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]

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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.

[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]

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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.

[71] Black's Law Dictionary 10th ed. 2014.

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 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.

[84] *See* Financial Services Institute, Fidelity Investments, and the Consumer Federation of America.

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 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.

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

[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).

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

Continued

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

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

Continued

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.	• Returns are less predictable because the interest credited at the end of each index period depends on changes in a market index.	• Returns are variable based on the performance of underlying funds in the subaccounts.[1]
	• 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.	• 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.	• The insurance company does not guarantee investment performance. Investment risk is borne by the contract owner.
		• 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.	• A variable annuity contract can offer hundreds of subaccounts and generally allows owners to transfer or reallocate their account values among the various subaccounts.
		• 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]	

	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.