applicable: The credit quality of the issuer; the effective yield; the call provisions; and the duration, provided that if the Retirement Investor's request is made prior to the transaction, the information must be provided prior to the transaction, and if the request is made after the transaction, the information must be provided within 30 business days after the request, (iii) that model contract disclosures or other model notice of the contractual terms which are reviewed for accuracy no less than quarterly and updated within 30 days as necessary are maintained on the Financial Institution's Web site, and (iv) that the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d) is available free of charge on the Financial Institution's Web site; and

(4) Describes whether or not the Adviser and Financial Institution will monitor the Retirement Investor's investments that are acquired through Principal Transactions and Riskless Principal Transactions and alert the Retirement Investor to any recommended change to those investments and, if so, the frequency with which the monitoring will occur and the reasons for which the Retirement Investor will be alerted.

(5) The Financial Institution will not fail to satisfy this Section II(e), or violate a contractual provision based thereon, solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, or if the Web site is temporarily inaccessible, provided that (i) in the case of an error or omission on the web, the Financial Institution discloses the correct information as soon as practicable, but not later than 7 days after the date on which it discovers or reasonably should have discovered the error or omission, and (ii) in the case of other disclosures, the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. To the extent compliance with this requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

(f) Ineligible Contractual Provisions. Relief is not available under the exemption if a Financial Institution's contract contains the following:

(1) Exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms;

(2) Except as provided in paragraph (f)(4) of this section, a provision under which the Plan, IRA or the 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 Adviser or Financial Institution, or in an individual or class claim agrees to an amount representing liquidated damages for breach of the contract; provided that, the parties may 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; or

(3) Agreements 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 this exemption.

(4) In the event provision on pre-dispute arbitration agreements for class or representative claims in paragraph (f)(2) of this section is ruled invalid by a court of competent jurisdiction, this provision shall not be a condition of this exemption with respect to contracts subject to the court's jurisdiction unless and until the court's decision is reversed, but all other terms of the exemption shall remain in effect.

(g) ERISA Plans. For recommendations to Retirement Investors regarding Principal Transactions and Riskless Principal Transactions with Plans that are covered by Title I of ERISA, relief under the exemption is conditioned upon the Adviser and Financial Institution complying with certain provisions of Section II, as follows:

(1) Prior to or at the same time as the execution of the Principal Transaction or Riskless Principal Transaction, the Financial Institution provides the Retirement Investor with a written statement of the Financial Institution's and its Advisers' fiduciary status, in accordance with Section II(b).

(2) The Financial Institution and the Adviser comply with the Impartial Conduct Standards of Section II(c).

(3) The Financial Institution adopts policies and procedures incorporating the requirements and prohibitions set forth in Section II(d)(1)-(4), and the Financial Institution and Adviser comply with those requirements and prohibitions.

(4) The Financial Institution provides the disclosures required by Section II(e).

(5) The Financial Institution and Adviser do not in any contract, instrument, or communication purport to disclaim any responsibility or liability for any responsibility, obligation, or duty under Title I of ERISA to the extent the disclaimer would be prohibited by ERISA section 410, waive or qualify the right of the Retirement Investor to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution, or require arbitration or mediation of individual claims in locations that are distant or that otherwise unreasonably limit the ability of the Retirement Investors to assert the claims safeguarded by this exemption.

Section III—General Conditions

The Adviser and Financial Institution must satisfy the following conditions to be covered by this exemption:

(a) Debt Security Conditions. Solely with respect to the purchase of a Debt Security by a Plan, participant or beneficiary account, or IRA:

(1) The Debt Security being purchased was not issued by the Financial Institution or any Affiliate;

(2) The Debt Security being purchased is not purchased by the Plan, participant or beneficiary account, or IRA in an underwriting or underwriting syndicate in which the Financial Institution or any Affiliate is an underwriter or a member;

(3) Using information reasonably available to the Adviser at the time of the transaction, the Adviser determines that the Debt Security being purchased:

(i) Possesses no greater than a moderate credit risk; and

(ii) Is sufficiently liquid that the Debt Security could be sold at or near its carrying value within a reasonably short period of time.

(b) Arrangement. The Principal Transaction or Riskless Principal Transaction is not part of an agreement, arrangement, or understanding designed to evade compliance with ERISA or the Code, or to otherwise impact the value of the Principal Traded Asset.

(c) Cash. The purchase or sale of the Principal Traded Asset is for cash.

Section IV—Disclosure Requirements

This section sets forth the Adviser's and the Financial Institution's disclosure obligations to the Retirement Investor.

(a) Pre-Transaction Disclosure. Prior to or at the same time as the execution of the Principal Transaction or Riskless Principal Transaction, the Adviser or the Financial Institution informs the Retirement Investor, orally or in writing, of the capacity in which the Financial Institution may act with respect to such transaction.

(b) Confirmation. The Adviser or the Financial Institution provides a written confirmation of the Principal Transaction or Riskless Principal Transaction. This requirement may be satisfied by compliance with Rule 10b–10 under the Securities Exchange Act of 1934, or any successor rule in effect in effect at the time of the transaction, or for Advisers and Financial Institutions not subject to the Securities Exchange Act of 1934, similar requirements imposed by another regulator or self-regulatory organization.

(c) Annual Disclosure. The Adviser or the Financial Institution sends to the Retirement Investor, no less frequently than annually, written disclosure in a single disclosure:

(1) A list identifying each Principal Transaction and Riskless Principal Transaction executed in the Retirement Investor's account in reliance on this exemption during the applicable period and the date and price at which the transaction occurred; and

(2) A statement that (i) the consent required pursuant to Section II(e)(2) is terminable at will upon written notice, without penalty to the Plan or IRA, (ii) the right of a Retirement Investor in accordance with Section II(e)(3)(ii) to obtain, free of charge, information about the Principal Traded Asset, including its salient attributes, (iii) model contract disclosures or other model notice of the contractual terms, which are reviewed for accuracy no less frequently than quarterly and updated within 30 days if necessary, are maintained on the Financial Institution's Web site, and (iv) the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d) are available free of charge on the Financial Institution's Web site.

(d) The Financial Institution will not fail to satisfy this Section IV solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, or if the Web site is temporarily inaccessible, provided that (i) in the case of an error or omission on the web, the Financial Institution discloses the correct information as soon as practicable, but not later than 7 days after the date on which it discovers or reasonably should have discovered the error or omission, and (ii) in the case of other disclosures, the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. To the extent compliance with the disclosure requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, the exemption provides that they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

(e) The Financial Institution prepares a written description of its policies and procedures and makes it available on its Web site and additionally, to Retirement Investors, free of charge, upon request. The description must accurately describe or summarize key components of the policies and procedures relating to conflict-mitigation and incentive practices in a manner that permits Retirement Investors to make an informed judgment about the stringency of the Financial Institution's protections against conflicts of interest. Additionally, Financial Institutions must provide their complete policies and procedures to the Department upon request.

Section V—Recordkeeping

This section establishes record retention and availability requirements that a Financial Institution must meet in order for it to rely on the exemption.

(a) The Financial Institution maintains for a period of six (6) years from the date of each Principal Transaction or Riskless Principal Transaction, in a manner that is reasonably accessible for examination, the records necessary to enable the persons described in Section V(b) to determine whether the conditions of this exemption have been met, except that:

(1) If such records are lost or destroyed, due to circumstances beyond the control of the Financial Institution, then no prohibited transaction will be considered to have occurred solely on the basis of the unavailability of those records; and

(2) No party other than the Financial Institution that is engaging in the Principal Transaction or Riskless Principal Transaction shall be subject to the civil penalty that may be assessed under ERISA section 502(i) or to the taxes imposed by Code sections 4975(a) and (b) if the records are not maintained or are not available for examination as required by Section V(b).

(b)(1) Except as provided in Section V(b)(2) or as precluded by 12 U.S.C. 484, and notwithstanding any provisions of ERISA sections 504(a)(2) and 504(b), the records referred to in Section V(a) are reasonably available at their customary location for examination during normal business hours by:

(i) Any duly authorized employee or representative of the Department or the Internal Revenue Service;

(ii) any fiduciary of the Plan or IRA that was a party to a Principal Transaction or Riskless Principal Transaction described in this exemption, or any duly authorized employee or representative of such fiduciary;

(iii) any employer of participants and beneficiaries and any employee organization whose members are covered by the Plan, or any authorized employee or representative of these entities; and

(iv) any participant or beneficiary of the Plan, or the beneficial owner of an IRA.

(2) None of the persons described in subparagraph (1)(ii) through (iv) are authorized to examine records regarding a Prohibited Transaction involving another Retirement Investor, or trade secrets of the Financial Institution, or commercial or financial information which is privileged or confidential; and

(3) Should the Financial Institution refuse to disclose information on the basis that such information is exempt from disclosure, the Financial Institution must by the close of the thirtieth (30th) day following the request, provide a written notice advising the requestor of the reasons for the refusal and that the Department may request such information.

(4) Failure to maintain the required records necessary to determine whether the conditions of this exemption have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions.

Section VI—Definitions

For purposes of this exemption:

(a) "Adviser" means an individual who:

(1) Is a fiduciary of a Plan or IRA solely by reason of the provision of investment advice described in ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B), or both, and the applicable regulations, with respect to the Assets involved in the transaction;

(2) Is an employee, independent contractor, agent, or registered representative of a Financial Institution; and

(3) Satisfies the applicable federal and state regulatory and licensing requirements of banking, and securities laws with respect to the covered transaction.

(b) "Affiliate" of an Adviser or Financial Institution means:

(1) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution. For this purpose, the term "control" means the power to exercise a controlling influence over the management or policies of a person other than an individual;

(2) Any officer, director, partner, employee, or relative (as defined in ERISA section 3(15)) of the Adviser or Financial Institution; or

(3) Any corporation or partnership of which the Adviser or Financial Institution is an officer, director, or partner of the Adviser or Financial Institution.

(c) Investment advice is in the "Best Interest" of the Retirement Investor when the Adviser 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, any Affiliate or other party.

(d) "Debt Security" means a "debt security" as defined in Rule 10b–10(d)(4) of the Exchange Act that is:

(1) U.S. dollar denominated, issued by a U.S. corporation and offered pursuant to a registration statement under the Securities Act of 1933;

(2) An "Agency Debt Security" as defined in FINRA rule 6710(l) or its successor;

(3) An "Asset Backed Security" as defined in FINRA rule 6710(m) or its successor, that is guaranteed by an Agency as defined in FINRA rule 6710(k) or its successor, or a Government Sponsored Enterprise as defined in FINRA rule 6710(n) or its successor; or

(4) A "U.S. Treasury Security" as defined in FINRA rule 6710(p) or its successor.

(e) "Financial Institution" means the entity that (i) employs the Adviser or otherwise retains such individual as an independent contractor, agent or registered representative, and (ii) customarily purchases or sells Principal Traded Assets for its own account in the ordinary course of its business, and that is:

(1) Registered as an investment adviser under the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 *et seq.*) or under the laws of the state in which the adviser maintains its principal office and place of business;

(2) A bank or similar financial institution supervised by the United States or state, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1))); and

(3) A broker or dealer registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(f) ''Independent'' means a person that:

(1) Is not the Adviser or Financial Institution or an Affiliate;

(2) Does not receive or is not projected to receive within the current federal income tax year, compensation or other consideration for his or her own account from the Adviser, Financial Institution or an Affiliate in excess of 2% of the person's annual revenues based upon its prior income tax year; and

(3) Does not have a relationship to or an interest in the Adviser, Financial Institution or an Affiliate that might affect the exercise of the person's best judgment in connection with transactions described in this exemption.

(g) ''Individual Retirement Account'' or ''IRA'' means any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in Code section 408(a) and a health savings account described in Code section 223(d).

(h) A ''Material Conflict of Interest'' exists when an Adviser or Financial Institution has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor.

(i) ''Plan'' means an employee benefit plan described in ERISA section 3(3) and any plan described in Code section 4975(e)(1)(A).

(j) ''Principal Traded Asset'' means:

(1) For purposes of a purchase by a Plan, participant or beneficiary account, or IRA,

(i) a Debt Security, as defined in subsection (d) above;

(ii) a certificate of deposit (CD);

(iii) an interest in a Unit Investment Trust, within the meaning of Section 4(2) of the Investment Company Act of 1940, as amended; or

(iv) an investment that is permitted to be purchased under an individual exemption granted by the Department under ERISA section 408(a) and/or Code section 4975(c), after the effective date of this exemption, that provides relief for investment advice fiduciaries to engage in the purchase of the investment in a Principal Transaction or a Riskless Principal Transaction with a Plan or IRA under the same conditions as this exemption; and

(2) for purposes of a sale by a Plan, participant or beneficiary account, or IRA, securities or other investment property.

(k) ''Principal Transaction'' means a purchase or sale of a Principal Traded Asset in which an Adviser or Financial Institution is purchasing from or selling to a Plan, participant or beneficiary account, or IRA on behalf of the Financial Institution's own account or the account of a person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Financial Institution. For purposes of this definition, a Principal Transaction does not include a Riskless Principal Transaction as defined in Section VI(m).

(l) ''Retirement Investor'' means:

(1) A fiduciary of a non-participant directed Plan subject to Title I of ERISA or described in Code section 4975(c)(1)(A) with authority to make investment decisions for the Plan;

(2) A participant or beneficiary of a Plan subject to Title I of ERISA or described in Code section 4975(c)(1)(A) with authority to direct the investment of assets in his or her Plan account or to take a distribution; or

(3) The beneficial owner of an IRA acting on behalf of the IRA.

(m) ''Riskless Principal Transaction'' means a transaction in which a Financial Institution, after having received an order from a Retirement Investor to buy or sell a Principal Traded Asset, purchases or sells the asset for the Financial Institution's own account to offset the contemporaneous transaction with the Retirement Investor.

Section VII—Transition Period for Exemption

(a) In general. ERISA and the Internal Revenue Code prohibit fiduciary advisers to employee benefit plans (Plans) and individual retirement plans (IRAs) from receiving compensation that varies based on their investment recommendations. ERISA and the Code also prohibit fiduciaries from engaging in securities purchases and sales with Plans or IRAs on behalf of their own accounts (Principal Transactions). This transition period provides relief from the restrictions of ERISA section 406(a)(1)(A) and (D) and section 406(b)(1) and (2), and the taxes imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A), (D), and (E) for the period from April 10, 2017, to January 1, 2018 (the Transition Period) for Advisers and Financial Institutions to engage in certain Principal Transactions and Riskless Principal Transactions with Plans and IRAs subject to the conditions described in Section VII(d).

(b) Covered transactions. This provision permits an Adviser or Financial Institution to engage in the purchase or sale of a Principal Traded Asset in a Principal Transaction or a Riskless Principal Transaction with a Plan, participant or beneficiary account, or IRA, and receive a mark-up, mark-down or other similar payment as applicable to the transaction for themselves or any Affiliate, as a result of the Adviser's and Financial Institution's advice regarding the Principal Transaction or the Riskless Principal Transaction, during the Transition Period.

(c) Exclusions. This provision does not apply if:

(1) The Adviser: (i) Has or exercises any discretionary authority or discretionary control respecting management of the assets of the Plan or IRA involved in the transaction or exercises any discretionary authority or control respecting management or the disposition of the assets; or (ii) has any discretionary authority or discretionary responsibility in the administration of the Plan or IRA; or

(2) The Plan is covered by Title I of ERISA, and (i) the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the Plan, or (ii) the Adviser 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;

(d) Conditions. The provision is subject to the following conditions:

(1) The Financial Institution and Adviser adhere to the following standards:

(i) When providing investment advice to the Retirement Investor regarding the Principal Transaction or Riskless Principal Transaction, the Financial Institution and the Adviser(s) provide investment advice that is, at the time of the recommendation, in the Best Interest of the Retirement Investor. As further defined in Section VI(c), 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 Adviser, Financial Institution or any Affiliate or other party;

(ii) The Adviser and Financial Institution will seek to obtain the best execution reasonably available under the circumstances with respect to the

Principal Transaction or Riskless Principal Transaction. Financial Institutions that are FINRA members shall satisfy this requirement if they comply with the terms of FINRA rules 2121 (Fair Prices and Commissions) and 5310 (Best Execution and Interpositioning), or any successor rules in effect at the time of the transaction, as interpreted by FINRA, with respect to the Principal Transaction or Riskless Principal Transaction; and

(iii) Statements by the Financial Institution and its Advisers to the Retirement Investor about the Principal Transaction or Riskless Principal Transaction, fees and compensation related to the Principal Transaction or Riskless Principal Transaction, Material Conflicts of Interest, and any other matters relevant to a Retirement Investor's decision to engage in the Principal Transaction or Riskless Principal Transaction, are not materially misleading at the time they are made.

(2) Disclosures. The Financial Institution provides to the Retirement Investor, prior to or at the same time as the execution of the recommended Principal Transaction or Riskless Principal Transaction, a single written disclosure, which may cover multiple transactions or all transactions occurring within the Transition Period, that clearly and prominently:

(i) Affirmatively states that the Financial Institution and the Adviser(s) act as fiduciaries under ERISA or the Code, or both, with respect to the recommendation;

(ii) Sets forth the standards in paragraph (d)(1) of this section and affirmatively states that it and the Adviser(s) adhered to such standards in recommending the transaction; and

(iii) Discloses the circumstances under which the Adviser and Financial Institution may engage in Principal Transactions and Riskless Principal Transactions with the Plan, participant or beneficiary account, or IRA, and identifies and discloses the Material Conflicts of Interest associated with Principal Transactions and Riskless Principal Transactions.

(iv) The disclosure may be provided in person, electronically or by mail. It does not have to be repeated for any subsequent recommendations during the Transition Period.

(v) The Financial Institution will not fail to satisfy this Section VII(d)(2) solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, provided the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. To the extent compliance with this Section VII(d)(2) requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know, or unless they should have known, that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

(3) The Financial Institution must designate a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards.

(4) The Financial Institution complies with the recordkeeping requirements of Section V(a) and (b).

Signed at Washington, DC, this 1st day of April, 2016.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

[FR Doc. 2016–07926 Filed 4–6–16; 11:15 am]

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DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

[Application Number D–11687]

ZRIN 1210–ZA25

Amendment to Prohibited Transaction Exemption (PTE) 75–1, Part V, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks

AGENCY: Employee Benefits Security Administration (EBSA), U.S. Department of Labor.

ACTION: Adoption of amendment to PTE 75–1, Part V.

SUMMARY: This document contains an amendment to PTE 75–1, Part V, a class exemption from certain prohibited transactions provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (the Code). The provisions at issue generally prohibit fiduciaries of employee benefit plans and individual retirement accounts (IRAs), from lending money or otherwise extending credit to the plans and IRAs and receiving compensation in return. PTE 75–1, Part V, permits the extension of credit to a plan or IRA by a broker-dealer in connection with the purchase or sale of securities; however, it originally did not permit the receipt of compensation for an extension of credit by broker-dealers that are fiduciaries with respect to the assets involved in the transaction. This amendment permits investment advice fiduciaries to receive compensation when they extend credit to plans and IRAs to avoid a failed securities transaction. The amendment affects participants and beneficiaries of plans, IRA owners, and fiduciaries with respect to such plans and IRAs.

DATES: *Issuance date:* This amendment is issued June 7, 2016.

Applicability date: This amendment is applicable to transactions occurring on or after April 10, 2017. See *Applicability Date,* below, for further information.

FOR FURTHER INFORMATION CONTACT: Susan Wilker, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor, (202) 693–8824 (this is not a toll-free number).

SUPPLEMENTARY INFORMATION: The Department is amending PTE 75–1, Part V on its own motion, pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637 (October 27, 2011)).

Executive Summary

Purpose of Regulatory Action

The Department grants this amendment to PTE 75–1, Part V, in connection with its publication today, elsewhere in this issue of the **Federal Register**, of a final regulation defining who is a "fiduciary" of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries (Regulation). The Regulation also applies to the definition of a "fiduciary" of a plan (including an IRA) under the

Principal Transaction or Riskless Principal Transaction. Financial Institutions that are FINRA members shall satisfy this requirement if they comply with the terms of FINRA rules 2121 (Fair Prices and Commissions) and 5310 (Best Execution and Interpositioning), or any successor rules in effect at the time of the transaction, as interpreted by FINRA, with respect to the Principal Transaction or Riskless Principal Transaction; and

(iii) Statements by the Financial Institution and its Advisers to the Retirement Investor about the Principal Transaction or Riskless Principal Transaction, fees and compensation related to the Principal Transaction or Riskless Principal Transaction, Material Conflicts of Interest, and any other matters relevant to a Retirement Investor's decision to engage in the Principal Transaction or Riskless Principal Transaction, are not materially misleading at the time they are made.

(2) Disclosures. The Financial Institution provides to the Retirement Investor, prior to or at the same time as the execution of the recommended Principal Transaction or Riskless Principal Transaction, a single written disclosure, which may cover multiple transactions or all transactions occurring within the Transition Period, that clearly and prominently:

(i) Affirmatively states that the Financial Institution and the Adviser(s) act as fiduciaries under ERISA or the Code, or both, with respect to the recommendation;

(ii) Sets forth the standards in paragraph (d)(1) of this section and affirmatively states that it and the Adviser(s) adhered to such standards in recommending the transaction; and

(iii) Discloses the circumstances under which the Adviser and Financial Institution may engage in Principal Transactions and Riskless Principal Transactions with the Plan, participant or beneficiary account, or IRA, and identifies and discloses the Material Conflicts of Interest associated with Principal Transactions and Riskless Principal Transactions.

(iv) The disclosure may be provided in person, electronically or by mail. It does not have to be repeated for any subsequent recommendations during the Transition Period.

(v) The Financial Institution will not fail to satisfy this Section VII(d)(2) solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, provided the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. To the extent compliance with this Section VII(d)(2) requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know, or unless they should have known, that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

(3) The Financial Institution must designate a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards.

(4) The Financial Institution complies with the recordkeeping requirements of Section V(a) and (b).

Signed at Washington, DC, this 1st day of April, 2016.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

[FR Doc. 2016–07926 Filed 4–6–16; 11:15 am]

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DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

[Application Number D–11687]

ZRIN 1210–ZA25

Amendment to Prohibited Transaction Exemption (PTE) 75–1, Part V, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks

AGENCY: Employee Benefits Security Administration (EBSA), U.S. Department of Labor.

ACTION: Adoption of amendment to PTE 75–1, Part V.

SUMMARY: This document contains an amendment to PTE 75–1, Part V, a class exemption from certain prohibited transactions provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (the Code). The provisions at issue generally prohibit fiduciaries of employee benefit plans and individual retirement accounts (IRAs), from lending money or otherwise extending credit to the plans and IRAs and receiving compensation in return. PTE 75–1, Part V, permits the extension of credit to a plan or IRA by a broker-dealer in connection with the purchase or sale of securities; however, it originally did not permit the receipt of compensation for an extension of credit by broker-dealers that are fiduciaries with respect to the assets involved in the transaction. This amendment permits investment advice fiduciaries to receive compensation when they extend credit to plans and IRAs to avoid a failed securities transaction. The amendment affects participants and beneficiaries of plans, IRA owners, and fiduciaries with respect to such plans and IRAs.

DATES: *Issuance date:* This amendment is issued June 7, 2016.

Applicability date: This amendment is applicable to transactions occurring on or after April 10, 2017. See *Applicability Date,* below, for further information.

FOR FURTHER INFORMATION CONTACT: Susan Wilker, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor, (202) 693–8824 (this is not a toll-free number).

SUPPLEMENTARY INFORMATION: The Department is amending PTE 75–1, Part V on its own motion, pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637 (October 27, 2011)).

Executive Summary

Purpose of Regulatory Action

The Department grants this amendment to PTE 75–1, Part V, in connection with its publication today, elsewhere in this issue of the **Federal Register**, of a final regulation defining who is a "fiduciary" of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries (Regulation). The Regulation also applies to the definition of a "fiduciary" of a plan (including an IRA) under the

Code. The Regulation amends a prior regulation specifying when a person is a "fiduciary" under ERISA and the Code by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. The Regulation amends a prior regulation, dating to 1975, specifying when a person is a "fiduciary" under ERISA and the Code by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. The Regulation takes into account the advent of 401(k) 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 existing regulation was issued. In light of the extensive changes in retirement investment practices and relationships, the Regulation updates 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.

This amendment to PTE 75–1, Part V, allows broker-dealers that are investment advice fiduciaries to receive compensation when they extend credit to plans and IRAs to avoid failed securities transactions entered into by the plan or IRA. In the absence of an exemption, these transactions would be prohibited under ERISA and the Code. In this regard, ERISA and the Code generally prohibit fiduciaries from lending money or otherwise extending credit to plans and IRAs, and from receiving compensation in return.

ERISA section 408(a) specifically authorizes the Secretary of Labor to grant and amend administrative exemptions from ERISA's prohibited transaction provisions.[1] Regulations at 29 CFR 2570.30 to 2570.52 describe the procedures for applying for an administrative exemption. In granting this amended exemption, the Department has determined that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners.

Summary of the Major Provisions

The amendment to PTE 75–1, Part V, allows investment advice fiduciaries that are broker-dealers to receive compensation when they lend money or otherwise extend credit to plans or IRAs to avoid the failure of a purchase or sale of a security. The exemption contains conditions that the broker-dealer lending money or otherwise extending credit must satisfy in order to take advantage of the exemption. In particular, the potential failure of the securities transaction may not be caused by the fiduciary or an affiliate, and the terms of the extension of credit must be at least as favorable to the plan or IRA as terms the plan or IRA could obtain in an arm's length transaction with an unrelated party. Certain advance written disclosures must be made to the plan or IRA, in particular, with respect to the rate of interest or other fees charged for the loan or other extension of credit.

Executive Order 12866 and 13563 Statement

Under Executive Orders 12866 and 13563, the Department must determine whether a regulatory action is "significant" and therefore subject to the requirements of the Executive Order and subject to review by the Office of Management and Budget (OMB). Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing and streamlining rules, and of promoting flexibility. It also requires federal agencies to develop a plan under which the agencies will periodically review their existing significant regulations to make the agencies' regulatory programs more effective or less burdensome in achieving their regulatory objectives.

Under Executive Order 12866, "significant" regulatory actions are subject to the requirements of the Executive Order and review by the OMB. Section 3(f) of Executive Order 12866, defines a "significant regulatory action" as an action that is likely to result in a rule (1) having an annual effect on the economy of $100 million or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as "economically significant" regulatory actions); (2) creating serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order. Pursuant to the terms of the Executive Order, OMB has determined that this action is "significant" within the meaning of Section 3(f)(4) of the Executive Order. Accordingly, the Department has undertaken an assessment of the costs and benefits of the proposal, and OMB has reviewed this regulatory action. The Department's complete Regulatory Impact Analysis is available at *www.dol.gov/ebsa.*

Regulation Defining a Fiduciary

As explained more fully in the preamble to the Regulation, ERISA is a comprehensive statute designed to protect the interests of plan participants and beneficiaries, the integrity of employee benefit plans, and the security of retirement, health, and other critical benefits. The broad public interest in ERISA-covered plans is reflected in its imposition of fiduciary responsibilities on parties engaging in important plan activities, as well as in the tax-favored status of plan assets and investments. One of the chief ways in which ERISA protects employee benefit plans is by

[1] Code section 4975(c)(2) authorizes the Secretary of the Treasury to grant exemptions from the parallel prohibited transaction provisions of the Code. Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)) ("Reorganization Plan") generally transferred the authority of the Secretary of the Treasury to grant administrative exemptions under Code section 4975 to the Secretary of Labor. To rationalize the administration and interpretation of dual provisions under ERISA and the Code, the Reorganization Plan divided the interpretive and rulemaking authority for these provisions between the Secretaries of Labor and of the Treasury, so that, in general, the agency with responsibility for a given provision of Title I of ERISA would also have responsibility for the corresponding provision in the Code. Among the sections transferred to the Department were the prohibited transaction provisions and the definition of a fiduciary in both Title I of ERISA and in the Code. ERISA's prohibited transaction rules, 29 U.S.C. 1106–1108, apply to ERISA-covered plans, and the Code's corresponding prohibited transaction rules, 26 U.S.C. 4975(c), apply both to ERISA-covered pension plans that are tax-qualified pension plans, as well as other tax-advantaged arrangements, such as IRAs, that are not subject to the fiduciary responsibility and prohibited transaction rules in ERISA. Specifically, section 102(a) of the Reorganization Plan provides the Department of Labor with "all authority" for "regulations, rulings, opinions, and exemptions under section 4975 [of the Code]" subject to certain exceptions not relevant here. Reorganization Plan section 102. In President Carter's message to Congress regarding the Reorganization Plan, he made explicitly clear that as a result of the plan, "Labor will have statutory authority for fiduciary obligations. . . . Labor will be responsible for overseeing fiduciary conduct under these provisions." Reorganization Plan, Message of the President. This amended exemption provides relief from the indicated prohibited transaction provisions of both ERISA and the Code.

requiring that plan fiduciaries comply with fundamental obligations rooted in the law of trusts. In particular, plan fiduciaries must manage plan assets prudently and with undivided loyalty to the plans and their participants and beneficiaries.[2] In addition, they must refrain from engaging in ''prohibited transactions,'' which ERISA does not permit because of the dangers posed by the fiduciaries' conflicts of interest with respect to the transactions.[3] When fiduciaries violate ERISA's fiduciary duties or the prohibited transaction rules, they may be held personally liable for the breach.[4] In addition, violations of the prohibited transaction rules are subject to excise taxes under the Code.

The Code also has rules regarding fiduciary conduct with respect to tax-favored accounts that are not generally covered by ERISA, such as IRAs. In particular, fiduciaries of these arrangements, including IRAs, are subject to the prohibited transaction rules and, when they violate the rules, to the imposition of an excise tax enforced by the Internal Revenue Service. Unlike participants in plans covered by Title I of ERISA, IRA owners do not have a statutory right to bring suit against fiduciaries for violations of the prohibited transaction rules.

Under this statutory framework, the determination of who is a ''fiduciary'' is of central importance. Many of ERISA's and the Code's protections, duties, and liabilities hinge on fiduciary status. In relevant part, ERISA section 3(21)(A) and Code section 4975(e)(3) provide that a person is a fiduciary with respect to a plan or IRA to the extent he or she (i) exercises any discretionary authority or discretionary control with respect to management of such plan or IRA, or exercises any authority or control with respect to management or disposition of its assets; (ii) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan or IRA, or has any authority or responsibility to do so; or, (iii) has any discretionary authority or discretionary responsibility in the administration of such plan or IRA.

The statutory definition deliberately casts a wide net in assigning fiduciary responsibility with respect to plan and IRA assets. Thus, ''any authority or control'' over plan or IRA assets is sufficient to confer fiduciary status, and any persons who render ''investment advice for a fee or other compensation, direct or indirect'' are fiduciaries, regardless of whether they have direct control over the plan's or IRA's assets and regardless of their status as an investment adviser or broker under the federal securities laws. The statutory definition and associated responsibilities were enacted to ensure that plans, plan participants, and IRA owners can depend on persons who provide investment advice for a fee to provide recommendations that are untainted by conflicts of interest. In the absence of fiduciary status, the providers of investment advice are neither subject to ERISA's fundamental fiduciary standards, nor accountable under ERISA or the Code for imprudent, disloyal, or biased advice.

In 1975, the Department issued a regulation, at 29 CFR 2510.3–21(c)(1975), defining the circumstances under which a person is treated as providing ''investment advice'' to an employee benefit plan within the meaning of ERISA section 3(21)(A)(ii) (the ''1975 regulation'').[5] The 1975 regulation narrowed the scope of the statutory definition of fiduciary investment advice by creating a five-part test for fiduciary advice. Under the 1975 regulation, for advice to constitute ''investment advice,'' an adviser must (1) render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property (2) on a regular basis (3) pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary that (4) the advice will serve as a primary basis for investment decisions with respect to plan assets, and that (5) the advice will be individualized based on the particular needs of the plan. The 1975 regulation provided that an adviser is a fiduciary with respect to any particular instance of advice only if he or she meets each and every element of the five-part test with respect to the particular advice recipient or plan at issue.

The market for retirement advice has changed dramatically since the Department first promulgated the 1975 regulation. Individuals, rather than large employers and professional money managers, have become increasingly responsible for managing retirement assets as IRAs and participant-directed plans, such as 401(k) plans, have supplanted defined benefit pensions. At the same time, the variety and complexity of financial products have increased, widening the information gap between advisers and their clients. Plan fiduciaries, plan participants and IRA investors must often rely on experts for advice, but are unable to assess the quality of the expert's advice or effectively guard against the adviser's conflicts of interest. This challenge is especially true of retail investors with smaller account balances who typically do not have financial expertise, and can ill-afford lower returns to their retirement savings caused by conflicts. The IRA accounts of these investors often account for all or the lion's share of their assets and can represent all of savings earned for a lifetime of work. Losses and reduced returns can be devastating to the investors who depend upon such savings for support in their old age. As baby boomers retire, they are increasingly moving money from ERISA-covered plans, where their employer has both the incentive and the fiduciary duty to facilitate sound investment choices, to IRAs where both good and bad investment choices are myriad and advice that is conflicted is commonplace. These rollovers are expected to approach $2.4 trillion cumulatively from 2016 through 2020.[6] These trends were not apparent when the Department promulgated the 1975 regulation. At that time, 401(k) plans did not yet exist and IRAs had only just been authorized.

As the marketplace for financial services has developed in the years since 1975, the five-part test has now come to undermine, rather than promote, the statutes' text and purposes. The narrowness of the 1975 regulation has allowed advisers, brokers, consultants and valuation firms to play a central role in shaping plan and IRA investments, without ensuring the accountability that Congress intended for persons having such influence and responsibility. Even when plan sponsors, participants, beneficiaries, and IRA owners clearly relied on paid advisers for impartial guidance, the 1975 regulation has allowed many advisers to avoid fiduciary status and disregard basic fiduciary obligations of care and prohibitions on disloyal and conflicted transactions. As a consequence, these advisers have been able to steer customers to investments based on their own self-interest (*e.g.,* products that generate higher fees for the adviser even if there are identical lower-fee products available), give imprudent advice, and engage in transactions that would otherwise be prohibited by ERISA and the Code

[2] ERISA section 404(a).

[3] ERISA section 406. ERISA also prohibits certain transactions between a plan and a ''party in interest.''

[4] ERISA section 409; *see also* ERISA section 405.

[5] The Department of Treasury issued a virtually identical regulation, at 26 CFR 54.4975–9(c), which interprets Code section 4975(e)(3).

[6] Cerulli Associates, ''Retirement Markets 2015.''

without fear of accountability under either ERISA or the Code.

In the Department's amendments to the 1975 regulation defining fiduciary advice within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B), (the "Regulation") which are also published in this issue of the **Federal Register**, the Department is replacing the existing regulation with one that more appropriately distinguishes between the sorts of advice relationships that should be treated as fiduciary in nature and those that should not, in light of the legal framework and financial marketplace in which IRAs and plans currently operate.[7] The Regulation describes the types of advice that constitute "investment advice" with respect to plan or IRA assets for purposes of the definition of a fiduciary at ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B). The Regulation covers ERISA-covered plans, IRAs, and other plans not covered by Title I, such as Keogh plans, and health savings accounts described in section 223(d) of the Code.

As amended, the Regulation provides that a person renders investment advice with respect to assets of a plan or IRA if, among other things, the person provides, directly to a plan, a plan fiduciary, plan participant or beneficiary, IRA or IRA owner, the following types of advice, for a fee or other compensation, whether 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; and

(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, selection of other persons to provide investment advice or investment management services, types of investment account arrangements (brokerage versus advisory), 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.

In addition, in order to be treated as a fiduciary, such person, either directly or indirectly (*e.g.,* through or together with any affiliate), must: represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code with respect to the advice described; represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code; render 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 direct 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.

The Regulation also provides that as a threshold matter in order to be fiduciary advice, the communication must be a "recommendation" as defined therein. The Regulation, as a matter of clarification, provides that a variety of other communications do not constitute "recommendations," including non-fiduciary investment education; general communications; and specified communications by platform providers. These communications which do not rise to the level of "recommendations" under the Regulation are discussed more fully in the preamble to the final Regulation.

The Regulation also specifies certain circumstances where the Department has determined that a person will not be treated as an investment advice fiduciary even though the person's activities technically may satisfy the definition of investment advice. For example, the Regulation contains a provision excluding recommendations to independent fiduciaries with financial expertise that are acting on behalf of plans or IRAs in arm's length transactions, if certain conditions are met. The independent fiduciary must be a bank, insurance carrier qualified to do business in more than one state, investment adviser registered under the Investment Advisers Act of 1940 or by a state, broker-dealer registered under the Securities Exchange Act of 1934 (Exchange Act), or any other independent fiduciary that holds, or has under management or control, assets of at least $50 million, and: (1) The person making the recommendation must know or reasonably believe 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 (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition); (2) the person must fairly inform 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 must fairly inform the independent fiduciary of the existence and nature of the person's financial interests in the transaction; (3) the person must know or reasonably believe that the independent fiduciary of the plan or IRA is a fiduciary under ERISA or the Code, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition); and (4) the person cannot 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.

Similarly, the Regulation provides that the provision of any advice to an employee benefit plan (as described in ERISA section 3(3)) by a person who is a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, or a swap clearing firm in connection with a swap or security-based swap, as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a) and section 3(a) of the Exchange Act (15 U.S.C. 78c(a)) is not investment advice if certain conditions are met. Finally, the Regulation describes certain communications by employees of a plan sponsor, plan, or plan fiduciary that would not cause the employee to be an investment advice fiduciary if certain conditions are met.

Prohibited Transactions

The Department anticipates that the Regulation will cover many investment professionals who did not previously consider themselves to be fiduciaries under ERISA or the Code. Under the Regulation, these entities will be subject to the prohibited transaction restrictions in ERISA and the Code that apply specifically to fiduciaries. The lending of money or other extension of credit between a fiduciary and a plan or IRA, and the plan's or IRA's payment of

[7] The Department initially proposed an amendment to its regulation defining a fiduciary within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) on October 22, 2010, at 75 FR 65263. It subsequently announced its intention to withdraw the proposal and propose a new rule, consistent with the President's Executive Orders 12866 and 13563, in order to give the public a full opportunity to evaluate and comment on the new proposal and updated economic analysis. The first proposed amendment to the rule was withdrawn on April 20, 2015, *see* 80 FR 21927.

compensation to the fiduciary in return may be prohibited by ERISA section 406(a)(1)(B) and Code section 4975(c)(1)(B) and (D). Further, ERISA section 406(b)(1) and Code section 4975(c)(1)(E) prohibit a fiduciary from dealing with the income or assets of a plan or IRA in his own interest or his own account. ERISA section 406(b)(2), which does not apply to IRAs, provides that a fiduciary shall 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.'' ERISA section 406(b)(3) and Code section 4975(c)(1)(F) prohibit a fiduciary from receiving any consideration for his own personal account from any party dealing with the plan or IRA in connection with a transaction involving assets of the plan or IRA.

Parallel regulations issued by the Departments of Labor and the Treasury explain that these provisions impose on fiduciaries of plans and IRAs a duty not to act on conflicts of interest that may affect the fiduciary's best judgment on behalf of the plan or IRA.[8] The prohibitions extend to a fiduciary causing a plan or IRA to pay an additional fee to such fiduciary, or to a person in which such fiduciary has an interest that may affect the exercise of the fiduciary's best judgment as a fiduciary. Likewise, a fiduciary is prohibited from receiving compensation from third parties in connection with a transaction involving the plan or IRA, or from causing a person in which the fiduciary has an interest which may affect its best judgment as a fiduciary to receive such compensation.[9]

As relevant to this notice, the Department understands that broker-dealers can be required, as part of their relationships with clearing houses, to complete securities transactions entered into by the broker-dealer's customers, even if a particular customer does not perform on its obligations. If a broker-dealer is required to advance funds to settle a trade entered into by a plan or IRA, or purchase a security for delivery on behalf of a plan or IRA, the result can potentially be viewed as a loan of money or other extension of credit to the plan or IRA. Further, in the event a broker-dealer steps into a plan's or IRA's shoes in any particular transaction, it may charge interest or other fees to the plan or IRA. These transactions potentially violate ERISA section 406(a)(1)(B) and Code section 4975(c)(1)(B) and (D).

Prohibited Transaction Exemptions

As reflected in the prohibited transaction provisions, ERISA and the Code strongly disfavor conflicts of interest. In appropriate cases, however, the statutes provide exemptions from the broad prohibitions on conflicts of interest. For example, ERISA section 408(b)(14) and Code section 4975(d)(17) specifically exempt transactions involving the provision of fiduciary investment advice to a participant or beneficiary of an individual account plan or IRA owner, including extensions of short term credit for settlements of securities trades, if the advice, resulting transaction, and the adviser's fees meet stringent conditions carefully designed to guard against conflicts of interest.

In addition, the Secretary of Labor has discretionary authority to grant administrative exemptions under ERISA and the Code on an individual or class basis, but only if the Secretary first finds that the exemptions are (1) administratively feasible, (2) in the interests of plans and their participants and beneficiaries and IRA owners, and (3) protective of the rights of the participants and beneficiaries of such plans and IRA owners. Accordingly, fiduciary advisers may always give advice without need of an exemption if they avoid the sorts of conflicts of interest that result in prohibited transactions. However, when they choose to give advice in which they have a conflict of interest, they must rely upon an exemption.

Pursuant to its exemption authority, the Department has previously granted several conditional administrative class exemptions that are available to fiduciary advisers in defined circumstances. The Department has, for example, permitted investment advice fiduciaries to receive compensation from a plan (*i.e.,* a commission) for executing or effecting securities transactions as agent for the plan.[10] Elsewhere in this issue of the **Federal Register**, a new ''Best Interest Contract Exemption'' is granted for the receipt of compensation by fiduciaries that provide investment advice to IRAs, plan participants and beneficiaries, and certain plan fiduciaries. Receipt by fiduciaries of compensation that varies, or compensation from third parties, as a result of advice to plans, would otherwise violate ERISA section 406(b) and Code section 4975(c). As part of the Department's regulation defining a fiduciary under ERISA section 3(21)(A)(ii), the Department is conditioning these existing and newly-granted exemptions on the fiduciary's commitment to adhere to certain impartial professional conduct standards; in particular, when providing investment advice that results in varying or third-party compensation, investment advice fiduciaries will be required to act in the best interest of the plans and IRAs they are advising.

The class exemptions described above do not provide relief for any extensions of credit that may be related to a plan's or IRA's investment transactions. PTE 75–1, Part V,[11] permits such an extension of credit to a plan or IRA by a broker-dealer in connection with the purchase or sale of securities. Specifically, the Department has acknowledged that the exemption is available for extensions of credit for: The settlement of securities transactions; short sales of securities; the writing of option contracts on securities, and purchasing of securities on margin.[12]

Relief under PTE 75–1, Part V, was historically limited in that the broker-dealer extending credit was not permitted to have or exercise any discretionary authority or control (except as a directed trustee) with respect to the investment of the plan or IRA assets involved in the transaction, *nor render investment advice within the meaning of 29 CFR 2510.3–21(c) with respect to those plan assets,* unless no interest or other consideration was received by the broker-dealer or any affiliate of the broker-dealer in connection with the extension of credit. Therefore, broker-dealers that are considered fiduciaries under the amended regulation would not be able to receive compensation for extending credit under PTE 75–1, Part V, as it existed prior to this amendment.

As part of its development of the Regulation, the Department considered public input indicating the need for

[8] Subsequent to the issuance of these regulations, Reorganization Plan No. 4 of 1978, 5 U.S.C. App. (2010), divided rulemaking and interpretive authority between the Secretaries of Labor and the Treasury. The Secretary of Labor was given interpretive and rulemaking authority regarding the definition of fiduciary under both Title I of ERISA and the Internal Revenue Code. *Id.* section 102(a) (''all authority of the Secretary of the Treasury to issue [regulations, rulings opinions, and exemptions under section 4975 of the Code] is hereby transferred to the Secretary of Labor'').

[9] 29 CFR 2550.408b–2(e); 26 CFR 54.4975–6(a)(5).

[10] *See* PTE 86–128, Exemption for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers, 51 FR 41686 (November 18, 1986), as amended, 67 FR 64137 (October 17, 2002), as further amended elsewhere in this issue of the **Federal Register**.

[11] 40 FR 50845 (October 31, 1975), as amended, 71 FR 5883 (February 3, 2006).

[12] *See* Preamble to PTE 75–1, Part V, 40 FR 50845 (Oct. 31, 1975); ERISA Advisory Opinion 86–12A (March 19, 1986).

additional prohibited transaction exemptions for investment advice fiduciaries. The Department was informed that relief was needed for broker-dealers to extend credit to plans and IRAs to avoid failed securities transactions, and to receive compensation in return. In the Department's view, the extension of credit to avoid a failed securities transaction currently falls within the contours of the existing relief provided by PTE 75–1, Part V, for extensions of credit "[i]n connection with the purchase or sale of securities." Accordingly, broker-dealers that are not fiduciaries, *e.g.,* those who execute transactions but do not provide advice, were permitted receive compensation for extending credit to avoid a failed securities transaction under the exemption as originally granted. The Department proposed this amendment to extend such relief to investment advice fiduciaries.

This amended exemption follows a lengthy public notice and comment process, which gave interested persons an extensive opportunity to comment on the proposed Regulation and exemption proposals. The proposals initially provided for 75-day comment periods, ending on July 6, 2015 but the Department extended the comment periods to July 21, 2015. The Department then held four days of public hearings on the new regulatory package, including the proposed exemptions, in Washington, DC from August 10 to 13, 2015, at which over 75 speakers testified. The transcript of the hearing was made available on September 8, 2015, and the Department provided additional opportunity for interested persons to comment on the proposals or hearing transcript until September 24, 2015. A total of over 3000 comment letters were received on the new proposals. There were also over 300,000 submissions made as part of 30 separate petitions submitted on the proposal. These comments and petitions came from consumer groups, plan sponsors, financial services companies, academics, elected government officials, trade and industry associations, and others, both in support and in opposition to the rule.[13] The Department has reviewed all comments, and after careful consideration of the comments, has decided to grant the amendment to PTE 75–1, Part V, as described herein. For the sake of convenience, the entire text of PTE 75–1, Part V, as amended, has been reprinted at the end of this notice.

[13] As used throughout this preamble, the term "comment" refers to information provided through these various sources, including written comments, petitions, and witnesses at the public hearing.

Discussion of the Final Amendment

I. Scope of Section (c)

As amended, PTE 75–1, Part V, Section (c) provides that a fiduciary within the meaning of ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B) may receive reasonable compensation for extending credit to a plan or IRA to avoid a failed purchase or sale of securities involving the plan or IRA. One commenter requested that Section (c) be broadened to cover all transactions that are covered by other sections of PTE 75–1, Part V, including short sales, options trading and margin transactions, but did not suggest any additional protective conditions. The commenter stated that extension of credit relief is critical to such transactions.

The Department declined to accept this request. As noted above, this amendment was intended to be a narrow expansion of the existing exemption to permit investment advice fiduciaries to receive compensation for extending credit to avoid a failed securities transaction. As a condition of the exemption, the proposal stated that the potential failure of the transaction could not be the result of the action or inaction by the fiduciary or an affiliate. The proposal further stated that, due to that limitation, the Department considered it unnecessary to condition the amended exemption on the protective impartial conduct standards that were proposed to apply to the other new and amended exemptions applicable to investment advice fiduciaries acting in conflicted transactions.

Extensions of credit entered into in connection with short sales, options trading and margin transactions expose retirement investors to the potential of losses that exceed their account value. Expanding the scope of the exemption to permit investment advice fiduciaries to provide advice on these transactions and earn compensation from the extension of credit would not be protective under the conditions of the amended exemption.

In the Department's view, this relief is not critical to all short sales, options and margin transactions. For example, the Department understands that some options transactions can occur in a cash account that does not involve an extension of credit. In addition, self-directed investors can still engage in the full extent of transactions that were permitted prior to the Applicability Date of the Regulation, and broker-dealers that are not fiduciaries will still be able to rely on the exemption to receive compensation. Finally, investors can receive unconflicted advice from an adviser regarding margin transactions entered into with an unaffiliated broker-dealer.

II. Conditions of Relief

In conjunction with the expanded relief in the amended exemption, Section (c) includes several conditions. First, the potential failure of the purchase or sale of the securities may not be caused by the broker-dealer or any affiliate. The Department changed the phrasing of this requirement in response to a comment, which said that the proposed phrasing—requiring that the potential failure could not be "the result of action or inaction by such fiduciary or affiliate"—was too vague, possibly overbroad, and would require a fact-intensive inquiry for every failure of the purchase or sale of securities, leading to a chaotic aftermath of each failed transaction and increasing cost to the investor.

According to the commenter, broker-dealers regularly "work out" issues relating to settlement failures and have policies and procedures to allocate costs, including not charging clients when it is the broker-dealer's fault. Thus, the commenter suggested that the language be revised to state that the failure "was not caused" by the fiduciary or an affiliate.

The Department accepted this comment. This condition was intended to ensure that broker-dealers will not profit from charging interest on settlement failures for which they are responsible. The Department has determined that the suggested change in phrasing is sufficiently protective of the plans and IRAs that may be paying interest.

Additionally, under the final amendment, the terms of the extension of credit must be at least as favorable to the plan or IRA as the terms available in an arm's length transaction between unaffiliated parties. The Department did not receive comments on this point and did not make any changes to the proposed requirement.

Finally, the plan or IRA must receive written disclosure of certain terms prior to the extension of credit. This disclosure does not need to be made on a transaction by transaction basis, and can be part of an account opening agreement or a master agreement. The disclosure must include the rate of interest or other fees that will be charged on such extension of credit, and the method of determining the balance upon which interest will be charged.

The plan or IRA must additionally be provided with prior written disclosure of any changes to these terms.

The required disclosures are intended to be consistent with the requirements of Securities and Exchange Act Rule 10b–16,[14] which governs broker-dealers' disclosure of credit terms in margin transactions. The Department understands that it is the practice of many broker-dealers to provide such disclosures to all customers, regardless of whether the customer is presently opening a margin account. To the extent such disclosure is provided, the disclosure terms of the exemption is satisfied. The Department received a comment that this is an appropriate disclosure standard.

III. Definitions and Recordkeeping

Consistent with other class exemptions published elsewhere in this edition of the **Federal Register**, the amendment defines the term ''IRA'' as any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.[15] The amendment also revises the recordkeeping provisions of PTE 75–1, Part V, to require the broker-dealer engaging in the covered transaction, as opposed to the plan or IRA, to maintain the records.

In response to comments received specific to some of the other exemptions adopted or amended elsewhere in this edition of the **Federal Register**, the Department has modified the recordkeeping provision to clarify which parties may view the records that are maintained by the broker-dealer. As revised, the exemption requires the records be ''reasonably'' available, rather than ''unconditionally available,'' and does not authorize plan fiduciaries, participants, beneficiaries, contributing employers, employee organizations with members covered by the plan, and IRA owners to examine records regarding a transaction involving another investor. In addition, broker-dealers are not required to disclose privileged trade secrets or privileged commercial or financial information to any of the parties other than the Department. The Department has made these changes to PTE 75–1, Part V for consistency with the other exemptions adopted or amended today.

IV. No Relief From ERISA Section 406(a)(1)(C) or Code Section 4975(c)(1)(C) for the Provision of Services

The amended exemption does not provide relief from a transaction prohibited by ERISA section 406(a)(1)(C), or from the taxes imposed by Code section 4975(a) and (b) by reason of Code section 4975(c)(1)(C), regarding the furnishing of goods, services or facilities between a plan and a party in interest or between an IRA and a disqualified person. The provision of investment advice to a plan or IRA is a service to the plan or IRA and compliance with this exemption will not relieve an investment advice fiduciary of the need to comply with ERISA section 408(b)(2), Code section 4975(d)(2), and applicable regulations thereunder. The disclosure standards under 408(b)(2) were recently finalized, and the Department took care to tailor those disclosure conditions for the plan marketplace. The Department believes that uniform standards are desirable and will promote broad compliance in this respect.

Applicability Date

The Regulation will become effective June 7, 2016 and this amended exemption is issued on that same date. The Regulation is effective at the earliest possible effective date under the Congressional Review Act. For the exemption, the issuance date serves as the date on which the amended exemption is intended to take effect for purposes of the Congressional Review Act. This date was selected in order to provide certainty to plans, plan fiduciaries, plan participants and beneficiaries, IRAs, and IRA owners that the new protections afforded by the Regulation are officially part of the law and regulations governing their investment advice providers, and to inform financial services providers and other affected service providers that the rule and amended exemption are final and not subject to further amendment or modification without additional public notice and comment. The Department expects that this effective date will remove uncertainty as an obstacle to regulated firms allocating capital and other resources toward transition and longer term compliance adjustments to systems and business practices.

The Department has also determined that, in light of the importance of the Regulation's consumer protections and the significance of the continuing monetary harm to retirement investors without the rule's changes, an Applicability Date of April 10, 2017 is appropriate for plans and their affected financial services and other service providers to adjust to the basic change from non-fiduciary to fiduciary status. This amendment has the same Applicability Date; parties may rely on the amended exemption as of the Applicability Date.

Paperwork Reduction Act Statement

In accordance with the requirements of the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506(c)(2)), the Amendment to Prohibited Transaction Exemption (PTE) 75–1, Part V, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks published as part of the Department's proposal to amend its 1975 rule that defines when a person who provides investment advice to an employee benefit plan or IRA becomes a fiduciary, solicited comments on the information collections included therein. The Department also submitted an information collection request (ICR) to OMB in accordance with 44 U.S.C. 3507(d), contemporaneously with the publication of the proposed regulation, for OMB's review. The Department received two comments from one commenter that specifically addressed the paperwork burden analysis of the information collections. Additionally many comments were submitted, described elsewhere in the preamble to the accompanying final rule, which contained information relevant to the costs and administrative burdens attendant to the proposals. The Department took into account such public comments in connection with making changes to the prohibited transaction exemption, analyzing the economic impact of the proposals, and developing the revised paperwork burden analysis summarized below.

In connection with publication of this final amendment to Prohibited Transaction Exemption (PTE) 75–1, Part V, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks, the Department submitted an ICR to OMB for its request of a revision to OMB Control Number 1210–0059. The

[14] 17 CFR 240.10b–16.

[15] The Department has previously determined, after consulting with the Internal Revenue Service, that plans described in 4975(e)(1) of the Code are included within the scope of relief provided by PTE 75–1 because it was issued jointly by the Department and the Service. *See* PTE 2002–13, 67 FR 9483 (March 1, 2002) (preamble discussion). For simplicity and consistency with the other new exemptions and amendments to other existing exemptions published elsewhere in this issue of the **Federal Register**, the Department has adopted this specific definition of IRA.

Department will notify the public when OMB approves the revised ICR.

A copy of the ICR may be obtained by contacting the PRA addressee shown below or at *http://www.RegInfo.gov.*

PRA ADDRESSEE: G. Christopher Cosby, Office of Policy and Research, U.S. Department of Labor, Employee Benefits Security Administration, 200 Constitution Avenue NW., Room N–5718, Washington, DC 20210. Telephone: (202) 693–8410; Fax: (202) 219–4745. These are not toll-free numbers.

As discussed in detail below, Section (c)(3) of the amendment requires that prior to the extension of credit, the plan must receive from the fiduciary written disclosure of (i) the rate of interest (or other fees) that will apply and (ii) the method of determining the balance upon which interest will be charged in the event that the fiduciary extends credit to avoid a failed purchase or sale of securities, as well as, prior written disclosure of any changes to these terms. Section (d) requires broker-dealers engaging in the transactions to maintain records demonstrating compliance with the conditions of the PTE. These requirements are information collection requests (ICRs) subject to the Paperwork Reduction Act.

The Department believes that this disclosure requirement is consistent with the disclosure requirement mandated by the Securities and Exchange Commission (SEC) in 17 CFR 240.10b–16(1) for margin transactions. Although the SEC does not mandate any recordkeeping requirement, the Department believes that it would be a usual and customary business practice for financial institutions to maintain any records necessary to prove that required disclosures had been distributed in compliance with the SEC's rule. Therefore, the Department concludes that these ICRs impose no additional burden on respondents.

General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under ERISA section 408(a) and Code section 4975(c)(2) does not relieve a fiduciary or other party in interest or disqualified person with respect to a plan from certain other provisions of ERISA and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of ERISA section 404 which require, among other things, that a fiduciary discharge his or her duties respecting the plan solely in the interests of the plan's participants and beneficiaries and in a prudent fashion in accordance with ERISA section 404(a)(1)(B);

(2) The Department finds that the class exemption as amended is administratively feasible, in the interests of the plan and of its participants and beneficiaries and IRA owners, and protective of the rights of the plan's participants and beneficiaries and IRA owners;

(3) The class exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the class exemption; and

(4) This amended class exemption is supplemental to, and not in derogation of, any other provisions of ERISA and the Code, including statutory or administrative exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

Exemption

The restrictions of section 406 of the Employee Retirement Income Security Act of 1974 (the Act) and the taxes imposed by section 4975(a) and (b) of the Internal Revenue Code of 1986 (the Code), by reason of section 4975(c)(1) of the Code, shall not apply to any extension of credit to an employee benefit plan or an individual retirement account (IRA) by a party in interest or a disqualified person with respect to the plan or IRA, provided that the following conditions are met:

(a) The party in interest or disqualified person:

(1) Is a broker or dealer registered under the Securities Exchange Act of 1934; and

(2) Does not have or exercise any discretionary authority or control (except as a directed trustee) with respect to the investment of the plan or IRA assets involved in the transaction, nor does it render investment advice (within the meaning of 29 CFR 2510.3–21) with respect to those assets, unless no interest or other consideration is received by the party in interest or disqualified person or any affiliate thereof in connection with such extension of credit.

(b) Such extension of credit:

(1) Is in connection with the purchase or sale of securities;

(2) Is lawful under the Securities Exchange Act of 1934 and any rules and regulations promulgated thereunder; and

(3) Is not a prohibited transaction within the meaning of section 503(b) of the Code.

(c) Notwithstanding section (a)(2), a fiduciary under section 3(21)(A)(ii) of the Act or Code section 4975(e)(3)(B) may receive reasonable compensation for extending credit to a plan or IRA to avoid a failed purchase or sale of securities involving the plan or IRA if:

(1) The potential failure of the purchase or sale of the securities is not caused by such fiduciary or an affiliate;

(2) The terms of the extension of credit are at least as favorable to the plan or IRA as the terms available in an arm's length transaction between unaffiliated parties;

(3) Prior to the extension of credit, the plan or IRA receives written disclosure of (i) the rate of interest (or other fees) that will apply and (ii) the method of determining the balance upon which interest will be charged, in the event that the fiduciary extends credit to avoid a failed purchase or sale of securities, as well as prior written disclosure of any changes to these terms. This Section (c)(3) will be considered satisfied if the plan or IRA receives the disclosure described in the Securities and Exchange Act Rule 10b–16;[16] and

(d) The broker-dealer engaging in the covered transaction maintains or causes to be maintained for a period of six years from the date of such transaction in a manner that is reasonably accessible for examination, such records as are necessary to enable the persons described in paragraph (e) of this exemption to determine whether the conditions of this exemption have been met with respect to a transaction, except that:

(1) No party other than the broker-dealer engaging in the covered transaction shall be subject to the civil penalty which may be assessed under section 502(i) of the Act, or to the taxes imposed by section 4975(a) and (b) of the Code, if such records are not maintained, or are not available for examination as required by paragraph (e) below; and

(2) A prohibited transaction will not be deemed to have occurred if, due to circumstances beyond the control of the broker-dealer, such records are lost or destroyed prior to the end of such six-year period.

(e)(1) Except as provided in paragraph (e)(2) of this exemption, and notwithstanding anything to the contrary in subsections (a)(2) and (b) of section 504 of the Act, the records referred to in paragraph (d) are

[16] 17 CFR 240.10b–16.

reasonably available at their customary location for examination during normal business hours by:

(A) An authorized employee or representative of the Department of Labor or the Internal Revenue Service,

(B) Any fiduciary of a plan that engaged in a transaction pursuant to this exemption, or any authorized employee or representative of such fiduciary;

(C) Any contributing employer and any employee organization whose members are covered by a plan described in paragraph (e)(1)(B), or any authorized employee or representative of these entities; or

(D) Any participant or beneficiary of a plan described in paragraph (e)(1)(B), IRA owner or the authorized representative of such participant, beneficiary or owner.

(2) None of the persons described in paragraph (e)(1)(B)–(D) of this exemption are authorized to examine records regarding a recommended transaction involving another investor, or privileged trade secrets or privileged commercial or financial information, of the broker-dealer engaging in the covered transaction, or information identifying other individuals.

(3) Should the broker-dealer engaging in the covered transaction refuse to disclose information on the basis that the information is exempt from disclosure, the broker-dealer must, by the close of the thirtieth (30th) day following the request, provide a written notice advising the requestor of the reasons for the refusal and that the Department may request such information.

(4) Failure to maintain the required records necessary to determine whether the conditions of this exemption have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions.

For purposes of this exemption, the terms ''party in interest,'' ''disqualified person'' and ''fiduciary'' shall include such party in interest, disqualified person, or fiduciary, and any affiliates thereof, and the term ''affiliate'' shall be defined in the same manner as that term is defined in 29 CFR 2510.3–21 and 26 CFR 54.4975–9. Also for the purposes of this exemption, the term ''IRA'' means any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

Signed at Washington, DC, this 1st day of April, 2016.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

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DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

ZRIN 1210–ZA25

[Application Number D–11850]

Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 84–24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters

AGENCY: Employee Benefits Security Administration (EBSA), Department of Labor.

ACTION: Adoption of amendment to and partial revocation of PTE 84–24.

SUMMARY: This document amends and partially revokes Prohibited Transaction Exemption (PTE) 84–24, an exemption from certain prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986 (the Code). The ERISA and Code provisions at issue generally prohibit fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs) from engaging in self-dealing in connection with transactions involving these plans and IRAs. Non-fiduciary service providers also may not enter into certain transactions with plans and IRAs without an exemption. The amended exemption allows fiduciaries and other service providers to receive compensation when plans and IRAs purchase insurance contracts, ''Fixed Rate Annuity Contracts,'' as defined in the exemption, securities of investment companies registered under the Investment Company Act of 1940, as well as certain related transactions. The amendments increase the safeguards of the exemption. This document also contains the revocation of the exemption as it applies to plan and IRA purchases of annuity contracts that do not satisfy the definition of a Fixed Rate Annuity Contract, and the revocation of the exemption as it applies to IRA purchases of investment company securities. The amendments and revocations affect participants and beneficiaries of plans, IRA owners, and certain fiduciaries and service providers of plans and IRAs.

DATES: *Issuance date:* This amendment and partial revocation is issued June 7, 2016.

Applicability date: This amendment and partial revocation is applicable to transactions occurring on or after April 10, 2017. For further information, see *Applicability Date,* below.

FOR FURTHER INFORMATION CONTACT: Brian Shiker or Brian Mica, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor, 200 Constitution Avenue NW., Suite 400, Washington, DC 20210, (202) 693–8824 (not a toll-free number).

SUPPLEMENTARY INFORMATION: The Department is amending PTE 84–24 [1] on its own motion, pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637 (October 27, 2011)).

Executive Summary

Purpose of Regulatory Action

The Department grants this amendment to PTE 84–24 in connection with its publication today, elsewhere in this issue of the **Federal Register**, of a final regulation defining who is a ''fiduciary'' of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries (Regulation). The Regulation also applies to the definition of a ''fiduciary'' of a plan (including an IRA) under the Code. The Regulation amends a prior regulation, dating to 1975, specifying when a person is a ''fiduciary'' under ERISA and the Code by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. The Regulation takes into account the advent of 401(k) 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 existing regulation was issued. In light of the extensive changes in retirement investment practices and relationships, the Regulation updates existing rules to distinguish more appropriately between the sorts of advice relationships that should be

[1] PTE 84–24, 49 FR 13208 (Apr. 3, 1984), as corrected, 49 FR 24819 (June 15, 1984), as amended, 71 FR 5887 (Feb. 3, 2006).