



IRA Providers Must Act Quickly to Comply With New Fiduciary Standards

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On April 10, 2017, the Department of Labor (DOL) will begin enforcing fiduciary standards for providers of individual retirement accounts (IRAs). While this date may seem far in the future, it is not. IRA providers must begin addressing compliance requirements now that will involve changes to programming, processes, procedures and training.

The Background

Until this year, the Department of Labor focused only on employer-sponsored retirement plans and did not regulate IRAs. However, the DOL determined that its lack of IRA oversight had jeopardized achievement of its mission to promote retirement security. It concluded that most IRA providers have conflicts of interest in advising customers about appropriate IRA investments. One conflict is that providers often recommend to a potential IRA customer that amounts be rolled from a qualified retirement plan or IRA to an IRA provided by that provider. Further, providers have conflicts related to investments recommended to IRA customers due to the wide variety of possible investments and their associated fees.

The New Rules

The DOL's new rules now define IRA providers as ERISA fiduciaries for purposes of the prohibited rules. As a result, IRA providers will be prohibited from receiving fees that vary based upon the providers' exercise of fiduciary authority, control or responsibility. However, the DOL also issued an exemption (the Best Interest Contract Exemption, or "BICE") that permits IRA providers to continue their IRA business, even with conflicts of interest, if the certain conditions are met, including that the provider agree by contract with the IRA owner that:

- The IRA provider and its advisors will be fiduciaries with respect to the IRA.
- The IRA provider and its advisors will act in the best interest of the IRA owner, without regard to the financial interests of the provider.
- The IRA provider will be subject to class action lawsuits with respect to its IRA activities.

Compliance Options

The options are:

- Comply with the BICE. This is the most expensive alternative in terms of implementation and maintenance cost.
- Comply with a more limited version of the BICE, the so-called Level Fee BICE, which applies if the IRA provider receives the same fee regardless of the investment selected. This is a much less expensive alternative in terms of implementation and maintenance, but some providers are concluding that this would result in undesirable changes to their business model and loss of profitability.
- Avoid answering the question, "Should I roll my retirement plan assets to an IRA with you?" This may allow the provider to qualify for a long-standing prohibited transaction exemption that could be more favorable to the institution than either BICE or Level Fee BICE. However, many providers are concluding that they must be able to answer that question.

- Get out of the business. Providers whose profit from IRA business is modest should consider this alternative. Not only is compliance with BICE costly, litigation over compliance defects is very possible, if not likely.

The April 10, 2017 deadline gives IRA providers relatively little time to select a compliance option and implement a strategy that meets their business needs. Fee models will need to be developed, documents drafted, IRA customers notified, and training protocols developed and implemented.

Contact Us

For more information about these new requirements, what Husch Blackwell has been doing to help clients comply with them, and how they impact your business, please reach out to your contact at Husch Blackwell or contact Mark Welker at 816.983.8148 or mark.welker@huschblackwell.com.

CLIENT DISCUSSION OUTLINE

Evaluation of 2016 DOL Regulation Relating to Fiduciary Status and Conflicts of Interest of Financial Industry Clients (“FIs”)

	BIC Under New Regulation	Level Fee BIC Under New Regulation
Advice recipients to whom/which the exemption applies:	<p>(1) Plan participant or beneficiary with authority to direct investments or take distribution</p> <p>(2) IRA owner</p> <p>(3) Fiduciary of an IRA or Plan with < \$50MM (Exemption Section I(b))</p> <p>NOTE: (a) “Plan” includes any ERISA plan or a non-ERISA plan that is qualified under IRC § 401(a) or 403(a) (Exemption Section VIII(j) and IRC § 4975(e)(i)(A))</p>	Same as BIC
Exemption does not apply to:	<p>Exemption does not apply (i) to FI’s own plans; or (ii) if the fiduciary that appointed FI is not independent; (iii) to robo advice; (iv) any recommended transaction with respect to which a FI Adviser has or exercises any discretionary authority or control over such transaction; or (v) any transaction between the Plan or IRA and FI (or a party that controls, is controlled by or is under common control with FI), unless the transaction involves an insurance or annuity contract, mutual fund or a “riskless” principal transaction (a “riskless” principal transaction is a purchase/sale by FI to offset a contemporaneous transaction with the Plan or IRA) (Exemption Section I(c))</p>	Same as BIC, except the exception for (iii) (robo advice) does not apply
Grandfather	<p>The BIC or Level Fee BIC exemptions are not needed for grandfathered amounts.</p> <p>(a) Grandfather applies only to amounts invested before the Applicability Date (April 10, 2017) or that are invested after the Applicability Date pursuant to a systematic purchase program established before the Applicability Date; Preamble p. 21066: “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.”</p> <p>Preamble p. 21066: “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.”</p> <p>Applicability Date, (2) no more than reasonable compensation is received, and (3) the Best Interest Standard is met: all advice meets prudent fiduciary test, based on the investment objectives, risk tolerance, financial circumstances and needs of the Retirement Investor, and are made without re: to the financial or other interests of the Adviser, FI (or its Affiliate or Related Entity);</p>	Permanent

	BIC Under New Regulation	Level Fee BIC Under New Regulation
	(c) Applies even if investments are exchanged 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 neither the Adviser nor the Financial Institution (or their Affiliates or Related Entities) receive more compensation (either as a dollar amount or percentage) than they were entitled to receive before the Applicability Date)	
Prevents prohibited transaction from being caused by receiving fees due to suggesting rollover or suggesting account type (such as Trust vs. Brokerage vs. IRA that holds CD or other financial institution deposit, or commission-based vs. asset based)?	Yes, this is an exemption from ERISA § 406(a)(1)(D) & 406(b) (and similar “conflict” PTs in 4975(a)(1)(D),(E),(F)). (Exemption Section I(a) & (b)) However, this type of advice will be exempt only if it is given without regard to the Adviser’s or FI’s interest, and only if the Adviser Compensation and Supervision Neutrality Requirement is met. (How can those requirements be met? See attached list of open issues.)	Same as BIC, except the Adviser Compensation and Supervision Neutrality Requirement is N/A.
Prevents prohibited transaction from being caused by fees varying based on investment advice or based on receiving fees from third parties?	Yes, exemption from ERISA § 406(a)(1)(D) & 406(b) (and similar “conflict” PTs in 4975(a)(1)(D),(E),(F))	Yes, exemption from ERISA § 406(a)(1)(D) & 406(b) (and similar “conflict” PTs in 4975(a)(1)(D),(E),(F)) (Exemption Section I(a) & (b))
Hire Me Exception	If solicitations are limited to “hire me” statements, then the BIC exemption is not needed to exempt such solicitations because such statements are not fiduciary in nature. However, it appears that the DOL will interpret this exception very narrowly. It would permit communication of FI’s alternative forms of accounts, how they work and the associated fees. It would permit FI to tout itself as being experienced and qualified. However, any statements that explain, for example, why a particular account structure or investment technique was adopted by FI might be viewed as crossing the line from “hire me” to fiduciary advice that the Retirement Investor should select that account type or investment technique.	

	BIC Under New Regulation	Level Fee BIC Under New Regulation
Impartial Conduct Standards	<p>(a) <u>Best Interest Standard</u>: All investment advice must be in the Best Interest of the Retirement Investor. This requires compliance with the ERISA prudence standard (even for IRAs and other non-ERISA plans): (1) “based on the investment objectives, risk tolerance, financial circumstances, and needs of the Plan, IRA participant, and (2) without re: to financial or other interests of FI or its Adviser or any other party (Exemption Section II(c)(1)); Preamble p. 21029: “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.”</p> <p>(b) <u>Reasonable Compensation</u>: FI, its Affiliates, Related Entities, and its Adviser will not receive unreasonable compensation (this is the same requirement as existing requirement of ERISA Section 408(b)(2)) (Exemption Section II(c)(2)); Preamble p. 21030: “Fiduciaries and other services providers may not charge more than reasonable compensation regardless of whether another fiduciary has signed off on the compensation.”</p> <p>(c) <u>Accurate Statements</u>: no material misleading statements. (Exemption Section II(c)(3))</p>	
How frequently must “Best Interest” be determined?	<p>“At the time of recommendation” Preamble, pg. 21011: “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.” See also Preamble p. 21016: “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.</p>	Same as BIC

	BIC Under New Regulation	Level Fee BIC Under New Regulation
<p>How frequently must "Best Interest" be determined?</p>	<p>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." Preamble p. 21028: "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. 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." Preamble p. 21029: "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."</p>	
<p>Who must comply with the Best Interest standard?</p>	<p>FI and its Advisers</p>	<p>FI must be a "Level Fee Fiduciary": only fee received by FI, its Advisers and any Affiliate or Related Party in connection with advisory or investment management services is a fixed percentage of asset value or a set fee that does not vary with the investment recommended. Not a commission or transaction based fee.</p> <p>Conditions: (1) Written acknowledgment of fiduciary status prior to or at same time as execution of recommended transaction per II(b); (2) Comply with II(c) (the three Impartial Conduct Standards)</p>

	BIC Under New Regulation	Level Fee BIC Under New Regulation
Who must comply with the Best Interest standard?		<p>(3) If make a recommendation to rollover from an ERISA Plan to an IRA, FI must document the specific reasons why recommendation was in Best Interest of Retirement Investor, including: (A) consider alternatives to rollover, including leaving money in Plan, if permitted; (B) take into account the Plan's and IRA's fees and expenses; (C) whether employer pays any administrative expenses; (D) the different levels of service and investments available under each option;</p> <p>(4) If make a recommendation to rollover from another IRA or to switch from commission-based to level fee, must document the reasons that is in Retirement Investor's Best Interest, including the services that will be provided for the fee. [Note that this exemption can apply even if the advice is robo-advice.]</p>
Warranties	<p>FI must affirmatively warrant that it has adopted and that FI in fact complies and will comply with the following:</p> <p>(a) written policies and procedures reasonably and prudently designed to ensure that FI's Advisors adhere to the three Impartial Conduct Standards. (Exemption Section II(d)(1))</p> <p>(b) In formulating its policies/procedures, FI specifically identified and documented all of its Material Conflicts of Interest (any conflict that "could" affect the best judgment of FI or its Advisor). (Exemption Section II(d)(2))</p> <p>(c) FI's policies/procedures are reasonably designed to prevent Material Conflicts of Interest from causing violations of any of the three Impartial Conduct Standards. (Exemption Section II(d)(2))</p> <p>(d) FI has designated person(s) who are responsible for addressing Material Conflicts of Interest and monitoring the Advisors' adherence to the three Impartial Conduct Standards. (Exemption Section II(d)(2))</p> <p>(e) FI's policies/procedures comply with the "Adviser Compensation and Supervision Neutrality Requirement" (Welker's term, not the DOL's) set forth below. (Exemption Section II(d)(3))</p>	N/A

	BIC Under New Regulation	Level Fee BIC Under New Regulation
Adviser Compensation and Supervision Neutrality Requirement	(a) FI's policies/procedures prohibit anything that is "intended to" or "would reasonably be expected to" cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. The things that could violate this include: (1) quotas; (2) appraisals; (3) performance/personnel actions; (4) bonuses; (5) contests; (6) special awards; (7) differential compensation; and (8) other actions or incentives. (Exemption Section II(d)(3))	N/A
Exceptions to Neutrality Requirement	<p>Differential compensation (including commissions) is permitted if: (1) it is based on "investment decisions" by "Plans, participant or beneficiary accounts or IRAs," and (2) FI's policies/procedures as a whole are reasonably and prudently designed to avoid misalignment of Advisers' interest with the interests of the Retirement Investor. (Exemption Section II(d)(3))</p> <p>Note: differential compensation may be based only on "neutral factors" tied to differences in services with respect to different types of investments, "as opposed to" differences in Third Party Payments in connection with particular investment recommendations. (Exemption Section II(d)(3) and See Attachment 1)</p> <p>(Third Party Payments include "sales charges"; "gross dealer concessions"; revenue sharing payments; 12b 1 fees; "distribution, solicitation or referral fees"; "volume-based" fees; fees for seminars and education; and any other compensation, consideration or "financial benefit" provided to FI (or affiliate) by a third party as a result of a transaction involving the Plan, participant or beneficiary account or IRA.)</p> <p>DOL states in preamble that it intended to preserve commissions and other transaction-based compensation so Retirement Investors may choose the best structure for them.</p>	N/A
Does the Adviser Compensation and Supervision Neutrality Requirement apply to Managers' and Supervisors' compensation and the supervision of them?	Yes, the neutrality requirement applies to incentives to managers and supervisors and the potential effect of such incentives on Advisers' recommendations. (Exemption Preamble p. 21037 and before that)	N/A
Are commission payments to brokers OK?	Yes, but only if (1) the Adviser does not make the purchase/sale decision, and (2) there are policies/procedures in place that are reasonably and prudently designed to avoid the Adviser's interest from not being aligned with the Retirement Investor's interest (e.g., oversight to avoid excessive trades, and policies to prevent selection of higher commission products or illiquid, risky or otherwise inappropriate products) Exemption Section II(d)(3)	N/A

	BIC Under New Regulation	Level Fee BIC Under New Regulation
Are FI's other forms of incentive compensation OK? (must avoid quotas, contests, awards, incentives, differential compensation et al that would be expected to cause Advisers to make recommendations that do not meet the Best Interest standard)		N/A
Are referral fees from an unrelated RIA permitted?	A bank "or similar financial institution supervised by the U.S. 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))," or its Advisors, may receive Compensation for referring a customer to an unaffiliated registered investment advisor in connection with the provision of investment advice by such institution and the Advisor to a Retirement Investor. The advice to use such unaffiliated RIA must meet the three Impartial Conduct Standards.	Yes, so long as "Level Fee Fiduciary" requirements are met
Are bonuses to FI employees permitted for referring customers to Trust or Brokerage?		Same as BIC
How might the Impartial Conduct Standards be met re: suggestions related to whether to rollover or the type of account to open?		Same as BIC
Application of exemption to accounts for which FI has transactional discretion, such as when the FI serves as discretionary trustee		Same as BIC
Application of exemption to accounts for which FI provides only fiduciary advice	Yes	Yes
Annuity/Insurance/ Other Investment Product Purchase Exclusion	Purchases of an investment product (e.g., annuities, insurance or mutual funds) by a Plan, participant/ beneficiary account or IRA, from a Financial Institution that is a party in interest or disqualified person are not prohibited due to ERISA § 406(a)(1)(A or (D)	Same as BIC

	BIC Under New Regulation	Level Fee BIC Under New Regulation
What the Annuity/ Insurance/Other Investment Product Exclusion does not cover	<p>(a) Purchases of investment products from a Financial Institution that are prohibited under any other section of ERISA, including 406(b) This prevents FI from receiving a different amount of compensation due to recommending annuities, insurance or other products vs. other investments. For example, if FI recommends a purchase of such an investment product from a third party Financial Institution that could affect FI's compensation, then that recommendation and the compensation must be covered by the general BIC exemption. See preamble p. 21017: "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."</p> <p>(b) Purchase of an investment product by an ERISA plan that covers employees of the Financial Institution from which the product is purchased.</p> <p>(c) Purchases whereby the Adviser has or exercises any discretionary authority or control.</p>	N/A
Other Requirements	<p>Disclosures are made pursuant to Exemption Section II(e), including a description of compensation, fees and conflicts (including summary of procedures on web and upon request)</p> <p>Disclosure to DOL/Record retention (Exemption Section V)</p> <p>Written contract with IRAs and other non-ERISA plans that contractually imposes fiduciary status, the Impartial Conduct Standards, and the Warranties on FI and its Advisers (Exemption Section II(a))</p> <p>Web and Transaction-Based Disclosures (Exemption Section III)</p> <p>FI acknowledges fiduciary status of it and its Advisers (this applies to all Retirement Investors)(Exemption Section II(b))</p>	<p>N/A</p> <p>N/A</p> <p>N/A</p> <p>N/A</p> <p>Applicable</p>
Impermissible contract terms	<p>(a) Disclaimer of or limitation on liability. (Exemption Section II(f)(1)). However, a prohibition on punitive damages and rescission is permitted (Exemption Section II(f)(2));</p> <p>(b) Waiver or qualification of right to bring or participate in class action (Exemption Section II(f)(2));</p> <p>(c) Liquidated damages (Exemption Section II(f)(2));</p> <p>(d) Distant venue for arbitration or mediation, or any other unreasonable limitation on assertion of claims (Exemption Section II(f)(3)).</p>	N/A

	BIC Under New Regulation	Level Fee BIC Under New Regulation
Breach of fiduciary duty and prohibited transaction compliance risks	<p>The following are examples of some of the questions a Retirement Investor might pose that will trigger a requirement to offer fiduciarily prudent advice and to comply with the Impartial Conduct Standards and the Adviser Compensation and Supervision Neutrality Requirement:</p> <p>(a) Should I roll my account at my former employer's retirement plan (or an existing IRA) to an IRA? Factors affecting answer: (1) support services offered by the existing plan, (2) quality of investments offered by existing plan, (3) diversification of investments offered by existing plan, (4) distribution options under existing plan, and (5) costs imposed on participant by existing plan.</p> <p>(b) If so, should I roll it to an IRA at FI? Factors affecting answer: (1) will FI best meet the Retirement Investors' needs, compared to other potential institutions/advisers?; (2) how do the costs, services, investments and other relevant factors compare between the existing plan and FI IRA?</p> <p>(c) If so, to what type of FI IRA? Financial Services? CD/ money market/deposit?</p> <p>(d) If so, would it be best for me to establish a commission based IRA or a management fee IRA?</p> <p>(e) Should my IRA be invested in mutual funds, ETFs, collective funds, annuities, life insurance, individual securities or other investments?</p> <p>(f) Should I convert to Roth?</p> <p>(g) Should I invest in indexed or actively managed funds?</p>	N/A
Definitions	<p>"Adviser" is someone who is a fiduciary due to providing investment advice who is: (1) a FI employee, agent, contractor or registered representative; and (2) satisfies federal and state licensing requirements for insurance, banking and securities laws.</p> <p>"Affiliates" 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.</p> <p>"Related Entities" 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.</p> <p>"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>	

	BIC Under New Regulation	Level Fee BIC Under New Regulation
	"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.	