Preliminary Annotated Responses:

Round One "Conflict of Interest Exemptions FAQs" (10/27/16)[1]

Compliance Dates

Q1. When do firms and their advisers have to comply with the conditions of the new BIC Exemption and Principal Transactions Exemption?

Firms and their advisers must comply with the exemptions' conditions only if they seek to give advice that would violate the prohibited transaction rules, which are designed to protect investors from conflicts of interest. Firms and advisers must either structure their compensation arrangements to avoid prohibited transactions or they must rely on an exemption such as the BIC Exemption or Principal Transactions Exemption.

The Department has adopted a phased implementation approach to both of these exemptions. The Rule's amended definition of fiduciary advice will first apply on April 10, 2017. On that same date, the BIC Exemption and Principal Transactions Exemption will become available to fiduciary advisers. At the outset, however, and for a transition period extending until January 1, 2018, fewer conditions will apply to financial institutions and advisers that seek to rely upon the exemptions. The transition period gives these fiduciaries additional time to prepare for full compliance with all of the conditions of the exemptions, while providing basic safeguards to protect the interests of retirement investors.

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

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

[1] These preliminary annotated responses were prepared in consultation with Retirement Law Group (RLG). RLG and PRI are separate entities. The information presented below represents our initial assessment of the Department of Labor's FAQ responses and is intended for educational purposes only. The preliminary annotated responses are not legal advice, are not to be acted on as such, may not be current and are subject to change without notice.

During the transition period, the financial institutions must also provide a notice to retirement investors that, among other things, acknowledges their fiduciary status and describes their material conflicts of interest. They must also designate a person responsible for addressing material conflicts of interest and monitoring advisers' adherence to the impartial conduct standards.

On January 1, 2018, the transition period ends and full compliance with all of the exemptions' conditions is required for firms and advisers that choose to engage in transactions that would otherwise be prohibited under ERISA and the Internal Revenue Code. These conditions importantly include, among other things, requirements to execute a contract with IRA investors with certain enforceable promises, fuller disclosures, and the implementation of specified policies and procedures to protect retirement investors from advice that is not in their best interest.

> *Nothing new here. This answer is simply a recitation of the rule. See, e.g., PRI previously-released "BICE Transitions Activities" worksheet on ARC at "Compliance Portal" > "Preliminary DOL Fiduciary Supplemental Resources" and related PRI "DOL FAQs" > "BICE Fundamentals," "BICE Examples" and "General Information and Key Definitions."*

Q2. When do firms and their advisers have to comply with the new conditions in pre- existing exemptions that were amended in connection with the Rule?

The Department amended the pre-existing exemptions to require compliance with the impartial conduct standards and, in some cases, to more tightly restrict their availability for transactions subject to significant conflicts of interest. These exemptions are Prohibited Transaction Exemptions (PTEs) 75-1, 77-4, 80-83, 83-1, 84-24, and 86-128. The new restrictions on the availability of these exemptions are effective April 10, 2017. Additionally, as noted above, the impartial conduct standards simply require fiduciaries to adhere to basic fiduciary norms and standards of fair dealing (act in the best interest of customers, charge no more than reasonable compensation, and avoid misleading statements). The Department concluded that financial institutions and their advisers should be able to meet these standards within a year after publication of the Rule in the Federal Register, and accordingly requires compliance with these conditions beginning April 10, 2017.

There is, however, an additional transition period for certain transactions under PTE 86-128, which generally require a written authorization executed in advance by an independent fiduciary or IRA owner. For IRAs and non-ERISA plans that were already customers of the financial institution as of April 10, 2017, the fiduciary engaging in the transaction need not obtain affirmative written consent for such transactions as would otherwise be required, but instead may rely on negative consent, as long as the fiduciary gave the required disclosures and consent termination form to the customer by that date (See PTE 86-128, as amended, at Section III(b)(2)).

> *This answer confirms that negative consent is available for existing customers under PTE 86-128; however, note existing customer is as of 4/10/17 (vs. the BICE which allows for negative consent for Existing Contracts and defines Existing Contract as, among other things, one entered into prior to 1/1/18. See, e.g., previously-released PRI "DOL FAQs" at "General Information and Key Definitions."*

Best Interest Contract Exemption – General Questions

Q3. Is the BIC Exemption broadly available for recommendations on all categories of assets in the retail advice market, as well as advice on rolling assets into an IRA or hiring an adviser?

Yes. The BIC Exemption is broadly available for a wide variety of transactions relating to the provision of fiduciary advice in the market for retail investments. Under ERISA and the Code, parties providing fiduciary investment advice to plan sponsors, plan participants and beneficiaries, and IRA owners, are not permitted to receive payments creating conflicts of interest unless they comply with a prohibited transaction exemption. Thus, if an adviser or financial institution receives compensation that creates such a conflict of interest (e.g., transaction-based payments such as commissions, or third party payments such as 12b-1 fees or revenue sharing), the transaction generally must meet the terms of an exemption.

> *Please note that this last statement is qualified by the term "generally" and does not apply if the third-party payments are offset against an advisory fee, for example. In such case, there would be no prohibited transaction in the first place and, therefore no need for a prohibited transaction exemption (i.e., the BICE). See, e.g., DOL Advisory Opinions 97-15A, 05-10A and previously-released PRI "DOL FAQs" > "BICE Fundamental," and "BICE Examples."*

The BIC Exemption is intended to be broadly available for advisers and financial institutions that provide investment advice to retail investors such as plan participants and beneficiaries and IRA owners, and is intended by the Department to serve as the primary exemption for investment advice transactions involving these retail investors. As such, it broadly covers recommendations to retail investors, including recommendations with respect to all categories of assets, advice to roll over plan assets, and recommendations on persons the customer should hire to serve as investment advisers or managers.

Q4. Is compliance with the BIC Exemption required as a condition of executing a transaction, such as a rollover, at the direction of a client in the absence of an investment recommendation?

No. In the absence of an investment recommendation, the rule does not treat individuals or firms as investment advice fiduciaries merely because they execute transactions at the customer's direction. Similarly, even if a person recommends a particular investment, the person is not a fiduciary unless the person receives compensation, direct or indirect, as a result of the advice.

If, however, the firm or adviser does make a recommendation concerning a rollover or investment transaction and receives compensation in connection with or as a result of that recommendation, it would be a fiduciary and would need to rely on an exemption. Under the terms of the Rule, a "fee or other compensation, direct or indirect," includes any explicit fee or compensation for the advice received by the adviser (or by an affiliate) from any source, and any other fee or compensation received from any source in connection with or as a result of the recommended purchase or sale of a security or the provision of investment advice services, "including, though not limited to commissions, loads, finder's fees, revenue sharing payments, shareholder servicing fees, marketing or distribution fees, underwriting compensation, payments to brokerage firms in return for shelf space, recruitment compensation paid in connection with transfers of accounts to a registered representative's new broker-dealer firm, gifts and gratuities, and expense reimbursements."

> *Nothing new here. This answer is simply a recitation of the PTE.*

Q5. If an adviser and firm are compensated solely on the basis of a fixed percentage of assets under management, do they need to rely on an exemption, such as the BIC Exemption, to avoid committing a non-exempt prohibited transaction?

As discussed in the preamble to the BIC Exemption, the ongoing receipt of 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 does not, in and of itself, raise prohibited transaction concerns or require a fiduciary to comply with a prohibited transaction exemption. However, transactions involving this kind of compensation may raise conflict of interest concerns. For example, there is a clear and substantial conflict of interest when an adviser recommends that a participant roll retirement savings 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, as noted in the BIC Exemption preamble, investment advice to switch from a commission-based account to an account that charges a fixed percentage of assets under management on an ongoing basis could be a prohibited transaction.

Because the prohibited transaction in these examples is relatively discrete and the provision of advice thereafter generally does not involve prohibited transactions, the BIC Exemption includes streamlined conditions to cover the discrete advice that requires the exemption. Discussed further below, the streamlined conditions apply to "level fee fiduciaries" who, with their affiliates, will receive only a "level fee" in connection with advisory or investment management services provided to a plan or IRA that is disclosed in advance to the retirement investor. As defined in the BIC Exemption, 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. Certain other conditions, described below in Q13, also apply.

In general, after the rollover, the ongoing receipt of compensation based on a fixed percentage of the value of the assets under management, where such values are determined by readily available independent sources or independent valuations, does not, in and of itself, violate the prohibited transaction rules or require compliance with an exemption. However, certain abusive practices involving fee-based accounts can violate the prohibition on self-dealing in ERISA 406(b)(1) and Code section 4795(c)(1)(E), and fall short of meeting the conditions of any applicable exemption. For example, in its "Report on Conflicts of Interest" (Oct. 2013), p.29, the Financial Industry Regulatory Authority (FINRA) suggests a number of circumstances in which advisers may recommend inappropriate commission- or fee-based accounts as a 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 little or no need for ongoing monitoring or advice; or first recommending a mutual fund with a front-end sales load, and shortly thereafter, recommending that the customer move the shares into an advisory account subject to asset-based fees). 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 and would not be covered by an exemption.

This answer is simply a recitation of the PTE. The question of whether recommendations to move from one type of advisory account/program to another, which results in more compensation paid to the FI or advisor, was not answered. Accordingly, we are still recommending this advice be covered by Level Fee Fiduciary BICE if no third-party payments are received as a result of the recommendation (e.g., revenue sharing, 12b-1 fees, etc. that are not offset in the recommended account type.). If the recommended account type will result in the receipt of such fees, then the full BICE would be required.

Q6. Is the BIC Exemption available for advisers who act as discretionary fiduciaries to retirement plans and then provide investment advice to a participant to roll over assets to an IRA for which the adviser will provide advice?

Yes. Section I(c) of the BIC Exemption contains exclusions that describe circumstances in which the exemption is not available, including an exclusion of relief for advisers that have or exercise any discretionary authority or discretionary control with respect to the recommended transaction. However, the BIC Exemption does provide relief for investment advice to roll over a participant's account, even if the adviser serves as a discretionary fiduciary with respect to the plan or that participant's account and will provide fiduciary investment advice following the rollover, as long as the adviser does not have or exercise any discretionary authority or discretionary control with respect to the decision to roll over and the other applicable conditions of the exemption are satisfied.

Nothing new here. A recommendation, by definition, is not discretion. See, e.g., previously-released PRI "DOL FAQs" > "BICE Examples" > "Discretionary IRAs and BICE."

Q7. Is the BIC Exemption available for recommendations to roll over assets to an IRA to be managed on a going-forward basis by a discretionary investment manager?

Yes. As noted above, the BIC Exemption does not provide relief for a recommended transaction if the adviser has or exercises any discretionary authority or discretionary control with respect to the transaction. However, it does provide relief for investment advice to roll over a plan account into an IRA, even if the adviser or financial institution will subsequently serve as a discretionary investment manager with respect to the IRA, as long as the adviser does not have or exercise any discretionary authority or discretionary control with respect to the decision to roll over assets of the plan to an IRA, and the other applicable conditions of the exemption are satisfied.

Nothing new here. See above response to Question No. 6.

Q8. Is the BIC Exemption available for prohibited conflicts of interest arising from the actions of a discretionary manager of assets held in a plan or IRA? What exemptions are available for these prohibited transactions?

As noted above, the BIC Exemption does not provide relief for a recommended transaction if the adviser has or exercises any discretionary authority or control with respect to the transaction. Persons with such discretionary investment authority have long been treated as fiduciaries under ERISA and the Internal Revenue Code. As such, they have been and continue to be subject to a regulatory regime that specifically addresses the issues raised when a fiduciary is given the discretionary authority to manage plan assets. Including discretionary fiduciaries in the relief provided by the BIC Exemption could expose discretionary fiduciaries—and the retirement investors they serve as fiduciaries—to conflicts they are currently not exposed to. The conditions of the BIC 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.

Some of the Department's existing exemptions would provide relief for conflicted compensation arrangements entered into by discretionary fiduciaries, if the exemptions' conditions are satisfied. For example, PTE 77-4 permits a discretionary fiduciary to invest assets of a plan or IRA in the fiduciary's -- or its affiliate's -- proprietary mutual fund. PTE 86-128 provides an exemption for discretionary fiduciaries or their affiliates to receive a commission for effecting or executing a securities transaction for a plan or IRA. In connection with the

Rule, the Department amended these and several other existing exemptions primarily to incorporate the impartial conduct standards as conditions and to clarify issues of scope. With the addition of the impartial conduct standards, these exemptions now require discretionary fiduciaries to act in the best interest of retirement investors, charge no more than reasonable compensation, and avoid misleading statements. To the extent discretionary fiduciaries worked with ERISA plans, the prudence and loyalty standards in ERISA section 404 were already applicable to them.

Nothing new here. See above response to Question No. 6.

Q9. The full BIC Exemption[2] provides that financial institutions cannot "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." Does this provision categorically preclude financial institutions from paying higher commission rates to advisers based on volume (e.g., by using an escalating grid under which the percentage commission paid to the adviser increases at certain thresholds).

Financial institutions may use such payment structures if they are not intended or reasonably expected to cause advisers to make recommendations that are not in the best interest of retirement investors and they do not cause advisers to violate the reasonable compensation standard. Accordingly, financial institutions must take special care in developing and monitoring compensation systems to ensure that they do not run counter to the fundamental obligation to provide advice that is in the customer's best interest. Financial institutions intending to use escalating grids should consider the following factors in developing their approach:

- The grid. Financial institutions must exercise care to avoid incentivizing advisers to make investment recommendations that are not in the retirement investor's best interest. Accordingly, as firms review possible grid structures, they should carefully consider the amounts used as the basis for calculating adviser compensation to avoid transmitting firm-level conflicts to the adviser. If, for example, different mutual fund complexes pay different commission rates to the firm, the grid cannot pass along this conflict of interest to advisers by paying the adviser more for the higher commission funds and less for the lower commission funds (e.g., by giving the adviser a set percentage of the commission generated for the firm). Such an approach would incentivize the adviser to recommend investments based on their profitability to the firm, rather than their value to the investor.

  However, the firm could define the "compensable" revenue that goes into the grid in such a way that it is level within different broad categories of investments based on neutral factors that aren't tied to how lucrative the investments are for the firm. Of course, any such compensation structure would be subject to appropriate oversight by the firm to ensure that recommendations are based on the customer's interest, rather than the adviser's interest in earning additional compensation. The touchstone is always to avoid structures that misalign the financial interests of the adviser with the interests of the retirement investor.

[2] The term "full BIC Exemption" is used in these FAQs to describe the relief that is subject to the exemption's full conditions, as distinguished from the relief provided for "level fee fiduciaries," subject to more streamlined conditions. See Q5 and Qs13-19.

While this answer was expected based upon the guidance set forth in the Preamble to the BICE and Sec. II(d)(3) of the BICE, it fails to highlight the fact that any differential compensation retained by the firm, which is not passed through the grid to the advisor, must still be reasonable. The Impartial Conduct Standards (Sec. II(c)(2) of the BICE) require that:

> *"[t]he 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)."*

If, for example, there are certain types investments pay commissions to the firm from three – six percent. The firm may limit the "compensable" revenue to the advisor to his/her payout based upon a three percent commission. This safeguard, while mitigating the conflict at the advisor-level, may still cause the firm to receive more than reasonable compensation if the advisor recommends one of the products that pays the firm six percent. PRI recommends that firms narrow approved products within each category of investments to those that pay the same or close to the same amount of third party payments (3 – 3.5 percent in the above-referenced example) to the firm unless there is a justification for receiving a greater amount (i.e., enhanced due diligence performed on the six percent product that is not required for the three percent product within the same category of investments).

- Neutral factors. As discussed in the preamble to the BIC Exemption, firms can pay different commission amounts for different broad categories of investments based on neutral factors. Under this approach, the firm eliminates variations in commissions within reasonably designed investment categories, but variation is permitted between these categories based on neutral factors, such as the time and complexity associated with recommending investments within different product categories. Thus, for example, a firm might adopt one commission structure for mutual fund investments, while providing a different structure for annuities, assuming there is a neutral basis for the distinction.

Example No. 4, entitled Commissions and Stringent Supervisory Structure, in the Preamble to the BICE provides for the establishment of a "commission-based compensation schedule for Advisers in which all variation in commissions is eliminated for recommendations of investments within reasonably designed categories;" yet the DOL's Response to FAQ No. 9, refers to "different commission amounts for different broad categories of investments…." [Emphasis added.] The DOL goes on to state the example provided in the Preamble to the BICE regarding "different product categories" such as "adopt[ing] one commission structure for mutual fund investments, while providing a different structure for annuities..." The corresponding provision in the BICE itself (Sec. II(d)(3)) merely refers to 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…"

It remains an even more open question, unfortunately, as to whether differential payments based upon different classes of mutual funds (e.g., short-term bond funds vs. emerging market equity funds) could be passed through the grid to the advisor. That said, the different categories of

investments are presented as examples, so firms could use a different approach so long as the policies and procedures and compensation practices, when viewed as a whole, are designed in a manner that is not "intended or would reasonably be expected to cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor" as required under Sec. II(d)(3) of the BICE.

PRI recommends that any approach that is not specifically referenced in the Preamble to the BICE be submitted to the DOL for comment and will assist its members in this regard.

For these purposes, "neutral factors" are factors that are not based on the financial interests of the firm (e.g., the profitability of the investment), but rather on significant differences in the work that justify drawing distinctions between categories and compensation. Because compensation varies between categories under this model, the financial institution should exercise special care to monitor recommendations between categories. Advisers cannot preferentially recommend particular product categories simply because they increase adviser compensation. The firm should also exercise care to ensure that any justifications for creating such categories are borne out in practice (e.g., if the rationale for paying a higher percentage for one category than another is the additional work necessary to make such recommendations, the firm should pay careful attention to whether its advisers are, in fact, performing the additional work).

See response above regarding compensation retained by the firm or paid to affiliates or related entities not exceeding that which is reasonable. It is also worth noting the introduction of the term "'significant' with respect to differences in the work that justify drawing distinctions between categories and compensation." This term does not appear in this context in either the Preamble to the BICE or the Sec. II(d)(3) of the BICE.

- Size of steps. Grids with one or several modest or gradual increases are less likely to create impermissible incentives than grids characterized by large increases. An appropriately structured grid would not rely on compensation thresholds that enable an adviser to disproportionately increase his or her compensation as the adviser reaches the threshold. Financial institutions must exercise care to avoid dramatic increases in compensation that undermine the best interest standard and create misaligned incentives for advisers to make recommendations based on their own financial interest, rather than the customer's interest in sound advice.

  Nothing new here. This guidance was set forth in the Preamble to the BICE and Sec. II(d)(3) of the BICE.

- Retroactivity. As the adviser reaches a threshold on the grid, any resulting increase in the adviser's compensation rate should generally be prospective – the new rate should apply only to new investments made once the threshold is reached. If the consequence of reaching a threshold is not only a higher compensation rate for new transactions, but also retroactive application of an increased rate of pay for past investments, the grid is likely to create acute conflicts of interest. Retroactivity magnifies the adviser's conflict of interest with respect to investment recommendations and increases the incentive to make the sales necessary to cross the threshold regardless of the investor's interest. Depending on the magnitude of past investments and the size of the percentage increase, the adviser

can accrue compensation that is wholly disproportional to the compensation that he or she would normally receive for the sales that put the adviser over the top.

While this answer was expected based upon the guidance set forth in the Preamble to the BICE and Sec. II(d)(3) of the BICE, this additional detail regarding retroactivity is helpful and should be followed.

- Oversight. Financial institutions employing escalating grids should pay particular attention to the conflicts of interest such grids create in establishing a system to monitor and supervise adviser recommendations, both at or near compensation thresholds and at a greater distance. Financial institutions should increase monitoring of adviser recommendations at or near compensation thresholds to ensure that adviser recommendations are driven by the customer's best interest, rather than the desire for increased compensation. Similarly, firms should pay special attention to ensuring that the thresholds do not create undue sales incentives. Unduly aggressive or unrealistic thresholds can create incentives to make the sale without regard to whether a sale is in the investor's financial interest.

Nothing new here.

By carefully designing their compensation structures in light of such factors, firms should be able to avoid creating incentive structures that are misaligned with the interests of retirement investors. For more information on this approach, see Example 4 in the preamble to the BIC Exemption, 81 FR 21038. Under the full BIC Exemption, the overarching standard is always to ensure that the firm's compensation practices are not intended and would not reasonably be expected to cause advisers to make recommendations that violate the best interest standard.

Accordingly, the firms should carefully assess their compensation practices for potential conflicts of interest, and work to avoid structures that undermine advisers' incentives to comply with the best interest standard. Additionally, upon request, the Department can provide feedback to parties on specific compensation approaches.

Nothing new here. The response, however, does reiterate that the DOL is available to provide feedback. PRI reminds its members that our staff is available to participate in calls, as appropriate, with the DOL.

Q10. Is "robo-advice" covered by the BIC Exemption or other exemption?

The full BIC Exemption does not cover advice provided *solely* through an interactive Web site in which computer software-based models or applications provide recommendations based on personal information that the investor supplies without any personal interaction or advice from an individual adviser (i.e., robo-advice). The Department did not make the full BIC Exemption generally available for such robo-advice based on its view that the marketplace for robo-advice is still evolving in ways that appear to avoid conflicts of interest that would violate the prohibited transactions provisions and that minimize cost. In addition, a separate exemption set forth in ERISA sections 408(b)(14) and 408(g) and the implementing regulations at 29 C.F.R. section 2550.408g-

1,[3] already provides an exemption for advice arrangements that rely upon computer models to deliver advice, provided that the arrangement meets specified conditions aimed at protecting the participant or IRA from biased advice.

However, the BIC Exemption does provide relief for robo-advice providers that are "level fee fiduciaries." As noted in Q5, there are circumstances in which even level fee fiduciaries may need an exemption. For example, there is a clear and substantial conflict of interest when an adviser recommends that a participant roll retirement savings out of a plan into a fee-based account that will generate ongoing fees for the adviser that it would not otherwise receive, even if the fees going-forward do not vary with the assets recommended or invested. Similarly, investment advice to switch from a commission-based account to an account that charges a fixed percentage of assets under management on an ongoing basis could be a prohibited transaction.

The streamlined level fee provisions of the BIC Exemption cover robo-advice providers engaging in these discrete transactions. The level fee provisions and conditions are discussed in the next section.

> *Nothing new here. This answer is simply a recitation of the PTE. However, the question of whether recommendations to hire a third-party advisor/manager (in this case a robo-advisor), which result in a solicitor fee paid to the firm and advisor, was answered in DOL Response to Question No. 18. See also, previously-released PRI "DOL FAQs" > "BICE Examples" > "Solicitor Fees Allowed" and "Third-Party Payments and Level Fee Fiduciary Status."*
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> *The third-party nature of the solicitor payment requires the firm to use the full BICE even though a solicitor fee is technically a level, asset-based fee that doesn't vary based upon the "investments recommended." Because a solicitor fee may vary based upon the investment advisor/manager recommended, PRI recommends adopting a tiered or level approach to compensating advisors using neutral factors (e.g., higher compensation may be paid when the advisor recommendation involves more complexity and/or more frequent monitoring by the advisor).*
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> *It is important to note, however, that many "solicitor" arrangements may not, in fact, involve third party payments. So long as the compensation paid to the firm (e.g., RIA) is not deducted from the third-party's fee, and bona fide services for value are provided by the advisor, then such arrangements may be better classified as "co-advisor" or "tri-party."*

Q11. Does the full BIC Exemption prohibit a financial institution or adviser from discounting prices paid by customers for services?

No. The Department understands that firms and advisers currently discount prices, and thereby their own compensation, based upon a variety of factors, such as the size of a client's account, the size of a particular transaction, the desire to attract a new client or begin building a practice, the level of service agreed upon between the client and the adviser, as well as to express appreciation to long-standing clients.

The full BIC Exemption requires financial institutions to adopt policies and procedures reasonably and

[3] *See also* Code section 4975(d)(17) and (f)(8).

prudently designed to ensure that individual advisers adhere to the exemption's impartial conduct standards. In addition, the full BIC Exemption requires that recommended transactions may not cause financial institutions and advisers to receive compensation in excess of reasonable compensation. If the financial institution has established a price or pricing schedule for services that satisfies the reasonable compensation standard, it is permissible for advisers to discount such prices for individual clients under the full BIC Exemption. Assuming that the discounts are not used in a manner that re-introduces conflicts of interest, neither the Rule nor the exemption prohibits such practices.

While not specifically addressed in the regulations, this answer is consistent with PRI's prior guidance to its members. Discounting fees does not violate the prohibitions on self-dealing or otherwise result in a prohibited transaction under ERISA or the Code. That said, if discounts are readily available and publicized, it may be factor that is later used to argue that the discounted amounts are reasonable in light of the value of services provided and/or complexity of the investments recommended and that standard pricing reflects something more than what is reasonable.

Q12. Is the payment of recruitment bonuses or awards to an adviser by a financial institution permissible under the full BIC Exemption? Does it matter if the bonus or award is contingent on the achievement of one or more sales targets?

Many financial institutions maintain adviser recruitment programs. The programs are structured in a variety of ways, often including forgivable loans. The recruitment incentives may involve a "signing" or "front-end" award, which is not tied to the movement of accounts or assets to the firm or on achievement of particular asset or sales targets, but rather is paid as a fixed sum contingent on the adviser's continued service in good standing at the financial institution. Such "signing" awards and bonuses are permissible under the full BIC Exemption because the payments do not turn on the adviser's particular recommendations or create inappropriate incentives to give advice that is not in the customer's best interest.

In addition to such front-end awards, financial institutions often also provide large "back-end" awards, as part of their recruitment programs, that are expressly contingent on the adviser's achievement of sales or asset targets. Such back-end awards can create acute conflicts of interest that are inconsistent with the full BIC Exemption's requirement that financial institutions adopt policies and procedures reasonably and prudently designed to ensure that individual advisers adhere to the exemption's impartial conduct standards. In particular, under the full BIC Exemption, financial institutions may not use or rely on bonuses, 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." Instead, firms must structure recruitment and other incentives carefully to avoid violation of these standards or evasion of the exemption's requirement. Unlike properly structured compensation grids as described in Q9, back-end awards commonly result in large amounts of income to the adviser that are paid on an "all or nothing" basis contingent on the adviser's satisfaction of revenue or asset targets. Such disproportional amounts of compensation significantly increase conflicts of interest for advisers making recommendations to investors, particularly as the adviser approaches the target. Accordingly, financial institutions generally may not enter into such arrangements under the full BIC Exemption.

Back-end bonuses were not expressly prohibited in the BICE, however, this position supports PRI's prior guidance as being inconsistent with the spirit of the anti-conflict policies and procedures.

The Department recognizes, however, that some firms may have entered into such back-end recruitment award arrangements with advisers prior to the date of this guidance, and may be contractually obligated to honor their commitments for some period into the future (e.g., the firm may have committed itself to enter into a series of forgivable loans based on meeting asset or revenue targets over a five-year period, and including repayment periods potentially stretching out for a still longer period). These agreements predated the Rule, exemptions, and this guidance, and, accordingly, were not designed to evade their terms. Based on these considerations, if before the date of this guidance, a financial institution entered into such an arrangement as part of a written and binding contract, and the firm determines in good faith that it is contractually bound to continue the arrangement after the applicability date, the financial institution may continue to rely on the full BIC Exemption for transactions involving that adviser, provided that it engages in stringent oversight of the adviser during the period of the arrangement, the period of time remaining under the arrangement is reasonable and consistent with general industry practices, and the arrangement does not otherwise violate the conditions of the exemption, ERISA, or the Code. It was not the Department's intent to overturn such pre-existing binding contracts in these circumstances, and the Department would not treat the parties as having created an impermissible incentive structure under the exemption based on such a pre- existing agreement. To the extent the financial institution chooses to honor these pre-existing arrangements, however, it must adopt special policies and procedures specifically aimed at the conflicts of interest introduced by the arrangements and designed to protect investors from harm. These policies and procedures should establish an especially strict system of supervision and monitoring of conflicts of interest, particularly as the adviser approaches sales targets.

> *This "safe harbor" for pre-existing "back end" bonuses is new. Please note, however, that the arrangement* ***must have been entered into prior to 10/27/16****.*

More generally, prudent financial institutions will adopt measures to protect retirement investors in connection with the recruitment of advisers, including such practices as careful screening of potential hires for past misconduct and disciplinary history; reliance on prudent supervisory policies, surveillance and technology to identify, review, and remediate improper sales practices or account transfers; training and education on the policies and procedures required to meet the impartial conduct standards; alerting investors to the potential conflicts and issues associated with recruitment practices and account transfers (see, e.g., FINRA Rule 2273); and discipline and nullification of awards where there is a conclusion of advisor wrongdoing. Firms have an obligation to avoid compensation structures that undermine advisers' incentives to comply with the best interest standard or that are designed to evade the proper application of that standard, and, accordingly, should carefully review their practices to ensure compliance.

> *This answer is problematic to the degree it purports to condition compliance with the BICE (e.g., via the Impartial Conduct Standards or Anti-Conflict Policies and Procedures), in part, upon screening of advisors' "past misconduct and disciplinary history." While recruitment bonuses and other forms of compensation may be considered to be received "in connection with" the advice provided to a retirement investor, they are considered permissible so long as "when viewed as a whole, [such practices] 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…" (See, e.g., Sec. II(d)(3) of the BICE; see also, the Preamble to the BICE) , the BICE did not refer to screening of advisors past conduct. Consequently, this answer appears to exceed that which is required under the BICE and may subject firms to additional risk if they could have or should have known that the advisor would not reasonably be expected to adhere to the Impartial Conduct Standards, including the best interest standard of care.*

Best Interest Contract Exemption – Level Fee Fiduciaries

Q13. Under the BIC Exemption, who are "level fee fiduciaries" and what prohibited transaction relief is available to them?

The BIC Exemption provides streamlined relief for "level fee fiduciaries" to receive compensation as a result of their provision of investment advice to retirement investors. In general, level fee fiduciaries do not have the sorts of conflicts of interest that give rise to prohibited transactions or require reliance on an exemption. 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 those fees do not vary with the assets recommended or invested.

Similarly, investment advice to switch from a commission-based account to an account that charges a fixed percentage of assets under management on an ongoing basis could be a prohibited transaction. The streamlined level fee provisions of the BIC Exemption are designed to provide relief for these discrete transactions.

Under these streamlined provisions of the, level fee fiduciaries, with their affiliates, may receive only a "level fee" in connection with advisory or investment management services provided to a plan or IRA, and the fee must be disclosed in advance to the retirement investor. As defined in the exemption, 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. Level fees do not include commissions or other transaction-based fees.

The streamlined conditions applicable to level fee fiduciaries require the financial institution to provide a written acknowledgment of its and its advisers' fiduciary status to the retirement investor. The financial institution and its advisers must satisfy the impartial conduct standards (requiring fiduciaries to act in the best interest of their clients, charge no more than reasonable compensation, and make no misleading statements) and document the reasons why the advice was considered to be in the best interest of the retirement investor. In the case of investment advice to roll over assets from an ERISA plan to an IRA, 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.[4] See BIC Exemption, Section II(h).

It should be emphasized that compliance with the streamlined conditions generally is not the only way for level fee fiduciaries to obtain relief under the BIC Exemption. In most cases, they can also avoid prohibited transactions simply by executing the Best Interest Contract with their customer and complying with the

[4] As further described in Q14, the documented factors and considerations are integral to a prudent analysis of whether a rollover is appropriate, regardless of whether the fiduciary is a "level fee" fiduciary or a fiduciary complying with the full BIC Exemption.

applicable conditions of the full BIC Exemption.[5] Thus, if firms or individual advisers are in doubt about their status as level fee fiduciaries, they have an alternative means of compliance that protects investors' interests in unbiased investment advice and provides relief from application of the prohibited transaction provisions.

See, e.g., previously-released PRI "DOL FAQs" > "BICE Fundamentals" > "Level Fee Fiduciary BICE."

Q14. Can an adviser and financial institution rely on the level fee provisions of the BIC Exemption for investment advice to roll over from an existing plan to an IRA if the adviser does not have reliable information about the existing plan's expenses and features?

As described in Q13, in the case of investment advice to roll over assets from an ERISA plan to an IRA, the streamlined level fee provisions of the BIC Exemption require advisers and financial institutions to document the reasons why the advice was considered to be in the best interest of the retirement investor. The documentation must take into account the fees and expenses associated with both the existing plan and the IRA; whether the employer pays for some or all of the existing plan's administrative expenses; and the different levels of services and investments available under each option.

To satisfy this requirement, the adviser and financial institution must make diligent and prudent efforts to obtain information on the existing plan. In general, such information should be readily available as a result of DOL regulations mandating plan disclosure of salient information to the plan's participants (see 29 CFR 2550.404a-5). If, despite prudent efforts, the financial institution is unable to obtain the necessary information or if the investor is unwilling to provide the information, even after fair disclosure of its significance, the financial institution could rely on alternative data sources, such as the most recent Form 5500 or reliable benchmarks on typical fees and expenses for the type and size of plan at issue. If the financial institution relies on such alternative data, it should explain the data's limitations and the written documentation should also include an explanation of how the financial institution determined that the benchmark or other data were reasonable.

This reasonable reliance standard, which results from an inability for the advisor to obtain the required information is new; however, PRI cautions firms from relying upon "alternative data sources." One reason is that the Form 5500 only provides information about indirect compensation paid from the plan (Schedule C) and investments offered by the plan (auditor report) if the plan has more than 100 participants. Given that roughly 85 percent of the plans in the U.S. hold less than $5 million in plan assets, this information may not currently be available via 5500 data.

Moreover, Form 5500 information can often be dated and inconclusive. The only way to obtain all of the required information (e.g., whether employer is paying all or some administrative expenses in-plan) is to have the participant request from the plan administrator the annual 404a-5 participant fee disclosure. This form is required to be provided to participants at least annually and upon request.

Because some of the administrative expenses, which are not included in the total annual operating expenses of the plan's "designated investment alternatives," may be expressed as a percentage or on an if/then basis, PRI continues to recommend that the participant also provide copies of his/her last four

[5] Robo-advice providers, however, may rely on the BIC Exemption only if they are level fee fiduciaries; relief is not available under the full BIC Exemption. See Q10.

quarterly statements. Any expenses deducted from participants' accounts (vs. those charged directly against the investment i.e., investment management, 12b-1, Sub-TA fees, etc.) must be disclosed to the participants in dollar amounts at least quarterly.

PRI has developed an updated IRA Rollover Intake Form designed to capture the required information already available on our home office version of ARC (via "Your Firm" tab and "Compliance Portal") and updated "Policies and Procedures: IRA Rollovers" will soon be available via the home office Compliance Portal. Supervisor and advisor training relating to IRA rollovers are also be available under the Your Firm tab on ARC.

Please note, that the PRI IRA Rollover Intake Form is designed to be used in conjunction with the PRI "Information & Disclosure Form" and "Special Notice for Participants Selecting IRA Rollovers."

As discussed on our recent PRI Member Roundtable (replay available in ARC Compliance Portal > Home Office Training), the IRA Rollover Intake Form currently captures more information than will be necessary for most plans. For example, ETFs, guarantees, company stock, etc. are not available in the vast majority of 401(k) plans and, therefore, those fields can be collapsed. So too can many of the administrative expense categories. A bundled provider plan will not have a TPA, for example, and will not typically charge participants to execute transactions. The form will become more streamlined in other words once we incorporate additional feedback from our members and lock it down as a final version with expand/collapse functionality.

Although the documentation requirement is only specifically recited in the level fee provisions of the BIC Exemption, the documented factors and considerations are integral to a prudent analysis of whether a rollover is appropriate. Accordingly, any fiduciary seeking to meet the best interest standard as set out in the exemption would engage in a prudent analysis of these factors and considerations before recommending that an investor roll over plan assets to an IRA or other investment, regardless of whether the fiduciary was a "level fee" fiduciary or a fiduciary complying with the full BIC Exemption.

Nothing new here, and this answer is consistent with prior PRI guidance. Any time a regulator gives you a roadmap, you are well-served to follow it. The data points articulated under the Level Fee Fiduciary BICE are what the DOL considers to be "relevant information" for purposes of providing prudent recommendations – a foundational fiduciary duty – and should therefore be part of the process for recommending IRA rollovers under both the Level Fee Fiduciary and full BICE.

Q15. In order for a financial institution to rely upon the streamlined provisions for "level fee fiduciaries" must the financial institution and its affiliates offer only "level fee" accounts?

No. An adviser, financial institution, and their affiliates may offer both "level fee" advisory services for which they can rely on the streamlined provisions, as well as commission-based brokerage accounts for which they have to rely on the full BIC Exemption. Retirement investors could invest in both types of accounts, but the institution and adviser should take care to ensure that any recommendations as to account type adhere to the impartial conduct standards and are not intended to evade the requirements of the exemption. *See also* Q5 (noting that certain abusive practices involving fee-based accounts can violate the prohibition on self-dealing in ERISA 406(b)(1) and Code section 4795(c)(1)(E), and fall short of meeting the conditions of any applicable exemption).

Nothing new here as this answer is consistent with prior PRI guidance. In order for a PT to result, the conflicted compensation must be received "in connection with" the recommended transaction. Compensation received by the firm or advisor that is not in connection with advisory or management services provided to a retirement investor will not disqualify the firm nor the advisor from utilizing the Level Fee Fiduciary BICE – provided that the only compensation received with respect to those transactions meet the requirements of the streamlined exemption. In other words, a firm can rely upon the Level Fee Fiduciary BICE for recommendations to invest some of the proceeds from an IRA rollover into a fee-based account with no third-party payments and use the full BICE for any recommendations to invest any remaining proceeds in a manner that results in the receipt of third-party payments.

Q16. Can a financial institution and adviser rely on the level fee provisions in the BIC Exemption to recommend a rollover from an employee benefit plan to an IRA if the adviser will become a discretionary manager with respect to the IRA assets after the rollover?

Yes. The BIC Exemption is available for investment advice to roll over a plan account to an IRA, even if the adviser will subsequently serve as a discretionary investment manager with respect to the IRA, as long as the adviser does not have or exercise any discretionary authority or discretionary control with respect to the decision to roll over assets of the plan to an IRA. The level fee provisions are available when 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" and is fully disclosed in advance to the Retirement Investor. If the discretionary manager, its financial institution and their affiliates satisfy this limitation and the other applicable conditions of the BIC Exemption for level fee fiduciaries, the exemption would provide relief for the rollover investment advice. As discussed in Q8, however, the BIC Exemption is not available for any prohibited conflicts of interest arising from the discretionary manager's conduct after the assets are rolled over to the discretionary account.

This answer appears to be superfluous. See, e.g., DOL response above at Question No. 7 and related previously-released PRI guidance; see also, previously-released PRI "DOL FAQs" > "BICE Examples" > "Discretionary IRAs and BICE."

Q17. Can an adviser and financial institution rely on the level fee provisions in the BIC Exemption if they recommend that investors transfer from commission-based accounts to accounts paying only a "level fee"?

Yes. Under the Rule, fiduciary investment advice includes a recommendation regarding the selection of investment accounts (e.g., brokerage or advisory). The BIC Exemption's relief for level fee fiduciaries includes relief for a recommendation to transfer from a commission-based account to a fee-based account. In addition to receiving only a "level fee" for themselves and their affiliates, the exemption requires the financial institution to provide a written acknowledgment of its and its advisers' fiduciary status to the retirement investor. The financial institution and its advisers must also satisfy the impartial conduct standards and document the reasons why the recommendation was in the best interest of the retirement investor. Additionally, the documentation must address the services that will be provided for the level fee. As noted above, even if the adviser is a "level fee fiduciary," it still must adhere to the impartial conduct standards. As a result, certain abusive practices involving fee-based accounts can violate the prohibition on self-dealing in ERISA 406(b)(1) and Code section 4795(c)(1)(E), and fall short of meeting the conditions of any applicable exemption. For example, in its "Report on Conflicts of Interest" (Oct. 2013), p.29, the Financial Industry Regulatory Authority (FINRA) suggests a number of circumstances in which advisers may recommend inappropriate commission- or fee- based accounts

as a 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 and would not be covered by an exemption. In making these recommendations, financial institutions and advisers should consider whether the type of account is appropriate in light of the services provided, the projected cost to the customer, alternative fee structures that are available, and the customer's fee structure preferences, in addition to non-price factors.

Nothing new here. This answer is simply a recitation of the PTE. See, e.g., previously-released PRI "DOL FAQs" > "BICE Fundamentals" > "Level Fee Fiduciary BICE vs. Full BICE" and "Level Fee Fiduciary BICE."

Q18. Can advisers and financial institutions rely on the "level fee" provisions in the BIC Exemption if they receive third party payments (e.g., 12b-1 fees or revenue sharing payments) in connection with the assets recommended? What if they only recommend assets that generate the same level of third party compensation?

For purposes of the exemption, 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. Third party payments such as 12b-1 fees and revenue sharing payments, even if they provide the same amount or percentage for each investment offered, are transaction-based fees and vary on the basis of a particular investment because they are paid only for the particular investments that are included in the arrangement. If the adviser or financial institution is going to recommend products that generate third party payments, they need to comply with the more stringent provisions of the full BIC Exemption to safeguard the investor from biased advice. The BIC Exemption includes a section specifically describing how such financial institutions and advisers can adhere to the best interest standard, even when they restrict the investments recommended based in whole or part on the receipt of third party compensation. *See* BIC Exemption, Section IV.

This answer confirms PRI's previously-released guidance; the third-party nature of the solicitor payment requires the firm to use the full BICE even though a solicitor fee is technically a level, asset-based fee that doesn't vary based upon the "investments recommended." See e.g., previously-released PRI "DOL FAQs" > "BICE Examples" > "Solicitor Fees Allowed" and "Third-Party Payments and Level Fee Fiduciary Status."

Because a solicitor fee may vary based upon the investment advisor/manager recommended, PRI recommends adopting a tiered or level approach to compensating advisors using neutral factors (e.g., higher compensation may be paid when the advisor recommendation involves more complexity and/or more frequent monitoring by the advisor).

It is important to note, however, that many "solicitor" arrangements may not, in fact, involve third party payments. So long as the compensation paid to the firm (e.g., RIA) is not deducted from the third-party's fee, and bona fide services for value are provided by the advisor, then such arrangements may be better classified as "co-advisor" or "tri-party."

Q19. Can a financial institution and adviser rely on the "level fee" provisions in the BIC Exemption if they sell only proprietary investments for which the financial institution pays the same commission to its advisers regardless of the investment selected?

No. The "level fee" provisions are not available for commission or transaction-based compensation arrangements, or for compensation structures that are limited to the sale of proprietary products. The availability of the compensation depends on the recommendation of a product (and acceptance of that recommendation by the advice recipient) and therefore is not level. If the adviser and financial institution are only going to recommend proprietary products, they need to comply with the more stringent provisions of the full BIC Exemption to safeguard the investor from biased advice. Section IV of the BIC Exemption specifically describes how such financial institutions and advisers can adhere to the best interest standard, even when they restrict investment recommendations to proprietary products.

Nothing new here. This answer is simply a recitation of the PTE.

Best Interest Contract Exemption – Bank Networking Arrangements

Section II(i) of the BIC Exemption provides conditions applicable to advisers who are bank employees, and financial institutions that are banks or similar financial institutions or savings associations, who receive compensation pursuant to a "bank networking arrangement." As defined in the BIC Exemption, bank networking arrangements involve the referral by banks and their employees to non-affiliates who are providers of retail non-deposit investment products, in accordance with applicable banking, securities and insurance regulations.

Q20. The BIC Exemption provisions regarding Bank Networking Arrangements address referrals by banks and bank employees only to non-affiliated financial institutions such as registered investment advisers, insurance companies or broker dealers. Why isn't relief provided for referrals to affiliates?

Under the Rule, a recommendation of *other* persons to provide investment advice or investment management services constitutes fiduciary investment advice, and receipt of compensation as a result of such advice is a prohibited transaction requiring compliance with an exemption. In contrast, marketing oneself or an affiliate (when it is disclosed as such), without otherwise making an investment recommendation covered by the Rule, does not constitute investment advice that may result in a prohibited transaction. Referrals to affiliates who are providers of retail non-deposit investment products therefore generally would not be considered fiduciary investment advice giving rise to a prohibited transaction for which an exemption is required.

Nothing new here. This answer is simply a recitation of the PTE.

Best Interest Contract Exemption and PTE 84-24 – Annuities

The Department has granted two exemptions that permit insurance agents and other advisers to receive compensation when they provide investment advice regarding the sale of annuities. PTE 84-24 (available for fixed rate annuity contracts) and the BIC Exemption (available for fixed rate, fixed indexed, and variable annuity contracts) are available if the applicable conditions are satisfied.

Q21. Can "insurance-only" agents continue to sell fixed rate and fixed indexed annuities to retirement investors after the applicability date of the Rule?

Yes. Both the BIC Exemption and PTE 84-24 provide relief for agents, including insurance-only agents, who sell fixed rate and fixed indexed annuities to retirement investors, as described below.

Under PTE 84-24, an insurance agent can receive an insurance commission on the sale of a recommended "fixed rate annuity contract." For purposes of the exemption, an insurance commission is a sales commission paid by the insurance company, but not revenue sharing payments, administrative fees, or marketing payments. The term "fixed rate annuity contract" is intended to describe the types of annuities commonly referred to as immediate annuities, traditional annuities, declared rate annuities and fixed rate annuities. Fixed indexed annuities and variable annuities are not covered by PTE 84-24, but relief is available for such annuities under the full BIC Exemption, which also covers a broader range of compensation.

PTE 84-24, like the BIC Exemption, requires insurance agents to comply with "impartial conduct standards," which are consumer protection standards that ensure that advisers adhere to fiduciary norms and basic standards of fair dealing. The standards specifically require advisers and financial institutions to:

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

Additionally, the exemption includes other conditions, including disclosure and consent requirements, and some restrictions on the parties that may rely on the exemption.

The chief differences between the full BIC Exemption and PTE 84-24 are that the full BIC Exemption: provides broader relief for compensation received on annuity sales (not just insurance commissions); requires the execution of the Best Interest Contract in transactions with IRA owners; requires that financial institutions put in place anti-conflict policies and procedures[6]; and imposes different disclosure obligations than PTE 84-24.

[6] Although PTE 84-24 does not condition relief on a specific policies and procedures requirement, the impartial conduct standards equally apply under both exemptions. As a result, financial institutions should implement prudent anti-conflict policies and procedures, regardless of which exemption they rely upon. In the absence of such policies and procedures, the financial institution is unlikely to be able to ensure adherence to the best interest standard.

Both exemptions require adherence to the impartial conduct standards, and neither exemption requires execution of a contract for advice given to ERISA-covered plans or their participants.

Nothing in these exemptions, the impartial conduct standards, or ERISA prohibits investment advice by "insurance-only" agents, or requires such insurance specialists to render advice with respect to other categories of assets outside their specialty or expertise. A prudent adviser should be careful, however, in accordance with the exemptions, to disclose any limitations on the types of products he or she recommends, and would refrain from recommending an annuity if it were not a prudent choice for the retirement investor. If, for example, it would be imprudent for the investor to purchase an annuity in light of the investor's liquidity needs, existing assets, lack of diversification, financial resources, or other considerations, the adviser should not recommend the annuity purchase, even if that means the agent cannot make a sale.

> *While the text of this answer is consistent with prior PRI guidance, the footnote introduces a more expansive interpretation of the Impartial Conduct Standards. The statement "… financial institutions should implement prudent anti-conflict policies and procedures, regardless of which exemption they rely upon…" is problematic to the degree that it presupposes that the best interest standard, which is required under the Impartial Conduct Standards, cannot be met in the absence of the strict conditions set forth in Sec. II(d)(3) of the BICE.*

Q22. Can insurance companies rely on independent insurance agents to sell fixed rate and fixed indexed annuities to retirement investors after the applicability date of the Rule?

Yes. The Department's exemptions for annuity sales (PTE 84-24 and the BIC Exemption) do not require insurance companies to use any particular distribution channel. While insurance companies may rely on a captive sales force to distribute their proprietary products, they may also distribute annuities through independent insurance agents or other channels.

PTE 84-24 provides relief for the insurance agent's receipt of an insurance commission and related employee benefits and for an insurance company's receipt of compensation and other consideration in connection with the sale of a recommended fixed rate annuity contract, provided the conditions of the exemption are satisfied. The full BIC Exemption provides broader relief under expanded conditions for transactions involving annuities of all kinds and for all forms of compensation. PTE 84-24, like the BIC Exemption, requires the independent insurance agent to satisfy the best interest standard and other impartial conduct standards when providing investment advice. Additionally, the exemption includes other conditions limiting the parties that may rely on the exemption and mandating specific disclosures.

Under the full BIC Exemption, advice recommendations must be overseen by an appropriate financial institution, which may be the insurance company that issues the annuity. As under the "suitability" rules that apply to insurance companies under many states' laws, the insurer or financial institution responsible for overseeing the agent's recommendations is responsible for adopting appropriate supervisory mechanisms to ensure the agent's (including independent agent's) compliance with its legal obligations to customers. Under the full BIC Exemption, the responsible financial institution must acknowledge its fiduciary status and the fiduciary status of the agent in connection with the covered annuity recommendations. Advice recommendations must adhere to the impartial conduct standards, including the best interest standard, and the financial institution must have policies and procedures in place that are reasonably and prudently designed to ensure adherence to these standards. In the case of IRA customers, these commitments must be expressed

in a written contract with the annuity investor (i.e., the Best Interest Contract). There is no requirement of a written contract for advice to ERISA plans and plan participants, but the standards of conduct are the same as for IRAs.

When an independent insurance agent recommends an annuity under the full BIC Exemption, the agent *and* the insurance company acting as the financial institution must satisfy the exemption's conditions, including the fiduciary acknowledgment and the impartial conduct standards, with respect to that transaction. In such cases, the insurance company effectively stands behind the agent's recommendation to purchase the insurance product, and makes a commitment to the retirement investor that it has policies and procedures in place that have been prudently designed to ensure that the agent's recommendations will be prudent and based upon the investor's financial interests, rather than, for example, sales incentives created by the insurer that run contrary to the investor's interests. Thus, as the full BIC Exemption states, the insurer, its affiliates, and related parties may not use or rely upon incentives, quotas, or other actions or incentives that are intended or would reasonably be expected to cause an adviser to give advice that violates the impartial conduct standards, including the obligation to make recommendations that are prudent and loyal.

While the independent agent may recommend products issued by a variety of insurers, the full BIC Exemption does not require insurance companies to exercise supervisory responsibility with respect to the practices of unrelated and unaffiliated insurance companies. If an insurer chooses to act as the supervisory financial institution for purposes of the exemption, its obligation is simply to ensure that the insurer, its affiliates, and related parties meet the exemption's terms with respect to the insurer's annuity which is the subject of the transaction. Under the exemption, the insurer must adopt and implement prudent supervisory and review mechanisms to safeguard the agent's compliance with the impartial conduct standards when recommending the insurer's products; avoid improper incentives to preferentially push the products, riders, and annuity features that are most lucrative for the insurer at the customer's expense; ensure that the agent receives no more than reasonable compensation for its services in connection with the transaction; and adhere to the disclosure and other conditions set forth in the exemptions. In other words, its responsibility is to oversee the recommendation and sale of its products, not recommendations and transactions involving other insurers.

If the insurance company adheres to these principles, it should be able to comply with the full BIC Exemption, regardless of whether it chooses to market its products through a captive sales force, independent agents, or other channels. The insurer could also bolster its oversight by contractually requiring an intermediary such as an independent marketing organization (IMO) to implement policies and procedures designed to ensure that all of the agents associated with the IMO adhere to the impartial conduct standards. Thus, for example, the IMO could eliminate potentially troubling compensation incentives across all the insurance companies that work with the IMO. While the insurance company remains responsible for compliance with the full BIC Exemption, nothing in the exemption precludes insurers from contracting with other parties, such as IMOs, for compliance work.

> *Such contractual arrangements with independent parties for compliance work would need to include policies and procedures "reasonably and prudently designed" to ensure compliance with the Impartial Conduct Standards and best interest standard of care. Prudence has generally been interpreted to require consideration of relevant information, or that which the fiduciary should know to be relevant, in order to arrive at a well-informed decision regarding the selection of the third-party service provider and periodic monitoring of its performance. Consequently, careful attention should be paid to ensure that appropriate*

due diligence is conducted and maintained on the third-party contractor such that the fiduciary's reliance on the third party's performance is reasonable.

Q23. What is the role of insurance intermediaries, such as independent marketing organizations (IMOs), in the sale of annuity contracts to retirement investors after the applicability date of the Rule? Can they receive compensation such as commissions and override payments?

Insurance intermediaries such as IMOs can continue to distribute the products of an insurance company through independent insurance agents after the applicability date of the Rule. An IMO can receive compensation as a result of an annuity purchase recommended by an insurance agent pursuant to either PTE 84-24 or the full BIC Exemption.

The full BIC Exemption requires that a "financial institution" execute the best interest contract and exercise supervisory authority over advisers. Under the exemption, marketing organizations like IMOs are not treated as financial institutions that can execute the Best Interest Contract. Instead, the exemption contemplates that the insurance company (or other enumerated financial institution) will take responsibility for ensuring that the exemption's conditions are met and that investment advice to buy the insurer's products are in the best interest of retirement investors.

This does not mean, however, that insurance companies and independent agents are prohibited from working with IMOs, assuming that the IMOs do not promote imprudent or disloyal advice or advice that otherwise violates the basic standards of fair dealing set forth in the BIC Exemption. Accordingly, the exemption specifically provides relief for compensation paid to "affiliates" and "related entities" of an adviser and financial institution, which would typically include IMOs.[7] Under the exemption, therefore, an IMO can continue to work with an insurance company and receive compensation if the insurance agent and the insurance company comply with the conditions of the exemption applicable to advisers and financial institutions, respectively.

Additionally, the BIC Exemption provides a process for IMOs to seek to be added to the definition of financial institution. Under this process, an IMO can apply to be treated as the financial institution with the responsibility to execute the best interest contract and ensure compliance with the exemption's terms. The Department presently has several such applications under consideration. If the Department grants an individual exemption to an IMO under this process, any other IMO that satisfies the definition and the conditions of the new exemption could also act as a financial institution under the BIC Exemption. Alternatively, the Department may propose a class exemption for IMOs. Before the Department grants such an exemption, it would have to find 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.

While this answer is mostly a recitation of the PTE, the possibility of a class exemption for financial institution status was not included in Sec. VIII(e) of the BICE.

[7] If an IMO is not an affiliate or related entity, or otherwise a party in interest or disqualified person with respect to the plan or IRA, the IMO's receipt of payments as a result of an adviser's advice would not be a prohibited transaction requiring compliance with an exemption.

Disclosures under the Best Interest Contract Exemption

Q24. After January 1, 2018, the full BIC Exemption requires the financial institution to maintain an electronic copy of the required best interest contract with its clients on its web site, which must be accessible to the retirement investor. Does the financial institution's website have to maintain an executed copy of each retirement investor's contract or is a model contract acceptable?

Section II of the BIC Exemption requires that financial institutions agree to certain standards and make specified warranties in a written contract with their IRA and non-ERISA plan customers. Section II(a)(2) of the BIC Exemption requires financial institutions to maintain an electronic copy of the retirement investors' contracts on its website that is accessible by the investor.

The best practice is for a financial institution to maintain an executed copy of the retirement investor's individual contract on its website that is accessible by the retirement investor. This ensures that the retirement investor will have ready access to a statement of his or her rights and potentially eliminates many needless disputes about the existence of the contract and the scope of the financial institution's obligations under that contract. To the extent the insurer uses a model contract that does not vary for a class of customers, it may nevertheless choose to post the model on its website along with an acknowledgment that it is bound by the terms of the model contract in its dealings with the specified customers. However, the financial institution should exercise care in this regard. The contract is a condition of the full BIC Exemption for IRA and non- ERISA plan investors. If, in fact, the model contract does not include all of the mandatory terms with respect to the particular customer, does not express the terms of the contract that was executed at the time of the transaction, or if the firm subsequently disclaims the contract posted on the website as the governing document, the exemption is not satisfied.

> *The ability to provide access to a "model contract" is new; however, firms should be careful in terms of how they distinguish among "classes of customers" – particularly as it relates to incorporating the disclosures required under Sec. II(e) of the BICE. The Sec. II(e) disclosures are required to be provided in the BIC or "in a separate single written disclosure provided to the Retirement Investor with the contract" and may vary based upon the particular investment(s), strategies and/or account type(s) recommended.*

Q25. How does a financial institution relying on a retirement investor's negative consent to amend an existing contract satisfy Section II(a)(2) of the full BIC Exemption, requiring the financial institution to maintain an electronic copy of the retirement investor's best interest contract on its web site that is accessible by the retirement investor?

Section II(a)(1)(ii) of the BIC Exemption provides that a financial institution can amend existing contracts with investors to add the best interest contract provisions required by the exemption by using a negative consent procedure. Financial institutions may deliver the proposed contract amendment prior to January 1, 2018, and consider the investor's failure to terminate the amended contract within 30 days as assent. An "existing contract" is defined in the exemption as an investment advisory agreement, investment program agreement, account opening agreement, insurance contract, annuity contract, or similar agreement or contract that was executed before January 1, 2018, and remains in effect. If the financial institution elects to use the negative consent procedure to establish the best interest contract, 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.

As a best practice, financial institutions can post the contract amendment in each retirement investor's account with information on the date and means of delivery. As in the preceding answer, however, financial institutions may post the model contract amendment provisions on their websites with a statement that the provisions are applicable to specified IRA and non- ERISA plan investors with existing contracts as of the relevant date.

While this answer was expected with respect to posting the negative consent BIC, the FAQ requires that it be accompanied with "information on the date and means of delivery." Accordingly, Sec. I of the PRI Supplemental BICE Agreement has been updated in the ARC Compliance Portal to capture this information.

Q26. Must the transaction disclosure required by Section III(a) of the full BIC Exemption be provided in connection with a recommendation to hold or to sell an investment product?

No. Section III(a) of the BIC Exemption requires financial institutions to provide certain disclosures "prior to or at the same time as the execution of the recommended investment in an investment product." This disclosure is required to be made only for purchase recommendations and does not have to be provided for recommendations to hold or to sell any investment products.

Nothing new here. This answer is simply a recitation of the PTE.

Q27. If a retirement investor requests specific disclosure of costs, fees or other compensation regarding recommended transactions under Section II(e) or III(a) of the full BIC Exemption, does this require the financial institution to disclose costs, fees or other compensation as of *the date of the recommendation* or as of *the date of the request*?

Section II(e) and III(a) of the BIC Exemption each require the financial institution to disclose that the retirement investor has the right to obtain specific disclosure of costs, fees, and compensation, including third party payments, regarding recommended transactions. The costs, fees, and 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. 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.

The information provided to retirement investors pursuant to Section II(e) and III(a) of the BIC Exemption should generally be provided as of *the date of the recommendation*. However, nothing in the exemption is intended to preclude the financial institution from providing the information as of a subsequent date if the retirement investor requests such subsequent information.

While this answer allows more operational flexibility, firms should be careful that an information provided after the date of the recommendation is not misleading.

Grandfathering in the Best Interest Contract Exemption

Section VII of the BIC Exemption provides an exemption for specified compensation received in connection with investments that were made before the April 10, 2017 applicability date of the Rule, as well as compensation for recommendations to continue to adhere to a systematic purchase program established before the applicability date. Among other conditions, any new advice with respect to the grandfathered investments must meet the best interest standard.

Q28. Are dividend reinvestment programs "systematic purchase programs" eligible for grandfathering relief under Section VII of the BIC Exemption?

Yes. As contemplated by the exemption, a systematic purchase program operates automatically after the applicability date. For example, a dividend reinvestment program in which dividends paid with respect to specific shares of stock are solely used to purchase additional shares of the stock would constitute a systematic purchase program. Thus, if an investor enters into a dividend reinvestment program prior to the applicability date, Section VII would apply if, after the applicability date, an adviser recommended that the investor continue to adhere to the dividend reinvestment program and received compensation as a result, provided the other applicable conditions of Section VII are satisfied. As noted in the text, the exemption is available for advice to continue to adhere to the program; the exemption does not extend to investment advice to make any changes to the program.

This clarification is helpful to the degree that the DOL expressly extends grandfathering to cover dividend reinvestment programs, but PRI cautions firms that any changes, including to increase amounts automatically contributed to an IRA under a systematic purchase program, would make any additional compensation received as a result of such recommendation ineligible for grandfathering.

Q29. Under Section VII(b)(3) of the BIC Exemption, grandfathering relief is not available for compensation received in connection with the investment of additional amounts in a previously acquired investment vehicle. If an adviser provides investment advice that a retirement investor invest an additional $100,000 in an annuity contract acquired prior to the applicability date, does that new deposit cause the "old money" in the annuity contract to cease to be eligible for grandfathering relief?

No. Investment advice to deposit the additional $100,000 is not eligible for grandfathering under Section VII; instead, the adviser and financial institution must comply with the applicable terms of Sections I through V of the BIC Exemption, or another exemption, for that advice. The additional deposit, however, does not cause compensation attributable to the annuity purchase that predated the applicability date to become ineligible for relief under Section VII.

This clarification is helpful insofar as the text of Sec. VII(b)(3) of the BICE provides that grandfathering in not available for "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..." Interestingly, that provision doesn't require that the investment of additional amounts occur as a result of investment advice provided by the firm or advisor. The FAQ, however, seems to accurately convey the required nexus between investment advice and the additional amounts invested.

Q30. Does investment advice to sell an investment product qualify for grandfathering under Section VII of the BIC Exemption?

Yes. Section VII specifically provides that the exemption applies to compensation received in connection with the "purchase, holding, sale, or exchange" of securities or other investment property acquired before the applicability date. Accordingly, compensation received as a result of investment advice to sell a grandfathered investment is covered by Section VII of the BIC Exemption. Advice regarding investment of the proceeds of the sale, however, must be made in accordance with the applicable terms of Sections I through V of the BIC Exemption, or another exemption, rather than the grandfathering provisions of Section VII.

Nothing new here. This answer is simply a recitation of the PTE.

Principal Transactions Exemption

The Department's new Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Principal Transactions Exemption) allows an adviser and financial institution to engage in principal transactions and riskless principal transactions involving certain investments, with plans, participant and beneficiary accounts, and IRAs. To safeguard the interests of plans, participants and beneficiaries, and IRA owners, the exemption requires financial institutions and advisers to satisfy certain conditions, including adhering to impartial conduct standards. The exemption limits the type of investments that may be purchased by the plans and IRAs, and contains certain other conditions which the adviser and financial institution must satisfy in order to rely on the exemption.

Q31. Is there a way to get an exemption for advice to engage in principal transactions involving assets that are not specifically covered by the Principal Transactions Exemption?

Yes. Parties interested in such an exemption can apply for an individual or class exemption to expand the scope of assets covered by the Principal Transactions Exemption. The Principal Transactions Exemption specifically contemplates a process by which the definition of "Principal Traded Asset[s]" can be expanded through individual exemptions. Thus, the definition of a Principal Traded Asset includes "an investment that is permitted to be purchased under an individual exemption granted by the Department . . . that provides relief for investment advice fiduciaries to engage in the purchase of the investment in a Principal Transaction or a Riskless Principal Transaction with a Plan or IRA under the same conditions as this exemption." This means that the Department may grant an individual exemption for a product to be sold on a principal basis in compliance with the terms of the Principal Transactions exemption, and that product will be added to the definition of Principal Traded Asset in the class exemption. At present, the Principal Transactions Exemption is expressly available for recommended sales to a plan or IRA of CDs, interests in UITs, and securities within the exemption's definition of "debt security." Debt securities are generally defined as corporate debt securities offered pursuant to a registration statement under the Securities Act of 1933; treasury securities; agency securities; and asset-backed securities that are guaranteed by an agency or government sponsored enterprise.

Nothing new here. This answer is simply a recitation of the PTE.

PTE 84-24

As amended, PTE 84-24, allows fiduciaries and other service providers to receive compensation in connection with plans' and IRAs' purchases of insurance contracts and "Fixed Rate Annuity Contracts," as defined in the exemption. It also provides relief for the receipt of compensation in connection with ERISA plans purchasing securities of investment companies registered under the Investment Company Act of 1940.

Q32. Does PTE 84-24 cover rollovers into an annuity?

Yes. Section I(b)(1) provides that the exemption permits "[t]he receipt, directly or indirectly, by an insurance agent or broker or a pension consultant of an Insurance Commission and related employee benefits, from an insurance company in connection with the purchase, with assets of a Plan or Individual Retirement Account (IRA), *including through a rollover or distribution*, of an insurance contract or Fixed Rate Annuity Contract." (Emphasis added.) Likewise, as amended, Section I(b)(4) of the exemption permits "[t]he purchase, with assets of a Plan or IRA, *including through a rollover or distribution*, of a Fixed Rate Annuity Contract or insurance contract from an insurance company, and the receipt of compensation or other consideration by the insurance company." (Emphasis added.)

Nothing new here. This answer is simply a recitation of the PTE.

Q33. The wording of PTE 84-24's reasonable compensation standard differs from the reasonable compensation standard used in the BIC Exemption. Does the Department intend to interpret them differently?

Section III(c) of PTE 84-24 provides that "[t]he combined total of all fees and compensation received by the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter for their services does not exceed reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2)[.]" Section II(c)(2) of the BIC Exemption requires that "[t]he 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)."

The two standards do not differ substantively and the Department intends to interpret these provisions the same way. In this regard, the reasonable compensation standard used in each exemption incorporates 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 investment advice. The essential question is whether the charges are reasonable in relation to what the investor stands to receive for his or her money. See 81 FR 21167 (PTE 84-24); 81 FR 21030 (BIC Exemption). In general, firms can ensure compliance with the standard by being attentive to market prices and benchmarks for the services; providing the investor proper disclosure of relevant costs, charges, and conflicts of interest; prudently evaluating the customer's need for the services, and avoiding fraudulent or abusive practices with respect to the service arrangement.

This answer is consistent with previously-released PRI guidance. See e.g., PRI "DOL FAQs" > "BICE Fundamentals" > "Reasonable Compensation" on ARC.

Compliance

Q34. How will the Department approach implementation of the new rule and exemptions during the period when financial institutions and advisers are coming into compliance?

The Department has been and will continue working together with fiduciaries, financial institutions, recordkeepers, insurance companies, advisers, and other stakeholders to help them come into compliance with the new rule and related prohibited transaction exemptions. This first set of FAQs is the product of those collaborations. We are also working on outreach to workers, retirees and their families to help them understand the new rule and benefits they will get from it.

Although the Department has broad authority to investigate or audit employee benefit plans and plan fiduciaries, compliance assistance is a high priority for the Department. The Department's general approach to implementation will be marked by an emphasis on assisting (rather than citing violations and imposing penalties on) plans, plan fiduciaries, financial institutions and others who are working diligently and in good faith to understand and come into compliance with the new rule and exemptions.

> *While this is a welcome gesture from the DOL, it should not be interpreted to impose a good faith compliance standard with the terms and conditions of the full BICE for non-ERISA plans and IRAs. It goes without saying that compliance assistance is not a high priority for the plaintiffs'/claimants' bar.*