



DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

[Application No. D-11712]

Proposed Best Interest Contract Exemption

ZRIN 1210-ZA25

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

ACTION: Notice of Proposed Class Exemption.

SUMMARY: This document contains a notice of pendency before the U.S. Department of Labor of a proposed exemption from certain prohibited transactions provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (the Code). The provisions at issue generally prohibit fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs) from engaging in self-dealing and receiving compensation from third parties in connection with transactions involving the plans and IRAs. The exemption proposed in this notice would allow entities such as broker-dealers and insurance agents that are fiduciaries by reason of the provision of investment advice to receive such compensation when plan participants and beneficiaries, IRA owners, and certain small plans purchase, hold or sell certain investment products in accordance with the fiduciaries' advice, under protective conditions to safeguard the interests of the plans, participants and beneficiaries, and IRA owners. The proposed exemption would affect participants and beneficiaries of plans, IRA owners and fiduciaries with respect to such plans and IRAs.

DATES: *Comments:* Written comments concerning the proposed class exemption must be received by the Department on or before **[INSERT DATE THAT IS 75 DAYS AFTER PUBLICATION OF THIS PROPOSED CLASS EXEMPTION IN THE FEDERAL REGISTER]**.

Applicability: The Department proposes to make this exemption available eight months after publication of the final exemption in the FEDERAL REGISTER. We request comment below on whether the applicability date of certain conditions should be delayed.

ADDRESSES: All written comments concerning the proposed class exemption should be sent to the Office of Exemption Determinations by any of the following methods, identified by ZRIN: 1210-ZA25:

Federal eRulemaking Portal: <http://www.regulations.gov> at Docket ID number: EBSA-2014-0016. Follow the instructions for submitting comments.

Email to: e-OED@dol.gov.

Fax to: (202) 693-8474.

Mail: Office of Exemption Determinations, Employee Benefits Security Administration, (Attention: D-11712), U.S. Department of Labor, 200 Constitution Avenue, NW, Suite 400, Washington DC 20210.

Hand Delivery/Courier: Office of Exemption Determinations, Employee Benefits Security Administration, (Attention: D-11712), U.S. Department of Labor, 122 C St. NW, Suite 400, Washington DC 20001.

Instructions. All comments must be received by the end of the comment period. The comments received will be available for public inspection in the Public Disclosure Room of the Employee Benefits Security Administration, U.S. Department of Labor, Room N-

1513, 200 Constitution Avenue, N.W., Washington, DC 20210. Comments will also be available online at www.regulations.gov, at Docket ID number: EBSA-2014-0016 and www.dol.gov/ebsa, at no charge.

Warning: All comments will be made available to the public. Do not include any personally identifiable information (such as Social Security number, name, address, or other contact information) or confidential business information that you do not want publicly disclosed. All comments may be posted on the Internet and can be retrieved by most Internet search engines.

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

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

Public Hearing: The Department plans to hold an administrative hearing within 30 days of the close of the comment period. The Department will ensure ample opportunity for public comment by reopening the record following the hearing and publication of the hearing transcript. Specific information regarding the date, location and submission of requests to testify will be published in a notice in the Federal Register.

Executive Summary

Purpose of Regulatory Action

The Department is proposing this exemption in connection with its proposed regulation under ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) (Proposed Regulation), published elsewhere in this issue of the FEDERAL REGISTER. The Proposed Regulation would amend the definition of a “fiduciary” under ERISA and the Code to specify when a person is a fiduciary by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. If adopted, the Proposed Regulation would replace an existing regulation dating to 1975. The Proposed Regulation is intended to take into account the advent of 401(k) plans and IRAs, the dramatic increase in rollovers, and other developments that have transformed the retirement plan landscape and the associated investment market over the four decades since the existing regulation was issued. In light of the extensive changes in retirement investment practices and relationships, the Proposed Regulation would update existing rules to distinguish more appropriately between the sorts of advice relationships that should be treated as fiduciary in nature and those that should not.

The exemption proposed in this notice (“the Best Interest Contract Exemption”) was developed to promote the provision of investment advice that is in the best interest of retail investors such as plan participants and beneficiaries, IRA owners, and small plans. ERISA and the Code generally prohibit fiduciaries from receiving payments from third parties and from acting on conflicts of interest, including using their authority to affect or increase their own compensation, in connection with transactions involving a plan or IRA. Certain types of fees and compensation common in the retail market, such as brokerage or insurance commissions, 12b-1 fees and revenue sharing payments, fall within these prohibitions when received by fiduciaries as a result of transactions involving advice to the plan participants and beneficiaries, IRA owners and small plan sponsors. To facilitate continued provision of advice to such retail

investors and under conditions designed to safeguard the interests of these investors, the exemption would allow certain investment advice fiduciaries, including broker-dealers and insurance agents, to receive these various forms of compensation that, in the absence of an exemption, would not be permitted under ERISA and the Code.

Rather than create a set of highly prescriptive transaction-specific exemptions, which has generally been the regulatory approach to date, the proposed exemption would flexibly accommodate a wide range of current business practices, while minimizing the harmful impact of conflicts of interest on the quality of advice. The Department has sought to preserve beneficial business models by taking a standards-based approach that will broadly permit firms to continue to rely on common fee practices, as long as they are willing to adhere to basic standards aimed at ensuring that their advice is in the best interest of their customers.

ERISA section 408(a) specifically authorizes the Secretary of Labor to grant administrative exemptions from ERISA's prohibited transaction provisions.¹ Regulations at 29 CFR section 2570.30 to 2570.52 describe the procedures for applying for an administrative exemption. Before granting an exemption, the Department must 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. Interested parties are permitted to submit comments to the Department through **[INSERT DATE THAT IS 75 DAYS FROM DATE OF PUBLICATION IN FEDERAL REGISTER OF THIS PROPOSED EXEMPTION]**. The Department plans to hold an

¹ Code section 4975(c)(2) authorizes the Secretary of the Treasury to grant exemptions from the parallel prohibited transaction provisions of the Code. Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)) generally transferred the authority of the Secretary of the Treasury to grant administrative exemptions under Code section 4975 to the Secretary of Labor. This proposed exemption would provide relief from the indicated prohibited transaction provisions of both ERISA and the Code.

administrative hearing within 30 days of the close of the comment period.

Summary of the Major Provisions

The proposed exemption would apply to compensation received by investment advice fiduciaries -- both individual “advisers”² and the “financial institutions” that employ or otherwise contract with them -- and their affiliates and related entities that is provided in connection with the purchase, sale or holding of certain assets by plans and IRAs. In particular, the exemption would apply when prohibited compensation is received as a result of advice to retail “retirement investors” including plan participants and beneficiaries, IRA owners, and plan sponsors (or their employees, officers or directors) of plans with fewer than 100 participants making investment decisions on behalf of the plans and IRAs.

In order to protect the interests of the plan participants and beneficiaries, IRA owners, and small plan sponsors, the exemption would require the adviser and financial institution to contractually acknowledge fiduciary status, commit to adhere to basic standards of impartial conduct, warrant that they have adopted policies and procedures reasonably designed to mitigate any harmful impact of conflicts of interest, and disclose basic information on their conflicts of interest and on the cost of their advice. The adviser and firm must commit to fundamental obligations of fair dealing and fiduciary conduct – to give advice that is in the customer’s best interest; avoid misleading statements; receive no more than reasonable compensation; and comply with applicable federal and state laws governing advice. This standards-based approach aligns the adviser’s interests with those of the plan or IRA customer, while leaving the adviser

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

and employing firm the flexibility and discretion necessary to determine how best to satisfy these basic standards in light of the unique attributes of their business. All financial institutions relying on the exemption would be required to notify the Department in advance of doing so. Finally, all financial institutions making use of the exemption would have to maintain certain data, and make it available to the Department, to help evaluate the effectiveness of the exemption in safeguarding the interests of the plan participants and beneficiaries, IRA owners, and small plans.

Executive Order 12866 and 13563 Statement

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

Under Executive Order 12866, “significant” regulatory actions are subject to the requirements of the Executive Order and review by the Office of Management and Budget (OMB). Section 3(f) of Executive Order 12866, defines a “significant regulatory action” as an action that is likely to result in a rule (1) having an annual effect on the economy of \$100 million

or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as an “economically significant” regulatory action); (2) creating serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order. Pursuant to the terms of the Executive Order, OMB has determined that this action is “significant” within the meaning of Section 3(f)(4) of the Executive Order. Accordingly, the Department has undertaken an assessment of the costs and benefits of the proposed exemption, and OMB has reviewed this regulatory action.

Background

Proposed Regulation Defining a Fiduciary

As explained more fully in the preamble to the Department’s Proposed Regulation under ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B), also published in this issue of the FEDERAL REGISTER, ERISA is a comprehensive statute designed to protect the interests of plan participants and beneficiaries, the integrity of employee benefit plans, and the security of retirement, health, and other critical benefits. The broad public interest in ERISA-covered plans is reflected in its imposition of fiduciary responsibilities on parties engaging in important plan activities, as well as in the tax-favored status of plan assets and investments. One of the chief ways in which ERISA protects employee benefit plans is by requiring that plan fiduciaries comply with fundamental obligations rooted in the law of trusts. In particular, plan fiduciaries must manage plan assets prudently and with undivided loyalty to the plans and their participants

and beneficiaries.³ In addition, they must refrain from engaging in “prohibited transactions,” which ERISA does not permit because of the dangers posed by the fiduciaries’ conflicts of interest with respect to the transactions.⁴ When fiduciaries violate ERISA’s fiduciary duties or the prohibited transaction rules, they may be held personally liable for the breach.⁵ In addition, violations of the prohibited transaction rules are subject to excise taxes under the Code.

The Code also has rules regarding fiduciary conduct with respect to tax-favored accounts that are not generally covered by ERISA, such as IRAs. Although ERISA’s general fiduciary obligations of prudence and loyalty do not govern the fiduciaries of IRAs, these fiduciaries are subject to the prohibited transaction rules. In this context, fiduciaries engaging in the prohibited transactions are subject to an excise tax enforced by the Internal Revenue Service. Unlike participants in plans covered by Title I of ERISA, IRA owners do not have a statutory right to bring suit against fiduciaries for violation of the prohibited transaction rules and fiduciaries are not personally liable to IRA owners for the losses caused by their misconduct. Nor can the Secretary of Labor bring suit to enforce the prohibited transactions rules on behalf of IRA owners. The exemption proposed herein, as well as the Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, published elsewhere in this issue of the FEDERAL REGISTER, would create contractual obligations for fiduciaries to adhere to certain standards (the Impartial Conduct Standards) if they want to take advantage of the exemption. IRA owners would have a right to enforce these new contractual rights.

³ ERISA section 404(a).

⁴ ERISA section 406. ERISA also prohibits certain transactions between a plan and a “party in interest.”

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

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

The statutory definition deliberately casts a wide net in assigning fiduciary responsibility with respect to plan and IRA assets. Thus, “any authority or control” over plan or IRA assets is sufficient to confer fiduciary status, and any persons who render “investment advice for a fee or other compensation, direct or indirect” are fiduciaries, regardless of whether they have direct control over the plan’s or IRA’s assets and regardless of their status as an investment adviser or broker under the federal securities laws. The statutory definition and associated responsibilities were enacted to ensure that plans, plan participants, and IRA owners can depend on persons who provide investment advice for a fee to provide recommendations that are untainted by conflicts of interest. In the absence of fiduciary status, the providers of investment advice are neither subject to ERISA’s fundamental fiduciary standards, nor accountable for imprudent, disloyal, or tainted advice under ERISA or the Code, no matter how egregious the misconduct or how substantial the losses. Retirement investors typically are not financial experts and consequently must rely on professional advice to make critical investment decisions. In the years since then,

the significance of financial advice has become still greater with increased reliance on participant directed plans and IRAs for the provision of retirement benefits.

In 1975, the Department issued a regulation, at 29 CFR 2510.3-21(c)(1975), defining the circumstances under which a person is treated as providing “investment advice” to an employee benefit plan within the meaning of ERISA section 3(21)(A)(ii) (the “1975 regulation”).⁶ The 1975 regulation narrowed the scope of the statutory definition of fiduciary investment advice by creating a five-part test that must be satisfied before a person can be treated as rendering investment advice for a fee. Under the 1975 regulation, for advice to constitute “investment advice,” an adviser who does not have discretionary authority or control with respect to the purchase or sale of securities or other property of the plan must (1) render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property (2) on a regular basis (3) pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary that (4) the advice will serve as a primary basis for investment decisions with respect to plan assets, and that (5) the advice will be individualized based on the particular needs of the plan. The regulation provides that an adviser is a fiduciary with respect to any particular instance of advice only if he or she meets each and every element of the five-part test with respect to the particular advice recipient or plan at issue. A 1976 Department of Labor Advisory Opinion further limited the application of the statutory definition of “investment advice” by stating that valuations of employer securities in connection with employee stock ownership plan (ESOP) purchases would not be considered fiduciary advice.⁷

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

⁷ Advisory Opinion 76-65A (June 7, 1976).

As the marketplace for financial services has developed in the years since 1975, the five-part test may now undermine, rather than promote, the statutes' text and purposes. The narrowness of the 1975 regulation allows advisers, brokers, consultants and valuation firms to play a central role in shaping plan investments, without ensuring the accountability that Congress intended for persons having such influence and responsibility. Even when plan sponsors, participants, beneficiaries and IRA owners clearly rely on paid consultants for impartial guidance, the regulation allows many advisers to avoid fiduciary status and the accompanying fiduciary obligations of care and prohibitions on disloyal and conflicted transactions. As a consequence, under ERISA and the Code, these advisers can steer customers to investments based on their own self-interest, give imprudent advice, and engage in transactions that would otherwise be prohibited by ERISA and the Code.

In the Department's Proposed Regulation defining a fiduciary under ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B), the Department seeks to replace the existing regulation with one that more appropriately distinguishes between the sorts of advice relationships that should be treated as fiduciary in nature and those that should not, in light of the legal framework and financial marketplace in which IRAs and plans currently operate.⁸ Under the Proposed Regulation, plans include IRAs.

The Proposed Regulation describes the types of advice that constitute "investment advice" with respect to plan or IRA assets for purposes of the definition of a fiduciary at ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B). The proposal provides, subject to certain

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

carve-outs, that a person renders investment advice with respect to assets of a plan or IRA if, among other things, the person provides, directly to a plan, a plan fiduciary, a plan participant or beneficiary, IRA or IRA owner, one of the following types of advice:

(1) A recommendation as to the advisability of acquiring, holding, disposing or exchanging securities or other property, including a recommendation to take a distribution of benefits or a recommendation as to the investment of securities or other property to be rolled over or otherwise distributed from a plan or IRA;

(2) A recommendation as to the management of securities or other property, including recommendations as to the management of securities or other property to be rolled over or otherwise distributed from the plan or IRA;

(3) An appraisal, fairness opinion or similar statement, whether verbal or written, concerning the value of securities or other property, if provided in connection with a specific transaction or transactions involving the acquisition, disposition or exchange of such securities or other property by the plan or IRA; and

(4) a recommendation of a person who is also going to receive a fee or other compensation in providing any of the types of advice described in paragraphs (1) through (3), above.

In addition, to be a fiduciary, such person must either (i) represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA (or the Code) with respect to the advice, or (ii) render the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is individualized to, or that such advice is specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA.

In the Proposed Regulation, the Department refers to FINRA guidance on whether particular communications should be viewed as “recommendations”⁹ within the meaning of the fiduciary definition, and requests comment on whether the Proposed Regulation should adhere to or adopt some or all of the standards developed by FINRA in defining communications which rise to the level of a recommendation. For more detailed information regarding the Proposed Regulation, see the Notice of the Proposed Regulation published in this issue of the Federal Register.

For advisers who do not represent that they are acting as ERISA or Code fiduciaries, the Proposed Regulation provides that advice rendered in conformance with certain carve-outs will not cause the adviser to be treated as a fiduciary under ERISA or the Code. For example, under the seller’s carve-out, counterparties in arm’s length transactions with plans may make investment recommendations without acting as fiduciaries if certain conditions are met.¹⁰ The proposal also contains a carve-out from fiduciary status for providers of appraisals, fairness opinions, or statements of value in specified contexts (e.g., with respect to ESOP transactions). The proposal additionally includes a carve-out from fiduciary status for the marketing of investment alternative platforms to plans, certain assistance in selecting investment alternatives and other activities. Finally, the Proposed Regulation carves out the provision of investment education from the definition of an investment advice fiduciary.

Prohibited Transactions

⁹ See NASD Notice to Members 01-23 and FINRA Regulatory Notices 11-02, 12-25 and 12-55.

¹⁰ Although the preamble adopts the phrase “seller’s carve-out” as a shorthand way of referring to the carve-out and its terms, the regulatory carve-out is not limited to sellers but rather applies more broadly to counterparties in arm’s length transactions with plan investors with financial expertise.

The Department anticipates that the Proposed Regulation will cover many investment professionals who do not currently consider themselves to be fiduciaries under ERISA or the Code. If the Proposed Regulation is adopted, these entities will become subject to the prohibited transaction restrictions in ERISA and the Code that apply specifically to fiduciaries. ERISA section 406(b)(1) and Code section 4975(c)(1)(E) prohibit a fiduciary from dealing with the income or assets of a plan or IRA in his own interest or his own account. ERISA section 406(b)(2) provides that a fiduciary shall not “in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries.” As this provision is not in the Code, it does not apply to transactions involving IRAs. ERISA section 406(b)(3) and Code section 4975(c)(1)(F) prohibit a fiduciary from receiving any consideration for his own personal account from any party dealing with the plan or IRA in connection with a transaction involving assets of the plan or IRA.

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

¹¹ Subsequent to the issuance of these regulations, Reorganization Plan No. 4 of 1978, 5 U.S.C. App. (2010), divided rulemaking and interpretive authority between the Secretaries of Labor and the Treasury. The Secretary of Labor was provided interpretive and rulemaking authority regarding the definition of fiduciary in both Title I of ERISA and the Internal Revenue Code.

such compensation.¹² Given these prohibitions, conferring fiduciary status on particular investment advice activities can have important implications for many investment professionals.

In particular, investment professionals typically receive compensation for services to retirement investors in the retail market through a variety of arrangements. These include commissions paid by the plan, participant or beneficiary, or IRA, or commissions, sales loads, 12b-1 fees, revenue sharing and other payments from third parties that provide investment products. The investment professional or its affiliate may receive such fees upon the purchase or sale by a plan, participant or beneficiary account, or IRA of the product, or while the plan, participant or beneficiary account, or IRA, holds the product. In the Department's view, receipt by a fiduciary of such payments would violate the prohibited transaction provisions of ERISA section 406(b) and Code section 4975(c)(1)(E) and (F) because the amount of the fiduciary's compensation is affected by the use of its authority in providing investment advice, unless such payments meet the requirements of an exemption.

Prohibited Transaction Exemptions

ERISA and the Code counterbalance the broad proscriptive effect of the prohibited transaction provisions with numerous statutory exemptions. For example, ERISA section 408(b)(14) and Code section 4975(d)(17) specifically exempt transactions in connection with the provision of fiduciary investment advice to a participant or beneficiary of an individual account plan or IRA owner where the advice, resulting transaction, and the adviser's fees meet certain conditions. The Secretary of Labor may grant administrative exemptions under ERISA and the Code on an individual or class basis if the Secretary finds that the exemption is (1) administratively feasible, (2) in the interests of plans and their participants and beneficiaries and

¹² 29 CFR 2550.408b-2(e); 26 CFR 54.4975-6(a)(5).

IRA owners, and (3) protective of the rights of the participants and beneficiaries of such plans and IRA owners.

Over the years, the Department has granted several conditional administrative class exemptions from the prohibited transactions provisions of ERISA and the Code. The exemptions focus on specific types of compensation arrangements. Fiduciaries relying on these exemptions must comply with certain conditions designed to protect the interests of plans and IRAs. In connection with the development of the Proposed Regulation, the Department has considered comments suggesting the need for additional prohibited transaction exemptions for the wide variety of compensation structures that exist today in the marketplace for investments. Some commentators have suggested that the lack of such relief may cause financial professionals to cut back on the provision of investment advice and the availability of products to plan participants and beneficiaries, IRAs, and smaller plans.

After consideration of the issue, the Department has determined to propose the new class exemption described below, which applies to investment advice fiduciaries providing advice to plan participants and beneficiaries, IRAs, and certain employee benefit plans with fewer than 100 participants (referred to as “retirement investors”). The exemption would apply broadly to many common types of otherwise prohibited compensation that such investment advice fiduciaries may receive, provided the protective conditions of the exemption are satisfied. The Department is also seeking public comment on whether it should issue a separate streamlined exemption that would allow advisers to receive otherwise prohibited compensation in connection with advice to invest in certain high-quality low-fee investments, subject to fewer conditions.

Elsewhere in this issue of the FEDERAL REGISTER, the Department is also proposing a new class exemption for “principal transactions” for investment advice fiduciaries selling certain debt securities out of their own inventories to plans and IRAs.

Lastly, the Department is also proposing, elsewhere in this issue of the FEDERAL REGISTER, amendments to the following existing class prohibited exemptions, which are particularly relevant to broker-dealers and other investment advice fiduciaries.

Prohibited Transaction Exemption (PTE) 86-128¹³ currently allows an investment advice fiduciary to cause a plan or IRA to pay the investment advice fiduciary or its affiliate a fee for effecting or executing securities transactions as agent. To prevent churning, the exemption does not apply if such transactions are excessive in either amount or frequency. The exemption also allows the investment advice fiduciary to act as the agent for both the plan and the other party to the transaction (i.e., the buyer and the seller of securities), and receive a reasonable fee. To use the exemption, the fiduciary cannot be a plan administrator or employer, unless all profits earned by these parties are returned to the plan. The conditions of the exemption require that a plan fiduciary independent of the investment advice fiduciary receive certain disclosures and authorize the transaction. In addition, the independent fiduciary must receive confirmations and an annual “portfolio turnover ratio” demonstrating the amount of turnover in the account during that year. These conditions are not presently applicable to transactions involving IRAs.

The Department is proposing to amend PTE 86-128 to require all fiduciaries relying on the exemption to adhere to the same impartial conduct standards required in the Best Interest Contract Exemption. At the same time, the proposed amendment would eliminate relief for investment advice fiduciaries to IRA owners; instead they would be required to rely on the Best

¹³ Class Exemption for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers, 51 FR 41686 (Nov. 18, 1986), amended at 67 FR 64137 (Oct. 17, 2002).

Interest Contract Exemption for an exemption for such compensation. In the Department's view, the provisions in the Best Interest Contract Exemption better address the interests of IRAs with respect to transactions otherwise covered by PTE 86-128 and, unlike plan participants and beneficiaries, there is no separate plan fiduciary in the IRA market to review and authorize the transaction. Investment advice fiduciaries to plans would remain eligible for relief under the exemption, as would investment managers with full investment discretion over the investments of plans and IRA owners, but they would be required to comply with all the protective conditions, described above. Finally, the Department is proposing that PTE 86-128 extend to a new covered transaction, for fiduciaries to sell mutual fund shares out of their own inventory (i.e. acting as principals, rather than agents) to plans and IRAs and to receive commissions for doing so. This transaction is currently the subject of another exemption, PTE 75-1, Part II(2) (discussed below) that the Department is proposing to revoke.

Several changes are proposed with respect to PTE 75-1, a multi-part exemption for securities transactions involving broker-dealers and banks, and plans and IRAs.¹⁴ Part I(b) and (c) currently provide relief for certain non-fiduciary services to plans and IRAs. The Department is proposing to revoke these provisions, and require persons seeking to engage in such transactions to rely instead on the existing statutory exemptions provided in ERISA section 408(b)(2) and Code section 4975(d)(2), and the Department's implementing regulations at 29 CFR 2550.408b-2. In the Department's view, the conditions of the statutory exemption are more appropriate for the provision of services.

PTE 75-1, Part II(2), currently provides relief for fiduciaries to receive commissions for

¹⁴ Exemptions from Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks, 40 FR 50845 (Oct. 31, 1975), as amended at 71 FR 5883 (Feb. 3, 2006).

selling mutual fund shares to plans and IRAs in a principal transaction. As described above, the Department is proposing to provide relief for these types of transactions in PTE 86-128, and so is proposing to revoke PTE 75-1, Part II(2), in its entirety. As discussed in more detail in the notice of proposed amendment/revocation, the Department believes the conditions of PTE 86-128 are more appropriate for these transactions.

PTE 75-1, Part V, currently permits broker-dealers to extend credit to a plan or IRA in connection with the purchase or sale of securities. The exemption does not permit broker-dealers that are fiduciaries to receive compensation when doing so. The Department is proposing to amend PTE 75-1, Part V, to permit investment advice fiduciaries to receive compensation for lending money or otherwise extending credit to plans and IRAs, but only for the limited purpose of avoiding a failed securities transaction.

PTE 84-24¹⁵ covers transactions involving mutual fund shares, or insurance or annuity contracts, sold to plans or IRAs by pension consultants, insurance agents, brokers, and mutual fund principal underwriters who are fiduciaries as a result of advice they give in connection with these transactions. The exemption allows these investment advice fiduciaries to receive a sales commission with respect to products purchased by plans or IRAs. The exemption is limited to sales commissions that are reasonable under the circumstances. The investment advice fiduciary must provide disclosure of the amount of the commission and other terms of the transaction to an independent fiduciary of the plan or IRA, and obtain approval for the transaction. To use this exemption, the investment advice fiduciary may not have certain roles with respect to the plan or IRA such as trustee, plan administrator, or fiduciary with written authorization to manage the

¹⁵ Class Exemption for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, Investment Companies and Investment Company Principal Underwriters, 49 FR 13208 (Apr. 3, 1984), amended at 71 FR 5887 (Feb. 3, 2006).

plan's assets and employers. However it is available to investment advice fiduciaries regardless of whether they expressly acknowledge their fiduciary status or are simply functional or "inadvertent" fiduciaries that have not expressly agreed to act as fiduciary advisers, provided there is no written authorization granting them discretion to acquire or dispose of the assets of the plan or IRA.

The Department is proposing to amend PTE 84-24 to require all fiduciaries relying on the exemption to adhere to the same impartial conduct standards required in the Best Interest Contract Exemption. At the same time, the proposed amendment would revoke PTE 84-24 in part so that investment advice fiduciaries to IRA owners would not be able to rely on PTE 84-24 with respect to (1) transactions involving variable annuity contracts and other annuity contracts that constitute securities under federal securities laws, and (2) transactions involving the purchase of mutual fund shares. Investment advice fiduciaries would instead be required to rely on the Best Interest Contract Exemption for compensation received in connection with these transactions. The Department believes that investment advice transactions involving annuity contracts that are treated as securities and transactions involving the purchase of mutual fund shares should occur under the conditions of the Best Interest Contract Exemption due to the similarity of these investments, including their distribution channels and disclosure obligations, to other investments covered in the Best Interest Contract Exemption. Investment advice fiduciaries to ERISA plans would remain eligible for relief under the exemption with respect to transactions involving all insurance and annuity contracts and mutual fund shares and the receipt of commissions allowable under that exemption. Investment advice fiduciaries to IRAs could still receive commissions for transactions involving non-securities insurance and annuity contracts, but they would be required to comply with all the protective conditions, described

above.

Finally, the Department is proposing amendments to certain other existing class exemptions to require adherence to the impartial conduct standards required in the Best Interest Contract Exemption. Specifically, PTEs 75-1, Part III, 75-1, Part IV, 77-4, 80-83, and 83-1, would be amended. Other than the amendments described above, however, the existing class exemptions will remain in place, affording additional flexibility to fiduciaries who currently use the exemptions or who wish to use the exemptions in the future. The Department seeks comment on whether additional exemptions are needed in light of the Proposed Regulation.

Proposed Best Interest Contract Exemption

As noted above, the exemption proposed in this notice provides relief for some of the same compensation payments as the existing exemptions described above. It is intended, however, to flexibly accommodate a wide range of current business practices, while minimizing the harmful impact of conflicts of interest on the quality of advice. The exemption permits fiduciaries to continue to receive a wide variety of types of compensation that would otherwise be prohibited. It seeks to preserve beneficial business models by taking a standards-based approach that will broadly permit firms to continue to rely on common fee practices, as long as they are willing to adhere to basic standards aimed at ensuring that their advice is in the best interest of their customers. This standards-based approach stands in marked contrast to existing class exemptions that generally focus on very specific types of investments or compensation and take a highly prescriptive approach to specifying conditions. The proposed exemption would provide relief for common investments¹⁶ of retirement investors under the umbrella of one

¹⁶ See Section VIII(c) of the proposed exemption, defining the term “Asset,” and the preamble discussion in the “*Scope of Relief in the Best Interest Contract Exemption*” section below.

exemption. It is intended that this updated approach will ease compliance costs and reduce complexity while promoting the provision of investment advice that is in the best interest of retirement investors.

Section I of the proposed exemption would provide relief for the receipt of prohibited compensation by “Advisers,” “Financial Institutions,” “Affiliates” and “Related Entities” for services provided in connection with a purchase, sale or holding of an “Asset”¹⁷ by a plan or IRA as a result of the Adviser’s advice. The exemption also uses the term “Retirement Investor” to describe the types of persons who can be advice recipients under the exemption.¹⁸ These terms are defined in Section VIII of this proposed exemption. The following sections discuss these key definitional terms of the exemption as well as the scope and conditions of the proposed exemption.

Entities Defined

1. Adviser

The proposed exemption contemplates that an individual person, an Adviser, will provide advice to the Retirement Investor. An Adviser must be an investment advice fiduciary of a plan or IRA who is an employee, independent contractor, agent, or registered representative of a “Financial Institution” (discussed in the next section), and the Adviser must satisfy the applicable federal and state regulatory and licensing requirements of insurance, banking, and securities laws with respect to the receipt of the compensation.¹⁹ Advisers may be, for example, registered

¹⁷ See Section VIII(c) of the proposed exemption.

¹⁸ While the Department uses the term “*Retirement Investor*” throughout this document, the proposed exemption is not limited only to investment advice fiduciaries of employee pension benefit plans and IRAs. Relief would be available for investment advice fiduciaries of employee welfare benefit plans as well.

¹⁹ See Section VIII(a) of the proposed exemption.

representatives of broker-dealers registered under the Securities Exchange Act of 1934, or insurance agents or brokers.

2. Financial Institutions

For purposes of the proposed exemption, a Financial Institution is the entity that employs an Adviser or otherwise retains the Adviser as an independent contractor, agent or registered representative.²⁰ Financial Institutions must be registered investment advisers, banks, insurance companies, or registered broker-dealers.

3. Affiliates and Related Entities

Relief is also proposed for the receipt of otherwise prohibited compensation by “Affiliates” and “Related Entities” with respect to the Adviser or Financial Institution.²¹

Affiliates are (i) any person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; (ii) any officer, director, employee, agent, registered representative, relative, member of family, or partner in, the Adviser or Financial Institution; and (iii) any corporation or partnership of which the Adviser or Financial Institution is an officer, director or employee or in which the Adviser or Financial Institution is a partner. For this purpose, “control” means the power to exercise a controlling influence over the management or policies of a person other than an individual.

Related Entities are entities other than Affiliates in which an Adviser or Financial Institution has an interest that may affect their exercise of their best judgment as fiduciaries.

4. Retirement Investor

The proposed exemption uses the term “Retirement Investor” to describe the types of persons who can be investment advice recipients under the exemption. The Retirement Investor

²⁰ See Section VIII(e) of the proposed exemption.

²¹ See Section VIII(b) and (k) of the proposed exemption.

may be a plan participant or beneficiary with authority to direct the investment of assets in his or her plan account or to take a distribution; in the case of an IRA, the beneficial owner of the IRA (i.e., the IRA owner); or a plan sponsor (or an employee, officer or director thereof) of a non-participant-directed ERISA plan that has fewer than 100 participants.²²

Scope of Relief in the Best Interest Contract Exemption

The Best Interest Contract Exemption set forth in Section I would provide prohibited transaction relief for the receipt by Advisers, Financial Institutions, Affiliates and Related Entities of a wide variety of compensation forms as a result of investment advice provided to the Retirement Investors, if the conditions of the exemption are satisfied. Specifically, Section I(b) of the proposed exemption provides that the exemption would permit an Adviser, Financial Institution and their Affiliates and Related Entities to receive compensation for services provided in connection with the purchase, sale or holding of an Asset by a plan, participant or beneficiary account, or IRA, as a result of an Adviser's or Financial Institution's investment advice to a Retirement Investor.

The proposed exemption would apply to the restrictions of ERISA section 406(b) and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(E) and (F). These provisions prohibit conflict of interest transactions and receipt of third-party payments by investment advice fiduciaries.²³ For relief to be available under the exemption, the Adviser and Financial Institution must comply with the applicable conditions, including entering

²² See Section VIII(1) of the proposed exemption.

²³ Relief is also proposed from ERISA section 406(a)(1)(D) and Code section 4975(c)(1)(D), which prohibit transfer of plan assets to, or use of plan assets for the benefit of, a party in interest (including a fiduciary).

into a contract that acknowledges fiduciary status and requires adherence to certain Impartial Conduct Standards.

The types of compensation payments contemplated by this proposed exemption include commissions paid directly by the plan or IRA, as well as commissions, trailing commissions, sales loads, 12b-1 fees, and revenue sharing payments paid by the investment providers or other third parties to Advisers and Financial Institutions. The exemption also would cover other compensation received by the Adviser, Financial Institution or their Affiliates and Related Entities as a result of an investment by a plan, participant or beneficiary account, or IRA, such as investment management fees or administrative services fees from an investment vehicle in which the plan, participant or beneficiary account, or IRA invests.

As proposed, the exemption is limited to otherwise prohibited compensation generated by investments that are commonly purchased by plans, participant and beneficiary accounts, and IRAs. Accordingly, the exemption defines the “Assets” that can be sold under the exemption as bank deposits, CDs, shares or interests in registered investment companies, bank collective funds, insurance company separate accounts, exchange-traded REITs, exchange-traded funds, corporate bonds offered pursuant to a registration statement under the Securities Act of 1933, agency debt securities as defined in FINRA Rule 6710(1) or its successor, U.S. Treasury securities as defined in FINRA Rule 6710(p) or its successor, insurance and annuity contracts (both securities and non-securities), guaranteed investment contracts, and equity securities within the meaning of 17 CFR section 230.405 that are exchange-traded securities within the meaning of 17 CFR 242.600. However, the definition does not encompass any equity security that is a

security future or a put, call, straddle, or any other option or privilege of buying an equity security from or selling an equity security to another without being bound to do so.²⁴

Prohibited compensation received for investments that fall outside the definition of Asset would not be covered by the exemption. Limiting the exemption in this manner ensures that the investments needed to build a basic diversified portfolio are available to plans, participant and beneficiary accounts, and IRAs, while limiting the exemption to those investments that are relatively transparent and liquid, many of which have a ready market price. The Department also notes that many investment types and strategies that would not be covered by the exemption can be obtained through pooled investment funds, such as mutual funds, that are covered by the exemption.

Request for Comment. The Department requests comment on the proposed definition of Assets, in particular:

- Do commenters agree we have identified all common investments of retail investors?
- Have we defined individual investment products with enough precision that parties will know if they are complying with this aspect of the exemption?
- Should additional investments be included in the scope of the exemption? Commenters urging addition of other investment products should fully describe the characteristics and fee structures associated with the products, as well as data supporting their position that the product is a common investment for retail investors.

The Department encourages parties to apply to the Department for individual or class exemptions for types of investments not covered by the exemption to the extent that they believe

²⁴ See Section VIII(c) of the proposed exemption.

the proposed package of exemptions does not adequately cover beneficial investment practices for which appropriate protections could be crafted in an exemption.

Limitation to Prohibited Compensation Received As a Result of Advice to Retirement Investors

The Department proposed this exemption to promote the provision of investment advice to retail investors that is in their best interest and untainted by conflicts of interest. The exemption would permit receipt by Advisers and Financial Institutions of otherwise prohibited compensation commonly received in the retail market, such as commissions, 12b-1 fees, and revenue sharing payments, subject to conditions designed specifically to protect the interests of the investors. For consistency with these objectives, the exemption would apply to the receipt of such compensation by Advisers, Financial Institutions and their Affiliates and Related Entities only when advice is provided to retail Retirement Investors, including plan participants and beneficiaries, IRA owners, and plan sponsors (including the sponsor's employees, officers, and directors) acting on behalf of non-participant-directed plans that have fewer than 100 participants. As discussed in the preamble to the Proposed Regulation and in the associated Regulatory Impact Analysis, these investors are particularly vulnerable to abuse. The proposed exemption is designed to protect these investors from the harmful impact of conflicts of interest, while minimizing the potential disruption to a retail market that relies upon many forms of compensation that ERISA would otherwise prohibit.

The Department believes that investment advice in the institutional market is best addressed through other approaches. Accordingly, the proposed exemption does not extend to transactions involving certain larger ERISA plans – those with more than 100 participants. Advice providers to these plans are already accustomed to operating in a fiduciary environment and within the framework of existing prohibited transaction exemptions, which tightly constrain

the operation of conflicts of interest. As a result, including large plans within the definition of Retirement Investor could have the undesirable consequence of reducing protections provided under existing law to these investors, without offsetting benefits. In particular, it could have the undesirable effect of increasing the number and impact of conflicts of interest, rather than reducing or mitigating them.

While the Department believes that the Best Interest Contract Exemption is not the appropriate way to address any potential concerns about the impact of the expanded fiduciary definition on large plans, the Department agrees that an adjustment is necessary to accommodate arm's length transactions with plan investors with financial expertise. Accordingly, as part of this regulatory project, the Department has separately proposed a seller's carve-out in the Proposed Conflict of Interest Regulation. Under the terms of that carve-out, persons who provide recommendations to certain ERISA plan investors with financial expertise (but not to plan participants or beneficiaries, or IRA owners) can avoid fiduciary status altogether. The seller's carve-out was developed to avoid the application of fiduciary status to a plan's counterparty in an arm's length commercial transaction in which the plan's representative has no reasonable expectation of impartial advice. When the carve-out's terms are satisfied, it is available for transactions with plans that have more than 100 participants.

The Department recognizes, however, that there are smaller non-participant-directed plans for which the plan sponsor (or an employee, officer or director thereof) is responsible for choosing the specific investments and allocations for their participating employees. The Department believes that these small plan fiduciaries are appropriately categorized with plan participants and beneficiaries and IRA owners, as retail investors. For this reason, the proposed exemption's definition of Retirement Investor includes plan sponsors (or employees, officers and

directors thereof) of plans with fewer than 100 participants.²⁵ As a result, the exemption would extend to advice providers to such smaller plans.

The proposed threshold of fewer than 100 participants is intended to reasonably identify plans that will most benefit from both the flexibility provided by this exemption and the protections embodied in its conditions. The threshold also mirrors the Proposed Regulations' 100-or-more participant threshold for the seller's carve-out. That threshold recognizes the generally greater sophistication possessed by larger plans' discretionary fiduciaries, as well as the greater vulnerability of retail investors, such as small plans. As explained in more detail in the preamble to the Proposed Regulation, investment recommendations to small plans, IRA owners and plan participants and beneficiaries do not fit the "arms length" characteristics that the seller's carve-out is designed to preserve. Recommendations to retail investors are routinely presented as advice, consulting, or financial planning services. In the securities markets, brokers' suitability obligations generally require a significant degree of individualization, and research has shown that disclaimers are ineffective in alerting typically unsophisticated investors to the dangers posed by conflicts of interest, and may even exacerbate the dangers. Most retail investors lack financial expertise, are unaware of the magnitude and impact of conflicts of interest, and are unable effectively to assess the quality of the advice they receive.

The 100 or more threshold is also consistent with that applicable for similar purposes under existing rules and practices. The Regulatory Flexibility Act (5 U.S.C. 601 et seq.) (RFA) imposes certain requirements with respect to Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act (5 U.S.C. 551 et

²⁵ The Department notes that plan participants and beneficiaries in ERISA plans can be Retirement Investors regardless of the number of participants in such plan. Therefore, the 100-participant limitation does not apply when advice is provided directly to the participants and beneficiaries.

seq.) and which are likely to have a significant economic impact on a substantial number of small entities. For purposes of the RFA, the Department considers a small entity to be an employee benefit plan with fewer than 100 participants. The basis of this definition is found in section 104(a)(2) of ERISA that permits the Secretary of Labor to prescribe simplified annual reports for pension plans that cover fewer than 100 participants. Under current Department rules, such small plans generally are eligible for streamlined reporting and relieved of related audit requirements.

The Department invites comment on the proposed exemption's limitation to prohibited compensation received as a result of advice to Retirement Investors. In particular, we ask whether commenters support the limitation as currently formulated, whether the definitions should be revised, or whether there should not be an exclusion with respect to such larger plans at all. Commenters on this subject are also encouraged to address the interaction of the exemption's limitation with the scope of the seller's carve-out in the Proposed Regulation. Finally, we request comment on whether the exemption should be expanded to cover advice to plan sponsors (including the sponsor's employees, officers, and directors) of participant-directed plans with fewer than 100 participants on the composition of the menu of investment options available under such plans, and if so, whether additional or different conditions should apply.

Exclusions in Section I(c) of the Proposed Exemption

Section I(c) of the proposal sets forth additional exclusions from the exemption. Section I(c)(1) provides that the exemption would not apply to the receipt of prohibited compensation from a transaction involving an ERISA plan if the Adviser, Financial Institution or Affiliate is the employer of employees covered by the ERISA plan. The Department believes that due to the special nature of the employer/employee relationship, an exemption permitting an Adviser and

Financial Institution to profit from investments by employees in their employer-sponsored plan would not be in the interest of, or protective of, the plans and their participants and beneficiaries. This restriction does not apply, however, in the case of an IRA or other similar plan that is not covered by Title I of ERISA. Accordingly, an Adviser or Financial Institution may provide advice to the beneficial owner of an IRA who is employed by the Adviser, its Financial Institution or an Affiliate, and receive prohibited compensation as a result, provided the IRA is not covered by Title I of ERISA.

Section I(c)(1) further provides that the exemption does not apply if the Adviser or Financial Institution is a named fiduciary or plan administrator, as defined in ERISA section 3(16)(A)) with respect to an ERISA plan, or an affiliate thereof, that was selected to provide advice to the plan by a fiduciary who is not independent of them.²⁶ This provision is intended to disallow selection of Advisers and Financial Institutions by named fiduciaries or plan administrators that have an interest in them.

Section I(c)(2) provides that the exemption does not extend to prohibited compensation received when the Adviser engages in a principal transaction with the plan, participant or beneficiary account, or IRA.²⁷ A principal transaction is a transaction in which the Adviser engages in a transaction with the plan, participant or beneficiary account, or IRA, on behalf of the account of the Financial Institution or another person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Financial Institution. Principal transactions involve conflicts of interest not addressed by the safeguards of this proposed exemption. Elsewhere in today's FEDERAL REGISTER, the Department is

²⁶ See Section VIII(f), defining the term "Independent."

²⁷ For purposes of this proposed exemption, however, the Department does not view a riskless principal transaction involving mutual fund shares as an excluded principal transaction.

proposing an exemption for investment advice fiduciaries to engage in principal transactions involving certain debt securities. The proposed exemption for principal transactions contains conditions specific to those transactions but is designed to align with this proposed exemption so as to ease parties' ability to comply with both exemptions with respect to the same investor.

Section I(c)(3) provides that the exemption would not cover prohibited compensation that is received by an Adviser or Financial Institution as a result of investment advice that is generated solely by an interactive website in which computer software-based models or applications provide investment advice to Retirement Investors based on personal information each investor supplies through the website without any personal interaction or advice from an individual Adviser. Such computer derived advice is often referred to as "robo-advice." While the Department believes that computer generated advice that is delivered in this manner may be very useful to Retirement Investors, relief will not be included in the proposal. As the marketplace for such advice is still evolving in ways that both appear to avoid conflicts of interest that would violate the prohibited transaction rules, and minimize cost, the Department believes that inclusion of such advice in this exemption could adversely modify the incentives currently shaping the market for robo-advice. Furthermore, a statutory prohibited transaction exemption at ERISA section 408(g) covers computer-generated investment advice and is available for robo-advice involving prohibited transactions if its conditions are satisfied. *See* 29 CFR 2550.408g-1.

Finally, Section I(c)(4) provides that the exemption is limited to Advisers who are fiduciaries by reason of providing investment advice.²⁸ Advisers who have full investment discretion with respect to plan or IRA assets or who have discretionary authority over the

²⁸ See also Section VIII(a), defining the term "Adviser."

administration of the plan or IRA, for example, are not affected by the Proposed Regulation and are therefore not the subject of this exemption.

Conditions of the Proposed Exemption

Sections II - V of the proposal list the conditions applicable to the Best Interest Contract Exemption described in Section I. All applicable conditions must be satisfied in order to avoid application of the specified prohibited transaction provisions of ERISA and the Code. The Department believes that these conditions are necessary for the Secretary to find that the exemption is administratively feasible, in the interests of plans and of their participants and beneficiaries, and IRA owners and protective of the rights of the participants and beneficiaries of such plans and IRA owners. Under ERISA section 408(a)(2), and Code section 4975(c)(2), the Secretary may not grant an exemption without making such findings. The proposed conditions of the exemption are described below.

Contractual Obligations Applicable to the Best Interest Contract Exemption (Section II)

Section II(a) of the proposal requires that an Adviser and Financial Institution enter into a written contract with the Retirement Investor prior to recommending that the plan, participant or beneficiary account, or IRA, purchase, sell or hold an Asset. The contract must be executed by both the Adviser and the Financial Institution as well as the Retirement Investor. In the case of advice provided to a plan participant or beneficiary in a participant-directed individual account plan, the participant or beneficiary should be the Retirement Investor that is the party to the contract, on behalf of his or her individual account.

The contract may be part of a master agreement with the Retirement Investor and does not require execution prior to each additional recommendation to purchase, sell or hold an Asset. The exemption, in particular the requirement to adhere to a best interest standard, does not

mandate an ongoing or long-term advisory relationship, but rather leaves that to the parties. The terms of the contract, along with other representations, agreements, or understandings between the Adviser, Financial Institution and Retirement Investor, will govern whether the nature of the relationship between the parties is ongoing or not.

The contract is the cornerstone of the proposed exemption, and the Department believes that by requiring a contract as a condition of the proposed exemption, it creates a mechanism by which a Retirement Investor can be alerted to the Adviser's and Financial Institution's obligations and be provided with a basis upon which its rights can be enforced. In order to comply with the exemption, the contract must contain every required element set forth in Section II(b)-(e) and also must not include any of the prohibited provisions described in Section II(f). It is intended that the contract creates actionable obligations with respect to both the Impartial Conduct Standards and the warranties, described below. In addition, failure to satisfy the Impartial Conduct Standards will result in loss of the exemption.

It should be noted, however, that compliance with the exemption's conditions is necessary only with respect to transactions that otherwise would constitute prohibited transactions under ERISA and the Code. The exemption does not purport to impose conditions on the management of investments held outside of ERISA-covered plans and IRAs. Accordingly, the contract and its conditions are mandatory only with respect to investments held by plans and IRAs.

1. Fiduciary Status

The proposal sets forth multiple contractual requirements. The first and most fundamental contractual requirement, which is set out in Section II(b) of proposal, is that that both the Adviser and Financial Institution must acknowledge fiduciary status under ERISA or

the Code, or both, with respect to any recommendations to the Retirement Investor to purchase, sell or hold an Asset. If this acknowledgment of fiduciary status does not appear in a contract with a Retirement Investor, the exemption is not satisfied with respect to transactions involving that Retirement Investor. This fiduciary acknowledgment is critical to ensuring that there is no uncertainty – before or after investment advice is given with regard to the Asset – that both the Adviser and Financial Institution are acting as fiduciaries under ERISA and the Code with respect to that advice.

The acknowledgment of fiduciary status in the contract is nonetheless limited to the advice to the Retirement Investor to purchase, sell or hold the Asset. The Adviser and Financial Institution do not become fiduciaries with respect to any other conduct by virtue of this contractual requirement.

2. Standards of Impartial Conduct

Building upon the required acknowledgment of fiduciary status, the proposal additionally requires that both the Adviser and the Financial Institution contractually commit to adhering to certain specifically delineated Impartial Conduct Standards when providing investment advice to the Retirement Investor regarding Assets, and that they in fact do adhere to such standards. Therefore, if an Adviser and/or Financial Institution fail to comply with the Impartial Conduct Standards, relief under the exemption is no longer available and the contract is violated.

Specifically, Section II(c)(1) of the proposal requires that under the contract the Adviser and Financial Institution provide advice regarding Assets that is in the “best interest” of the Retirement Investor. Best interest is defined to mean that the Adviser and Financial Institution act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial

circumstances, and the needs of the Retirement Investor, when providing investment advice to them. Further, under the best interest standard, the Adviser and Financial Institution must act without regard to the financial or other interests of the Adviser, Financial Institution or their Affiliates or any other party. Under this standard, the Adviser and Financial Institution must put the interests of the Retirement Investor ahead of the financial interests of the Adviser, Financial Institution or their Affiliates, Related Entities or any other party.

The best interest standard set forth in this exemption is based on longstanding concepts derived from ERISA and the law of trusts. For example, ERISA section 404 requires a fiduciary to act “solely in the interest of the participants . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.” Similarly, both ERISA section 404(a)(1)(A) and the trust-law duty of loyalty require fiduciaries to put the interests of trust beneficiaries first, without regard to the fiduciaries’ own self-interest. Accordingly, the Department would expect the standard to be interpreted in light of forty years of judicial experience with ERISA’s fiduciary standards and hundreds more with the duties imposed on trustees under the common law of trusts. In general, courts focus on the process the fiduciary used to reach its determination or recommendation – whether the fiduciaries, “at the time they engaged in the challenged transactions, employed the proper procedures to investigate the merits of the investment and to structure the investment.” Donovan v. Mazzola, 716 F.2d 1226, 1232 (9th Cir. 1983). Moreover, a fiduciary’s investment recommendation is measured based on the circumstances prevailing at the time of the transaction, not on how the investment turned out with the benefit of hindsight.

In this regard, the Department notes that while fiduciaries of plans covered by ERISA are subject to the ERISA section 404 standards of prudence and loyalty, the Code contains no provisions that hold IRA fiduciaries to these standards. However, as a condition of relief under the proposed exemption, both IRA and plan fiduciaries would have to agree to, and uphold, the best interest and Impartial Conduct Standards, as set forth in Section II(c). The best interest standard is defined to effectively mirror the ERISA section 404 duties of prudence and loyalty, as applied in the context of fiduciary investment advice.

In addition to the best interest standard, the exemption imposes other important standards of impartial conduct in Section II(c) of the proposal. Section II(c)(2) requires that the Adviser and Financial Institution agree that they will not recommend an Asset if the total amount of compensation anticipated to be received by the Adviser, Financial Institution, and their Affiliates and Related Entities in connection with the purchase, sale or holding of the Asset by the plan, participant or beneficiary account, or IRA, will exceed reasonable compensation in relation to the total services they provide to the applicable Retirement Investor. The obligation to pay no more than reasonable compensation to service providers is long recognized under ERISA. *See* ERISA section 408(b)(2), 29 CFR 2550.408b-2(a)(3), and 29 CFR 2550.408c-2. The reasonableness of the fees depends on the particular facts and circumstances. Finally, Section II(c)(3) requires that the Adviser's and Financial Institution's statements about Assets, fees, material conflicts of interest, and any other matters relevant to a Retirement Investor's investment decisions, not be misleading.

Under ERISA section 408(a) and Code section 4975(c), the Department cannot grant an exemption unless it first finds that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of

participants and beneficiaries of plans and IRA owners. An exemption permitting transactions that violate the requirements of Section II(c) would be unlikely to meet these standards.

3. Warranty - Compliance with Applicable Law

Section II(d) of the proposal requires that the contract include certain warranties intended to be protective of the rights of Retirement Investors. In particular, to satisfy the exemption, the Adviser, and Financial Institution must warrant that they and their Affiliates will comply with all applicable federal and state laws regarding the rendering of the investment advice, the purchase, sale or holding of the Asset and the payment of compensation related to the purchase, sale and holding. Although this warranty must be included in the contract, the exemption is not conditioned on compliance with the warranty. Accordingly, the failure to comply with applicable federal or state law could result in contractual liability for breach of warranty, but it would not result in loss of the exemption, as long as the breach did not involve a violation of one of the exemption's other conditions (e.g., the best interest standard). De minimis violations of state or federal law would be unlikely to violate the exemption's other conditions, such as the best interest standard, and would not typically result in the loss of the exemption.

4. Warranty - Policies and Procedures

The Financial Institution must also contractually warrant that it has adopted written policies and procedures that are reasonably designed to mitigate the impact of material conflicts of interest that exist with respect to the provision of investment advice to Retirement Investors and ensure that individual Advisers adhere to the Impartial Conduct Standards described above. For purposes of the exemption, a material conflict of interest is deemed to exist when an Adviser or Financial Institution has a financial interest that could affect the exercise of its best judgment

as a fiduciary in rendering advice to a Retirement Investor regarding an Asset.²⁹ Like the warranty on compliance with applicable law, discussed above, this warranty must be in the contract but the exemption is not conditioned on compliance with the warranty. Failure to comply with the warranty could result in contractual liability for breach of warranty.

As part of the contractual warranty on policies and procedures, the Financial Institution must state that in formulating its policies and procedures, it specifically identified material conflicts of interest and adopted measures to prevent those material conflicts of interest from causing violations of the Impartial Conduct Standards. Further, the Financial Institution must state that neither it nor (to the best of its knowledge) its Affiliates or Related Entities will use quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differentiated compensation or other actions or incentives to the extent they would tend to encourage individual Advisers to make recommendations that are not in the best interest of Retirement Investors.

While these warranties must be part of the contract between the Adviser and Financial Institution and the Retirement Investor, the proposal does not mandate the specific content of the policies and procedures. This flexibility is intended to allow Financial Institutions to develop policies and procedures that are effective for their particular business models, within the constraints of their fiduciary obligations and the Impartial Conduct Standards.

Under the proposal, a Financial Institution's policies and procedures must not authorize compensation or incentive systems that would tend to encourage individual Advisers to make recommendations that are not in the best interest of Retirement Investors. Consistent with the general approach in the proposal to the Financial Institution's policies and procedures, however,

²⁹ See Section VIII(h) of the proposed exemption.

there are no particular required compensation or employment structures. Certainly, one way for a Financial Institution to comply is to adopt a “level-fee” structure, in which compensation for Advisers does not vary based on the particular investment product recommended. But the exemption does not mandate such a structure. The Department believes that the specific implementation of this requirement is best determined by the Financial Institution in light of its particular circumstances and business models.

For further clarification, the Department sets forth the following examples of broad approaches to compensation structures that could help satisfy the contractual warranty regarding the policies and procedures. In connection with all these examples, it is important that the Financial Institution carefully monitor whether the policies and procedures are, in fact, working to prevent the provision of biased advice. The Financial Institution must correct isolated or systemic violations of the Impartial Conduct Standards and reasonably revise policies and procedures when failures are identified.

Example 1: Independently certified computer models.³⁰ The Adviser provides investment advice that is in accordance with an unbiased computer model created by an independent third party. Under this example, the Adviser can receive any form or

³⁰ These examples should not be read as retracting views the Department expressed in prior Advisory Opinions regarding how an investment advice fiduciary could avoid prohibited transactions that might result from differential compensation arrangements. Specifically, in Advisory Opinion 2001-09A, the Department concluded that the provision of fiduciary investment advice would not result in prohibited transactions under circumstances where the advice provided by the fiduciary with respect to investment funds that pay additional fees to the fiduciary is the result of the application of methodologies developed, maintained and overseen by a party independent of the fiduciary in accordance with the conditions set forth in the Advisory Opinion. A computer model also can be used as part of an advice arrangement that satisfies the conditions under the prohibited transaction exemption in ERISA section 408(b)(14) and (g), described above.

amount of compensation so long as the advice is rendered in strict accordance with the model.³¹

Example 2: Asset-based compensation. The Financial Institution pays the Adviser a percentage, which does not vary based on the types of investments, of the dollar amount of assets invested by the plans, participant and beneficiary accounts, and IRAs with the Adviser. Under this example, assume the Financial Institution established the percentage as 0.1% on a quarterly basis. If a plan, participant or beneficiary account, or IRA, invested a total of \$10,000 with the Adviser, divided 25% in equity securities, 50% in proprietary mutual funds, and 25% in bonds underwritten by non-Related Entities, and did not withdraw any of the money within the quarter, the Adviser would receive 0.1% of the \$10,000.

Example 3: Fee offset. The Financial Institution establishes a fee schedule for its services. It accepts transaction-based payments directly from the plan, participant or beneficiary account, or IRA, and/or from third party investment providers. To the extent the payments from third party investment providers exceed the established fee for a particular service, such amounts are rebated to the plan, participant or beneficiary account, or IRA. To the extent third party payments do not satisfy the established fee, the plan, participant or beneficiary account, or IRA is charged directly for the remaining amount due.³²

³¹ As previously noted, this exemption is not available for advice generated solely by a computer model and provided to the Retirement Investor electronically without live advice. Nevertheless, this exemption remains available in the hypothetical because the advice is delivered by a live Adviser.

³² See footnote 31 *supra*. Certain types of fee-offset arrangements may result in avoidance of prohibited transactions altogether. In Advisory Opinion Nos. 97-15A and 2005-10A, the Department explained that a fiduciary investment adviser could provide investment advice to a

Example 4: Differential Payments Based on Neutral Factors. The Financial Institution establishes payment structures under which transactions involving different investment products result in differential compensation to the Adviser based on a reasonable assessment of the time and expertise necessary to provide prudent advice on the product or other reasonable and objective neutral factors. For example, a Financial Institution could compensate an Adviser differently for advisory work relating to annuities, as opposed to shares in a mutual fund, if it reasonably determined that the time to research and explain the products differed. However, the payment structure must be reasonably designed to avoid incentives to Advisers to recommend investment transactions that are not in Retirement Investors' best interest.

Example 5: Alignment of Interests. The Financial Institution's policies and procedures establish a compensation structure that is reasonably designed to align the interests of the Adviser with the interests of the Retirement Investor. For example, this might include compensation that is primarily asset-based, as discussed in Example 2, with the addition of bonuses and other incentives paid to promote advice that is in the Best Interest of the Retirement Investor. While the compensation would be variable, it would align with the customer's best interest.

These examples are not exhaustive, and many other compensation and employment arrangements may satisfy the contractual warranties. The exemption imposes a broad standard for the warranty and policies and procedures requirement, not an inflexible and highly-prescriptive set of rules. The Financial Institution retains the latitude necessary to design its

plan with respect to investment funds that pay it or an affiliate additional fees without engaging in a prohibited transaction if those fees are offset against fees that the plan otherwise is obligated to pay to the fiduciary.

compensation and employment arrangements, provided that those arrangements promote, rather than undermine, the best interest and Impartial Conduct Standards.

Whether a Financial Institution adopts one of the specific approaches taken in the examples above or a different approach, the Department expects that it will engage in a good faith process to prudently establish and oversee policies and procedures that will effectively mitigate conflicts of interest and ensure adherence to the Impartial Conduct Standards. To this end, Financial Institutions may also want to consider designating an individual or group responsible for addressing material conflicts of interest issues. An internal compliance officer or a committee could monitor adherence to the Impartial Conduct Standards and consider ways to ensure compliance. The individual or group could also develop procedures for reporting material conflicts of interest and for handling external and internal complaints within the Financial Institution, and disciplinary measures for non-compliance with the Impartial Conduct Standards. Additionally, Financial Institutions should consider how best to inform and train individual Advisers on the Impartial Conduct Standards and other requirements of the exemption.

Additionally, Financial Institutions could consider the following components of effective policies and procedures relating to an Adviser's compensation: (i) avoiding creating compensation thresholds that enable an Adviser to increase his or her compensation disproportionately through an incremental increase in sales; (ii) monitoring activity of Advisers approaching compensation thresholds such as higher payout percentages, back-end bonuses, or participation in a recognition club, such as a President's Club; (iii) maintaining neutral compensation grids that pay the Adviser a flat payout percentage regardless of product type sold (so long as they do not merely transmit the Financial Institution's conflicts to the Adviser); (iv) refraining from providing higher compensation or other rewards for the sale of proprietary

products or products for which the firm has entered into revenue sharing arrangements; (v) stringently monitoring recommendations around key liquidity events in the investor's lifecycle where the recommendation is particularly significant (e.g. when an investor rolls over his pension or 401(k) account); and (vi) developing metrics for good and bad behavior (red flag processes) and using clawbacks of deferred compensation to adjust compensation for employees who do not properly manage conflicts of interest.³³

The Department seeks comments on all aspects of its discussion of the sorts of policies and procedures that will satisfy the required contractual warranties of Section II(d)(2)-(4). In particular, the Department requests comments on whether the exemption should be more prescriptive about the terms of policies and procedures, or provide more detailed examples of acceptable policies and procedures. In addition, the Department requests comments on whether commenters believe the examples describe policies and procedures that would achieve the investor-protective objectives of the exemption.

5. Contractual Disclosures

Finally, Section II(e) of the proposal requires certain disclosures in the written contract. If the disclosures do not appear in a contract with a Retirement Investor, the exemption is not satisfied with respect to transactions involving that Retirement Investor. First, Section II(e)(1) provides that the Financial Institution and the Adviser must identify in the written contract any material conflicts of interest. This disclosure may be a general description of the types of material conflicts of interest applicable to the Financial Institution and Adviser, provided the disclosure also informs the Retirement Investor that a more specific description that is kept

³³ See FINRA Report on Conflicts of Interest, October 2013.

current is available on the Financial Institution's website (web address provided) and by mail, upon request of the Retirement Investor.

Second, Section II(e)(2) requires that the written contract must inform the Retirement Investor of the right to obtain complete information about all of the fees currently associated with the Assets in which it is invested, including all of the fees payable to the Adviser, Financial Institution, and any Affiliates and Related Entities in connection with such investments. The fee information must be complete, and it must include both the direct and the indirect fees paid by the plan or IRA.³⁴ Section II(e)(3) provides that the written contract also must disclose to the Retirement Investor whether the Financial Institution offers proprietary products or receives third party payments with respect to the purchase, sale or holding of any Asset. Third party payments, for purposes of this exemption, are defined as sales charges (when not paid directly by the plan, participant or beneficiary account, or IRA), 12b-1 fees, and other payments paid to the Adviser, Financial Institution or any Affiliate or Related Entity by a third party as a result of the purchase, sale or holding of an Asset by a plan, participant or beneficiary account, or IRA. A proprietary product is defined for purposes of this exemption as a product that is managed by the Financial Institution or any of its Affiliates. In conjunction with this disclosure, the contract must provide the address of a webpage that discloses the compensation arrangements entered into by the Adviser and the Financial Institution, as required by Section III(c) of the proposal and discussed below.

³⁴ To the extent compliance with this information request requires Advisers and Financial Institutions to obtain such information from entities that are not closely affiliated with them, the Adviser or Financial Institution may supply such information to the Retirement Investor in compliance with the exemption provided the Adviser and Financial Institution act in good faith and do not know that the materials are incomplete or inaccurate. For purposes of the proposed exemption, Affiliates within the meaning of Section VIII(b)(1) and (2) are considered closely affiliated such that the good faith reliance would not apply.

Enforcement of the Contractual Obligations

The contractual requirements set forth in Section II of the proposal are enforceable. Plans, plan participants and beneficiaries, IRA owners, and the Department may use the contract as a tool to ensure compliance with the exemption. The Department notes, however, that this contractual tool creates different rights with respect to plans, participants and beneficiaries, IRA owners and the Department.

1. IRA Owners

The contract between the IRA owner and the Adviser and Financial Institution forms the basis of the IRA owner's enforcement rights. As outlined above, the contract embodies obligations on the part of the Adviser and Financial Institution. The Department intends that all the contractual obligations (the Impartial Conduct Standards and the warranties) will be actionable by IRA owners. The most important of these contractual obligations for enforcement purposes is the obligation imposed on both the Adviser and the Financial Institution to comply with the Impartial Conduct Standards. Because these standards are contractually imposed, the IRA owner has a contract claim if, for example, the Adviser recommends an investment product that is not in the best interest of the IRA owner.

2. Plans, Plan Participants and Beneficiaries

The protections of the exemption and contractual terms will also be enforceable by plans, plan participants and beneficiaries. Specifically, if an Adviser or Financial Institution received compensation in a prohibited transaction but failed to satisfy any of the Impartial Conduct Standards or any other condition of the exemption, the Adviser and Financial Institution would be unable to qualify for relief under the exemption, and, as a result, could be liable under ERISA section 502(a)(2) and (3). An Adviser's failure to comply with the exemption or the Impartial

Conduct Standards would result in a non-exempt prohibited transaction and would likely constitute a fiduciary breach. As a result, a plan, plan participant or beneficiary would be able to sue under ERISA section 502(a)(2) or (3) to recover any loss in value to the plan (including the loss in value to an individual account), or to obtain disgorgement of any wrongful profits or unjust enrichment. Additionally, plans, participants and beneficiaries could enforce their obligations in an action based on breach of the agreement.

3. The Department

In addition, the Department would be able to enforce ERISA's prohibited transaction and fiduciary duty provisions with respect to employee benefit plans, but not IRAs, in the event that the Adviser or Financial Institution received compensation in a prohibited transaction but failed to comply with the exemption or the Impartial Conduct Standards. If, for example, any of the specific conditions of the exemption are not met, the Adviser and Financial Institution will have engaged in a non-exempt prohibited transaction, and the Department will be entitled to seek relief under ERISA section 502(a)(2) and (5).

4. Excise Taxes under the Code

In addition to the claims described above that may be brought by IRA owners, plans, plan participants and beneficiaries, and the Department, to enforce the contract and ERISA, Advisers and Financial Institutions that engage in prohibited transactions under the Code are subject to an excise tax. The excise tax is generally equal to 15% of the amount involved. Parties who have participated in a prohibited transaction for which an exemption is not available must pay the excise tax and file Form 5330 with the Internal Revenue Service.

Prohibited Provisions

Finally, in order to preserve these various enforcement rights, Section II(f) of the proposal provides that certain provisions may not be part of the contract. If these provisions appear in a contract with a Retirement Investor, the exemption is not satisfied with respect to transactions involving that Retirement Investor. First, the proposal requires that the contract may not contain exculpatory provisions that disclaim or otherwise limit liability for an Adviser's or Financial Institution's violations of the contract's terms. Second, the contract may not require the Retirement Investor to agree to waive or qualify its right to bring or participate in a class action or other representative action in court in a contract dispute with the Adviser or Financial Institution. The right of a Retirement Investor to bring a class-action claim in court (and the corresponding limitation on fiduciaries' ability to mandate class-action arbitration) is consistent with FINRA's position that its arbitral forum is not the correct venue for class-action claims. As proposed, this section would not affect the ability of a Financial Institution or Adviser, and a Retirement Investor, to enter into a pre-dispute binding arbitration agreement with respect to individual contract claims. The Department expects that most individual arbitration claims under this exemption will be subject to FINRA's arbitration procedures and consumer protections. The Department seeks comments on whether there are certain procedures and/or consumer protections that it should adopt or mandate for those disputes not covered by FINRA.

Disclosure Requirements for Best Interest Contract Exemption (Section III)

In order to facilitate access to information on Financial Institution and Adviser compensation, the proposal requires both public disclosure and disclosure to Retirement Investors.

1. Webpage

Section III(c) of the proposal requires that the Financial Institution maintain a public webpage that provides several different types of information. The webpage must show the direct and indirect material compensation payable to the Adviser, Financial Institution and any Affiliate for services provided in connection with each Asset (or, if uniform across a class of Assets, the class of Assets) that a plan, participant or beneficiary account, or an IRA, is able to purchase, hold, or sell through the Adviser or Financial Institution, and that a plan, participant or beneficiary account, or an IRA has purchased, held, or sold within the last 365 days, the source of the compensation, and how the compensation varies within and among Asset classes. The webpage must be updated at reasonable intervals, not less than quarterly. The compensation may be expressed as a monetary amount, formula or percentage of the assets involved in the purchase, sale or holding.

The information provided by the webpage will provide a broad base of information about the various pricing and compensation structures adopted by Financial Institutions and Advisers. The Department believes that the data provided on the webpage will provide information that can be used by financial information companies to analyze and provide information comparing the practices of different Advisers and Financial Institutions. Such information will allow a Retirement Investor to evaluate costs and Advisers' and Financial Institutions' compensation practices.

The webpage information must be provided in a manner that is easily accessible to a Retirement Investor and the general public. Appendix I to this notice is an exemplar of a possible web disclosure. In addition, the webpage must also contain a version of the same information that is formatted in a machine-readable manner. The Department recognizes that

machine readable data can be formatted in many ways. Therefore, the Department requests comment on the format and data fields that should be required under such a condition.

2. Individual Transactional Disclosure

In Section III(a), the exemption requires point of sale disclosure to the Retirement Investor, prior to the execution of the investment transaction, regarding the all-in cost and anticipated future costs of recommended Assets. The disclosure is designed to make as clear and salient as possible the total cost that the plan, participant or beneficiary account, or IRA will incur when following the Adviser's recommendation, and to provide cost information that can be compared across different Assets that are recommended for investment. In addition, the projection of the costs over various holding periods would inform the Retirement Investor of the cumulative impact of the costs over time and of potential costs when the investment is sold.

As proposed, the disclosure requirement of Section III(a) would be provided in a summary chart designed to direct the Retirement Investor's attention to a few important data points regarding fees, in a time frame that would enable the Retirement Investor to discuss other (possibly less costly) alternatives with the Adviser prior to executing the transaction. The disclosure chart does not have to be provided again with respect to a subsequent recommendation to purchase the same investment product, so long as the chart was previously provided to the Retirement Investor within the past 12 months and the total cost has not materially changed.

To the extent compliance with the point of sale disclosure requires Advisers and Financial Institutions to obtain cost information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1)

a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.³⁵

The required chart would disclose with respect to each Asset recommended, the “total cost” to the plan, participant or beneficiary account, or IRA, of the investment for 1-, 5- and 10-year periods expressed as a dollar amount, assuming an investment of the dollar amount recommended by the Adviser, and reasonable assumptions about investment performance, which must be disclosed.

As defined in the proposal, the “total cost” of investing in an asset means the sum of the following, as applicable: acquisition costs, ongoing costs, disposition costs, and any other costs that reduce the asset’s rate of return, are paid by direct charge to the plan, participant or beneficiary account, or IRA, or reduce the amounts received by the plan, participant or beneficiary account, or IRA (e.g., contingent fees, such as back-end loads, including those that phase out over time, with such terms explained beneath the table). The terms “acquisition costs,” “ongoing costs,” and “disposition costs,” are defined in the proposal. Appendix II to this proposal contains a model chart that may be used to provide the information required under this section. Use of the model chart is not mandatory. However, use of an appropriately completed model chart will be deemed to satisfy the requirement of Section III(a).

Request for comment. The Department requests comment on the design of this proposed point of sale disclosure, as well as issues related to the ability of the Adviser to provide the

³⁵ See proposed definition of Affiliate, Section VIII(b)(1) and (b)(2).

disclosure and whether it will provide information that is meaningful to Retirement Investors. In general, commenters are asked to address the anticipated cost of compliance with the point of sale disclosure and whether the disclosure as we have described it will provide information that is more useful to Retirement Investors than other similar disclosures that are required under existing law. As discussed below in more detail, the Department requests comment on whether the disclosure can be designed to provide information that would result in a useful comparison among Assets; whether it is feasible for Advisers and Financial Institutions to obtain reliable information to complete the chart at the time it would be required to be provided to the Retirement Investor; and whether the disclosure, without information on other characteristics of the investment, would improve Retirement Investors' ability to make informed investment decisions.

Design. As explained above, the proposal contemplates a chart with the following information: all-in cost of the Asset, and the cost if held for 1-, 5-, and 10 years. The all-in cost would be calculated with the following components: "acquisition costs," "ongoing costs," "disposition costs," and "other." The Department seeks comment on all aspects of this approach. In particular, we ask:

- Are the all-in costs of the investments permitted under the proposal capable of being reflected accurately in the chart?
- Are all-in costs already reflected in the summary prospectuses for certain investments?
- Have we correctly identified the possible various costs associated with the permitted investments?

- Should the point of sale disclosure requirement be limited to certain events, such as opening a new account or rolling over existing investments? If so, what changes would be needed to the model chart?
- Are our proposed definitions of the various costs clear enough to result in information that is reasonably comparable across different Financial Institutions?
- Is it possible to attribute all the costs to the account of a particular plan, participant or beneficiary, or IRA?
- How should long-term costs be measured?

Feasibility. The point of sale disclosure is proposed to be an individualized disclosure provided prior to the execution of the transaction. The Department seeks comment on whether there are practical impediments to the creation and disclosure of the chart in the time frame proposed.

Therefore, we ask:

- Will Advisers and Financial Institutions have access to the information required to be disclosed in the chart?
- Are there existing systems at Financial Institutions that could produce the disclosure required in this proposal? If not, what is the cost of developing a system to comply?
- What are the costs associated with providing the disclosure?
- Would the costs be reduced if the Adviser and Financial Institution could provide the disclosure for full portfolios of investments, rather than for each investment recommendation separately?
- Would the costs be reduced if the timing of the disclosure was more closely aligned with the SEC's disclosure requirements applicable to broker-dealers (i.e. at or before the completion of the transaction), rather than point of sale?

- Are there particular asset classes for which this kind of point of sale disclosure is more feasible or less feasible? What share of assets held by Retirement Investors or share of transactions executed by Advisers and Financial Institutions fall within the asset classes for which the point of sale disclosure is more feasible and less feasible?
- Are there particular asset classes for which all the information that would be required to be disclosed in the chart is currently required in a similar format under existing law?
- Would the required disclosure be more feasible or less costly if a narrative statement were required instead of a summary chart?

Impact. The point of sale disclosure would be intended to inform the Retirement Investor of the costs associated with the investment. Would such a disclosure in this simple format provide information that is meaningful and likely to improve a Retirement Investor's decision making?

We ask for input on the following:

- Would the simplified format result in the communication of information that is accurate, and contribute to informed investment decisions?
- Do commenters recommend an alternative format or alternative disclosures?
- Would the relative fees associated with different types of investment products, without a required disclosure of the relative risks of the product (i.e., mutual fund ongoing fees versus a one-time brokerage commission for a stock transaction) contribute to informed investment decisions?
- In the absence of a required benchmark, is the disclosure of the all-in fees of a particular investment helpful to the Retirement Investor? If not, how could a benchmark be crafted for the various Assets permitted to be sold under the proposal?

Alternative. Instead of the point of sale disclosure as proposed, would a “cigarette warning”-style disclosure be as effective and less costly? For example, the disclosure could read:

“Investors are urged to check loads, management fees, revenue-sharing, commissions, and other charges before investing in any financial product. These fees may significantly reduce the amount you are able to invest over time and may also determine your adviser’s take-home pay. If these fees are not reported in marketing materials or made apparent by your investment adviser, do not forget to ask about them.”

3. Individual Annual Disclosure

Section III(b) of the proposal requires individual disclosure in the form of an annual disclosure. Specifically, the proposal requires the Adviser or Financial Institution to provide each Retirement Investor with an annual written disclosure within 45 days of the end of the applicable year. The annual disclosure must include: (i) a list identifying each Asset purchased or sold during the applicable period and the price at which the Asset was purchased or sold; (ii) a statement of the total dollar amount of all fees and expenses paid by the plan, participant or beneficiary account, or IRA, both directly and indirectly, with respect to each Asset purchased, held or sold during the applicable period; and (iii) a statement of the total dollar amount of all compensation received by the Adviser and Financial Institution, directly or indirectly, from any party, as a result of each Asset sold, purchased or held by the plan, participant or beneficiary account, or IRA, during the applicable period. This disclosure is intended to show the Retirement Investor the impact of the cost of the Adviser’s advice on the investments by the plan, participant or beneficiary account, or IRA.

The Department requests comment on this disclosure, in light of the potential point of sale disclosure. We are particularly interested in comments discussing whether both disclosures would be helpful and, if not, which would be more useful to Retirement Investors?

4. *Non-security insurance and annuity contracts.*

Section III(a) and (b) will apply to all Assets as defined in the proposal. This includes insurance and annuity contracts that are securities under federal securities law, such as variable annuities, and insurance and annuity contracts that are not, such as fixed annuities. The Department requests comment on whether the types of information required in the Section III(a) and (b) disclosures are applicable and available with respect to insurance and annuity contracts that are not securities.

In this regard, we note that PTE 84-24³⁶ is an existing exemption under which certain investment advice fiduciaries can receive commissions on insurance and annuity contracts and mutual fund shares that are purchased by plans and IRAs. Elsewhere in this issue of the FEDERAL REGISTER, the Department has proposed to revoke relief under PTE 84-24 as it applies to IRA transactions involving annuity contracts that are securities (including variable annuity contracts) and mutual fund shares. The fact that IRA owners generally do not benefit from the protections afforded by the fiduciary duties owed by plan sponsors to their employee benefit plans makes it critical that their interests are protected by appropriate conditions in the Department's exemptions. In our view, this proposed Best Interest Contract Exemption contains conditions that are uniquely protective of IRA owners.

³⁶ Class Exemption for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, Investment Companies and Investment Company Principal Underwriters, 49 FR 13208 (Apr. 3, 1984), amended at 71 FR 5887 (Feb. 3, 2006).

The Department has determined however that PTE 84-24 should remain available for investment advice fiduciaries to receive commissions for IRA (and plan) purchases of insurance and annuity contracts that are not securities. This distinction is due in part to uncertainty as to whether the disclosure requirements proposed herein are readily applicable to insurance and annuity contracts that are not securities, and whether the distribution methods and channels of insurance products that are not securities fit within this exemption's framework.

The Department requests comment on this approach. In particular, we ask whether we have drawn the correct lines between insurance and annuity products that are securities and those that are not, in terms of our decision to continue to allow IRA transactions involving non-security insurance and annuity contracts to occur under the conditions of PTE 84-24 while requiring IRA transactions involving securities to occur under the conditions of this proposed Best Interest Contract Exemption.

In order for us to evaluate our approach, we request public comment the current disclosure requirements applicable to insurance and annuity contracts that are not securities. Can Section III(a) and (b) can be revised with respect to such non-securities insurance and annuity contracts to provide meaningful information to investors as to the costs of such investments and the overall compensation received by Advisers and Financial Institutions in connection with the transactions? In addition, the Department requests information on the distribution methods and channels applicable to insurance and annuity products that are not securities. What are common structures of insurance agencies?

Finally, we request public input as to whether any conditions of this proposed Best Interest Contract Exemption, other than the disclosure conditions discussed above, would be

inapplicable to non-security insurance and annuity products? Are any aspects of this exemption particularly difficult for insurance companies to comply with?

Range of Investment Options (Section IV)

Section IV(a) of the proposal requires a Financial Institution to offer for purchase, sale, or holding and the Adviser to make available to the plan, participant or beneficiary account, or IRA, for purchase, sale or holding a broad range of investment options. These investment options should enable an Adviser to make recommendations to the Retirement Investor with respect to all of the asset classes reasonably necessary to serve the best interests of the Retirement Investor in light of the Retirement Investor's objectives, risk tolerance and specific financial circumstances. The Department believes that ensuring that an Adviser has a wide range of investment options at his or her disposal is the most likely method by which a Retirement Investor can be assured of developing a balanced investment portfolio.

The Department recognizes, however, that some Financial Institutions limit the investment products that a Retirement Investor may purchase, sell or hold based on whether the products generate third-party payments or are proprietary products, or for other reasons (e.g., the firms specialize in particular asset classes or product types). Both Financial Institutions and Advisers often rely on the ability to sell proprietary products or the ability to generate additional revenue through third-party payments to support their business models. The proposal permits Financial Institutions with such business models to rely on the exemption provided additional conditions are satisfied.

The additional conditions are set forth in Section IV(b) of the proposal. First, before limiting the investment products a Retirement Investor may purchase, sell or hold, the Financial Institution must make a specific written finding that the limitations do not prevent the Adviser from providing advice that is in the best interest of the Retirement Investors (i.e., advice that

reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party) or from otherwise adhering to the Impartial Conduct Standards.

Second, the proposal provides that the payments received in connection with these limited menus be reasonable in relation to the value of specific services provided to Retirement Investors in exchange for the payments and not in excess of the services' fair market value. This is more specific than the reasonable compensation requirement set forth in the contract under Section II because of the limitation placed by the Financial Institution on the investments available for Adviser recommendation. The Department intends to ensure that such additional payments received in connection with the advice are for specific services to Retirement Investors.

The proposal additionally provides that the Financial Institution or Adviser, before giving any recommendations to a Retirement Investor, must give clear written notice to the Retirement Investor of any limitations placed by the Financial Institution on the investment products offered by the Adviser. In this regard, it is insufficient for the notice merely to state that the Financial Institution "may" limit investment recommendations, without specifically disclosing the extent to which the Financial Institution in fact does so.

Finally, the proposal would require an Adviser or Financial Institution to notify the Retirement Investor if the Adviser does not recommend a sufficiently broad range of investment options to meet the Retirement Investor's needs. For example, the Department envisions the provision of such a notice when the Adviser and Financial Institution provide advice with respect

to a limited class of investment products, but those products do not meet a particular investor's needs. The Department requests comment on whether it is possible to state this standard with more specificity, or whether more detailed guidance is needed for parties to determine when compliance with the condition would be necessary. The Department also requests comment on whether any specific disclosure is necessary to inform the Retirement Investor about the particular conflicts of interest associated with Advisers that recommend only proprietary products, and, if so, what the disclosure should say.

The conditions of Section IV do not apply to an Adviser or Financial Institution with respect to the provision of investment advice to a participant or beneficiary of a participant directed individual account plan concerning the participant's or beneficiary's selection of designated investment options available under the plan, provided the Adviser and Financial Institution did not provide advice to the responsible plan fiduciary regarding the menu of designated investment options. In such circumstances, the Adviser and Financial Institution are not responsible for the limitations on the investment options.

EBSA Disclosure and Recordkeeping (Section V)

1. Notification to the Department of Reliance on the Exemption.

Before receiving prohibited compensation in reliance on Section I of this exemption, Section V(a) of the proposal requires that the Financial Institution notify the Employee Benefits Security Administration of the intention to rely on this exemption. The notice need not identify any specific plan or IRA. The notice will remain in effect until it is revoked in writing. The Department envisions accepting the notice via email and regular mail.

This is a notice provision only and does not require any approval or finding by the Department that the Financial Institution is eligible for the exemption. Once a Financial

Institution has sent the notice, it can immediately begin to rely on the exemption provided the conditions are satisfied.

2. *Data Request*

Section V(b) of the proposed exemption also would require Financial Institutions to maintain certain data, which is specified in Section IX, for six years from the date of the applicable transaction. The data request would require Financial Institutions to maintain and disclose to the Department upon request specific information regarding purchases, sales, and holdings by Retirement Investors made pursuant to advice provided by Advisers and Financial Institutions relying on the proposed exemption. Financial Institutions may maintain this information in any form that may be readily analyzed by the Department or simply as raw data. Receipt of this additional data will assist the Department in assessing the effectiveness of the exemption.

No party, other than the Financial Institution responsible for compliance, will be subject to the taxes imposed by Code section 4975(a) and (b), if applicable, if the Financial Institution fails to maintain the data or the data are not available for examination.

Request for Comment. The proposed data request covers certain information with respect to investment inflows, outflows and holdings, and returns, by plans, participant and beneficiary accounts, and IRAs and is intended to assist the Department in evaluating the effectiveness of the exemption. We request comment on whether these are the appropriate data points for the covered Assets. Are the terms used clear enough to result in information that is reasonably comparable across different Financial Institutions? Or should we include precise definitions of inflows, outflows, holdings, returns, etc.? If so, please suggest specifically how these terms

should be defined. Are different terms needed to request comparable information regarding insurance and annuity contracts that are not securities?

3. General Recordkeeping

Finally, Section V(c) and (d) of the proposal contains a general recordkeeping requirement applicable to the Financial Institution. The general recordkeeping requirement relates to the records necessary for the Department and certain other entities to determine whether the conditions of this exemption have been satisfied.

Effect of Failure to Comply with Conditions

If the exemption is granted, relief under the Best Interest Contract Exemption will be available only if all applicable conditions described above are satisfied. Satisfaction of the conditions is determined on a transaction by transaction basis, however. Thus, the effect of noncompliance with a condition depends on whether the condition applies to a single transaction or multiple transactions. For example, if an Adviser fails to provide a transaction disclosure in accordance with Section III(a) with respect to an Asset purchased by a plan, participant or beneficiary account, or an IRA, the relief provided by the Best Interest Contract Exemption would be unavailable to the Adviser and Financial Institution only for the otherwise prohibited compensation received in connection with the investment in that specific Asset by the plan, participant or beneficiary account, or IRA. More broadly, if an Adviser and Financial Institution fail to enter into a contract with a Retirement Investor in accordance with Section II, relief under the Best Interest Contract Exemption would be unavailable solely with respect to the investments by that Retirement Investor, not all Retirement Investors to which the Adviser and Financial Institution provide advice. However, if a Financial Institution fails to comply with a condition that is necessary for all transactions involving investment advice to Retirement Investors, such as

the maintenance of the webpage required by Section III(c), the Financial Institution will not be eligible for the relief under the Best Interest Contract Exemption for all prohibited transactions entered into during the period in which the failure to comply existed.

Supplemental Exemptions

1. Proposed Insurance and Annuity Exemption (Section VI)

The Best Interest Contract Exemption, as set forth above, permits Advisers and Financial Institutions to receive compensation that would otherwise be prohibited by the self-dealing and conflicts of interest provisions of ERISA and the Code. ERISA and the Code contain additional prohibitions on certain specific transactions between plans and IRAs and “parties in interest” and “disqualified persons,” including service providers. These additional prohibited transactions include: (i) the purchase or sale of an asset between a plan/IRA and a party in interest/disqualified person, and (ii) the transfer of plan/IRA assets to a party in interest/disqualified person. These prohibited transactions are subject to excise tax and personal liability for the fiduciary.

A plan’s or IRA’s purchase of an insurance or annuity product would be a prohibited transaction if the insurance company has a pre-existing relationship with the plan/IRA as a service provider, or is otherwise a party in interest/disqualified person. In the Department’s view, this circumstance is common enough in connection with recommendations by Advisers and Financial Institutions to warrant proposal of an exemption for these types of transactions in conjunction with the Best Interest Contract Exemption. The Department anticipates that the fiduciary that causes a plan’s or IRA’s purchase of an insurance or annuity product would not be the Adviser or Financial Institution but would instead be another fiduciary, such as a plan sponsor or IRA owner, acting on the Adviser’s or Financial Institution’s advice. Because the

party requiring relief for this prohibited transaction is separate and independent of the Adviser and Financial Institution, the Department is proposing this exemption subject to discrete conditions described below.

Although there is an existing exemption which would often cover these transactions, PTE 84-24, the Department is proposing elsewhere in this issue of the FEDERAL REGISTER to revoke that exemption to the extent it provides relief for transactions involving IRAs' purchase of variable annuity contracts and other annuity contracts that are securities under federal securities law. We have therefore decided to provide an exemption for these transactions as part of this document, both to ensure that relief is available for transactions involving IRAs but also for ease of compliance for transactions involving other Retirement Investors (i.e., plan participants, beneficiaries and small plan sponsors).

As with the Best Interest Contract Exemption, relief under the proposed insurance and annuity exemption in Section VI would not extend to a plan covered by Title I of ERISA where (i) the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the plan, or (ii) the Adviser or Financial Institution is a named fiduciary or plan administrator (as defined in ERISA section 3(16)(A)) with respect to the plan, or an affiliate thereof, that has not been selected by a fiduciary that is Independent. The conditions proposed for the insurance and annuity exemption are that the transaction must be effected by the insurance company in the ordinary course of its business as an insurance company, the combined total of all fees and compensation received by the insurance company is not in excess of reasonable compensation under the circumstances, the purchase is for cash only, and that the terms of the purchase are at

least as favorable to the plan as the terms generally available in an arm's length transaction with an unrelated party.³⁷

2. *Exemption for Pre-Existing Transactions (Section VII)*

Section VII of the proposal would provide an exemption for Advisers, Financial Institutions, and their Affiliates and Related Entities in connection with transactions that occurred prior to the applicability date of the Proposed Regulation, if adopted. Specifically, the exemption would provide relief from ERISA sections 406(a)(1)(D) and 406(b) for the receipt of prohibited compensation, after the applicability date of the regulation, by an Adviser, Financial Institution and any Affiliate or Related Entity for services provided in connection with the purchase, sale or holding of an Asset before the applicability date. The Department is proposing this exemption to provide relief for investment professionals that may have provided advice prior to the applicability date of the regulation but did not consider themselves fiduciaries. Their receipt after the applicability date of ongoing periodic payments of compensation attributable to a purchase, sale or holding of an Asset by a plan, participant or beneficiary account, or IRA, prior to the applicability date of the regulation might otherwise raise prohibited transaction concerns.

The Department is also proposing this exemption for Advisers and Financial Institutions who were considered fiduciaries before the applicability date, but who entered into transactions involving plans and IRAs before the applicability date in accordance with the terms of a prohibited transaction exemption that has since been amended. Section VII would permit

³⁷ The condition requiring the purchase to be made for cash only is not intended to preclude purchases with plan or IRA contributions, but rather to preclude transactions effected in-kind through an exchange of securities or other assets. In-kind exchanges would not be permitted as part of this class exemption due to the potential need for conditions relating to valuation of the assets to be exchanged.

Advisers, Financial Institutions, and their Affiliates and Related Entities, to receive compensation such as 12b-1 fees, after the applicability date, that is attributable to a purchase, sale or holding of an Asset by a plan, participant or beneficiary account, or an IRA, that occurred prior to the applicability date.

In order to take advantage of this relief, the exemption would require that the compensation must be received pursuant to an agreement, arrangement or understanding that was entered into prior to the applicability date of the regulation, and that the Adviser and Financial Institution not provide additional advice to the plan or IRA, regarding the purchase, sale or holding of the Asset after the applicability date of the regulation. Relief would not be extended to compensation that is excluded pursuant to Section I(c) of the proposal or to compensation received in connection with a purchase or sale transaction that, at the time it was entered into, was a non-exempt prohibited transaction. The Department requests comment on whether there are other areas in which exemptions would be desirable to avoid unforeseen consequences in connection with the timing of the finalization of the Proposed Regulation.

3. Low Fee Streamlined Exemption

While the flexibility of the Best Interest Contract Exemption is designed to accommodate a wide range of current business practices and avoid the need for highly prescriptive regulation, the Department acknowledges that there may be actors in the industry that would prefer a more prescriptive approach. The Department believes that both approaches could be desirable and could, if designed properly, minimize the harmful impact of conflicts of interest on the quality of advice. Accordingly, in addition to the Best Interest Contract Exemption, the Department is also considering issuing a separate streamlined exemption that would allow Advisers and Financial Institutions (and their Affiliates and Related Entities) to receive otherwise prohibited

compensation in connection with plan, participant and beneficiary accounts, and IRA investments in certain high-quality low-fee investments, subject to fewer conditions. However, at this point, the Department has been unable to operationalize this concept and therefore has not proposed text for such a streamlined exemption. Instead, we seek public input to assist our consideration and design of the exemption.

A low-fee streamlined exemption is an attractive idea that, if properly crafted, could achieve important goals. It could minimize the compliance burdens for Advisers offering high-quality low-fee investment products with minimal potential for material conflicts of interest, as discussed further below. Products that met the conditions of the streamlined exemption could be recommended to plans, participants and beneficiaries, and IRA owners, and the Adviser could receive variable and third-party compensation as a result of those recommendations, without satisfying some or all of the conditions of the Best Interest Contract Exemption. The streamlined exemption could reward and encourage best practices with respect to optimizing the quality, amount, and combined, all-in cost of recommended financial products, financial advice, and other related services. In particular, a streamlined exemption could be useful in enhancing access to quality, affordable financial products and advice by savers with smaller account balances. Additionally, because it would be premised on a fee comparison, it would apply only to investments with relatively simple and transparent fee structures.

In this regard, the Department believes that certain high-quality investments are provided pursuant to fee structures in which the payments are sufficiently low that they do not present serious potential material conflicts of interest. In theory, a streamlined exemption with relatively few conditions could be constructed around such investments. Facilitating investments in such high-quality low-fee products would be consistent with the prevailing (though by no means

universal) view in the academic literature that posits that the optimal investment strategy is often to buy and hold a diversified portfolio of assets calibrated to track the overall performance of financial markets. Under this view, for example, a long-term recommendation to buy and hold a low-priced (often passively managed) target date fund that is consistent with the investor's future risk appetite trajectory is likely to be sound. As another example, under this view, a medium-term recommendation to buy and hold (for 5 or perhaps 10 years) an inexpensive, risk-matched balanced fund or combination of funds, and afterward to review the investor's circumstances and formulate a new recommendation also is likely to be sound.

If it could be constructed appropriately, a streamlined exemption for high-quality low-fee investments could be subject to relatively few conditions, because the investments present minimal risk of abuse to plans, participants and beneficiaries, and IRA owners. The aim would be to design conditions with sufficient objectivity that Advisers and Financial Institutions could proceed with certainty in their business operations when recommending the investments. The Department does not anticipate that such a streamlined exemption would require Advisers and Financial Institutions to undertake the contractual commitments to adhere to the Impartial Conduct Standards or adopt anti-conflict policies and procedures with respect to advice given on such products, as is proposed in the Best Interest Contract Exemption. However, some of the required disclosures proposed in the Best Interest Contract Exemption would likely be imposed in the streamlined exemption.

The Department has initially focused on mutual funds as the only type of investment widely held by Retirement Investors that would be readily susceptible to the type of expense calculations necessary to implement the low-fee streamlined exemption. This is due to the transparency associated with mutual fund investments and, in particular, the requirement that the

mutual fund disclose its fees and operating expenses in its prospectus. Accordingly, data on mutual fund fees and expenses is widely available.

Within the category of mutual fund investments, the Department is considering whether the streamlined exemption would be available to funds with all-in fees below a certain amount. However, the Department lacks data regarding the characteristics of mutual funds with low all-in fees. Consequently, we are exploring whether the streamlined exemption should contain additional conditions to safeguard the interests of plans, participants and beneficiaries, and IRA owners. For example, the streamlined exemption could require that the investment product be “broadly diversified to minimize risk for targeted return,” or “calibrated to provide a balance of risk and return appropriate to the investor’s circumstances and preferences for the duration of the recommended holding period.” However, we recognize that adding conditions might undercut the usefulness of the streamlined exemption.

Request for Comment. The Department requests comment on these possible initial terms of a streamlined exemption and other questions relating to the technical design of such an exemption and its likely utility to Advisers and Financial Institutions. Additionally, the Department requests public input on the likely consequences of the establishment of a low-fee streamlined exemption.

Design. The Department requests public input on the technical design challenges in defining high-quality low-fee investment products that would satisfy the policy goals of the streamlined exemption. We are concerned that there may be no single, objective way to evaluate fees and expenses associated with mutual funds (or other investments) and no single cut-off to determine when fees are sufficiently low. One cut-off could be too low for some investors’ needs and too high for others’. A very low cut-off would strongly favor passively managed

funds. A high cut-off would permit recommendations that may not be sound and free from bias. Multiple cut-offs for different product categories would be complex and would risk introducing bias between the categories. In addition, it is unclear whether mutual funds with the lowest fees necessarily represent the highest quality investments for Retirement Investors. As noted above, the streamlined exemption would not expressly contain a “best interest” standard.

To further aid in the design of the streamlined exemption, the Department requests comments on the questions below. The Regulatory Impact Analysis for the Proposed Regulation, published elsewhere in this issue of the FEDERAL REGISTER, describes additional questions the Department is considering regarding the development of a low-fee streamlined exemption.

- *Should the streamlined exemption cover investment products other than mutual funds?*

The streamlined exemption would be based on the premise that low-cost investment products distributed pursuant to relatively unconflicted fee structures present minimal risk of abuse to plans, participants and beneficiaries, and IRA owners. In order to design a streamlined exemption for the sale of such products, the products must have fee structures that are transparent, publicly available, and capable of being compared reliably. Are there other investments commonly held by Retirement Investors that meet these criteria?

- *How should the fee calculation be performed?* How should fees be defined for the fee calculation to ensure a useful metric? Should the fee calculation include both ongoing management/administrative fees and one-time distribution/transactional costs? What time period should the fee calculation cover? Should it cover fees as projected over future time periods (e.g., one, five and ten year periods) to lower the impact of one-time

transactional costs such as sales loads? If so, what discount rate should be used to determine the present value of future fees?

- *How should the Department determine the fee cut-off?* If the Department established a streamlined exemption for low-fee mutual funds and other products, how would the precise fee cut-off be determined? How often should it be updated? What are characteristics of mutual funds with very low fees? Should the cut-off be based on a percentage of the assets invested (i.e., a specified number of basis points) or as a percentile of the market? If a percentile, how should reliable data be obtained to determine fund percentiles? Are there available and appropriate sources of industry benchmarking data? Should the Department collect data for this purpose? Is the range of fees in the market known? Are there data that would suggest that mutual funds with relatively low fees are (or are not) high quality investments for a wide variety of Retirement Investors?
- *Should the low-fee cutoff be applied differently to different types of funds?* Should a single fee cut-off apply broadly to all mutual funds, or would that exclude entire categories of funds with certain investment strategies? Would it be appropriate to develop sub-categories of funds for the fee cut-offs? If so, how should the sub-categories be defined?
- *Should ETFs be covered?* Within the category of mutual funds, should exchange-traded funds (ETFs) be covered under the streamlined exemption? If so, how would the commission associated with an ETF transaction be incorporated into the low-fee calculation?

- *What, if any, conditions other than low fees should be required as part of the streamlined exemption?* If the streamlined exemption covers only mutual funds, are conditions relating to their availability and transparent pricing unnecessary? Are conditions relating to liquidity necessary? Should funds covered by the streamlined exemption be required to be broadly diversified to minimize risk for targeted return? Should the streamlined exemption contain a requirement that the investment be calibrated to provide a balance of risk and return appropriate to the investor’s circumstances and preferences for the duration of the recommended holding period? Should the funds be required to meet the requirements of a “qualified default investment alternative,” as described in 29 CFR 2550.404c-5?
- *How should the low-fee cut-off be communicated to Advisers and Financial Institutions?* Should the initial cut-off and subsequent updates be written as a condition of the exemption, or publicized through other formats? How would Advisers and Financial Institutions be sure that certain funds meet the low-fee cut-off? By what means and how frequently should Advisers and Financial Institutions be required to confirm that mutual funds that they recommend (or recommended in the past) continue to meet the low-fee cut-off?
- *How could consumers police the low-fee cut-off?* What enforcement mechanism could be used to assure that the Advisers taking advantage of such a safe harbor are correctly analyzing whether their products meet the cut-off?

Utility. In addition to seeking comment on the technical design of the streamlined exemption, the Department asks for information on whether the low-fee streamlined exemption would effectively reduce the compliance burden for a significant number of Advisers and Financial

Institutions. Because of its design, the low-fee streamlined exemption would generally apply on a product-by-product basis rather than at the Financial Institution level, unless the Financial Institution and its Advisers exclusively advise retail customers to invest in the low-fee products.

Therefore, the Department asks:

- *Would Advisers and Financial Institutions restrict their business models to offer only the low-fee mutual funds that the Department envisions covering in the streamlined exemption? Or, would Advisers that offer products outside the streamlined exemption (higher-fee mutual funds as well as other investment products such as stocks and bonds) rely on the streamlined exemption for the low-fee mutual fund investments and the Best Interest Contract Exemption for the other investments? If Advisers and Financial Institutions had to implement the safeguards required by the Best Interest Contract Exemption for many of their Retirement Investor customers, would the availability of the streamlined exemption result in material cost savings to them?*
- *How do low-fee investment products compensate Advisers for distribution? Do low-fee funds tend to pay sales loads, revenue sharing and 12b-1 fees? If not, how would Advisers and Financial Institutions be compensated within the low-fee confines of the streamlined exemption?*
- *What design features would be most likely to enhance the utility of the low-fee streamlined exemption?*

Consequences. The Department seeks the public's views on the potential consequences of granting a streamlined exemption for certain types of investments.

- *Would a streamlined exemption limited to low-fee mutual fund investments or other categories of investments be in the interests of plans and their participants and*

beneficiaries? Would the availability of the streamlined exemption discourage Advisers and Financial Institutions from offering other types of investments, including higher-cost mutual funds, even if the offering of such other investments would be in the best interest of the plan, participant or beneficiary, or IRA owner? Would the streamlined exemption have the beneficial effect of reducing investment costs? On the other hand, could the streamlined exemption result in some of the lowest-cost investment products increasing their fees to the cut-off threshold? Would it expand the number of Financial Institutions that developed low-fee options, making them more widely available?

- *How would the streamlined exemption affect the marketplace for investment products?*
Would a low-fee streamlined exemption have the unintended effect of unduly promoting certain investment styles? Which types of Advisers and Financial Institutions would be most affected and would they be likely to revise their business models in response? Would there be increased competition among Advisers and Financial Institutions to offer investment products with lower fees? Would Retirement Investors have more choices to diversify while paying less in fees? Would Financial Institutions and Advisers offer other incentives to Retirement Investors in order to sell specific products?

Availability of Other Prohibited Transaction Exemptions

Certain existing exemptions, including amendments thereto and superseding exemptions, provide relief for specific types of transactions that are outside of the scope of this proposed exemption. A person seeking relief for a transaction covered by one of those existing exemptions would need to comply with its requirements and conditions. Those exemptions are as follows:

(1) PTE 75-1 (Part III)³⁸, which provides relief for a plan's acquisition of securities during an underwriting or selling syndicate from any person other than a fiduciary who is a member of the syndicate.

(2) PTE 75-1 (Part V),³⁹ which exempts an extension of credit to a plan from a party in interest.

(3) PTE 83-1,⁴⁰ which provides relief for certain transactions involving mortgage pool investment trusts and pass-through certificates evidencing interests therein.

(4) PTE 2004-16,⁴¹ which provides relief for a fiduciary of the plan who is the employer of employees covered under the plan to establish individual retirement plans for certain mandatory distributions on behalf of separated employees at a financial institution that is itself or an affiliate, and also select a proprietary investment product as the initial investment for the plan.

(5) PTE 2006-16,⁴² which exempts certain loans of securities by plans to broker-dealers and banks and provides relief for the receipt of compensation by a fiduciary for services rendered in connection with the securities loans.

Applicability Date

The Department is proposing that compliance with the final regulation defining a fiduciary under ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) will begin eight months after publication of the final regulation in the FEDERAL REGISTER (Applicability Date). The Department proposes to make this exemption, if granted, available on the Applicability Date. Further, the Department is proposing to revoke relief for transactions

³⁸ 40 FR 50845 (Oct. 31, 1975).

³⁹ Id., as amended at 71 FR 5883 (Feb. 3, 2006).

⁴⁰ 48 FR 895 (Jan. 7, 1983).

⁴¹ 69 FR 57964 (Sept. 28, 2004).

⁴² 71 FR 63786 (Oct. 31, 2006).

involving IRAs from two existing exemptions, PTEs 86-128 and 84-24, as of the Applicability Date.⁴³ As a result, Advisers and Financial Institutions, including those newly defined as fiduciaries, will generally have to comply with this exemption to receive many common forms of compensation in transactions involving IRAs.

The Department recognizes that complying with the requirements of the exemption may represent a significant adjustment for many Advisers and Financial Institutions, particularly in their dealings with IRA owners. At the same time, in the Department's view, it is essential that Advisers and Financial Institutions wishing to receive compensation under the exemption institute certain conditions for the protection of IRA customers as of the Applicability Date. These safeguards include: acknowledging fiduciary status,⁴⁴ complying with the Impartial Conduct Standards,⁴⁵ adopting anti-conflict policies and procedures,⁴⁶ notifying EBSA of the use of the exemption,⁴⁷ and recordkeeping.⁴⁸ The Department requests comment on whether Financial Institutions anticipate that there will be existing contractual obligations or other barriers that would prevent them from implementing the exemption's policies and procedures requirement in this time frame.

The Department also specifically requests comment on whether it should delay certain other conditions of the exemption as applicable to IRA transactions for an additional period (e.g., three months) following the Applicability Date. For example, one possibility would be to delay the requirement that Advisers and Financial Institutions execute a contract with their IRA

⁴³ See the notices with respect to these proposals, published elsewhere in this issue of the FEDERAL REGISTER.

⁴⁴ See Section II(b).

⁴⁵ See Section II(c).

⁴⁶ See Section II(d)(2) – (4).

⁴⁷ See Section V(a).

⁴⁸ See Section V(c).

customers for an additional three-month period, as well as the disclosure requirements in Sections III and the data collection requirements described in Section IX. This phased approach would give Financial Institutions additional time to review and refine their policies and procedures and to put new compliance systems in place, without exposure to contractual liability to the IRA owners.

The Department does not believe that such additional delay would be warranted for Advisers and Financial Institutions with respect to transactions involving ERISA plan sponsors and ERISA plan participants and beneficiaries. Advisers and Financial Institutions to ERISA plans and their participants and beneficiaries are accustomed to working within the existing exemptions, such as PTEs 86-128 and 84-24, and such exemptions would remain available to them while they develop systems for complying with this exemption.⁴⁹ Nevertheless, the Department also requests comments on the appropriate period for phasing in some or all of the exemption's conditions with respect to ERISA plans as well as IRAs.

The Department additionally notes that, elsewhere in this issue of the FEDERAL REGISTER, it has proposed to revoke another existing exemption, PTE 75-1, Part II(2), in its entirety in connection with a proposed amendment to PTE 86-128. The Department requests comment on whether this exemption is widely used and whether it should delay revocation for some period after the Applicability Date while Advisers and Financial Institutions develop systems for complying with PTE 86-128.

⁴⁹In this regard, the Department anticipates making the Impartial Conduct Standards amendments to PTEs 86-128 and 84-24 effective as of the Applicability Date.

No Relief Proposed From ERISA Section 406(a)(1)(C) or Code section 4975(c)(1)(C) for the Provision of Services

If granted, this proposed exemption will not provide relief from a transaction prohibited by ERISA section 406(a)(1)(C), or from the taxes imposed by Code section 4975(a) and (b) by reason of Code section 4975(c)(1)(C), regarding the furnishing of goods, services or facilities between a plan and a party in interest. The provision of investment advice to a plan under a contract with a plan fiduciary is a service to the plan and compliance with this exemption will not relieve an Adviser or Financial Institution of the need to comply with ERISA section 408(b)(2), Code section 4975(d)(2), and applicable regulations thereunder.

Paperwork Reduction Act Statement

As part of its continuing effort to reduce paperwork and respondent burden, the Department conducts a preclearance consultation program to provide the general public and Federal agencies with an opportunity to comment on proposed and continuing collections of information in accordance with the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506(c)(2)(A)). This helps to ensure that the public understands the Department's collection instructions, respondents can provide the requested data in the desired format, reporting burden (time and financial resources) is minimized, collection instruments are clearly understood, and the Department can properly assess the impact of collection requirements on respondents.

Currently, the Department is soliciting comments concerning the proposed information collection request (ICR) included in the Best Interest Contract Exemption (PTE) as part of its proposal to amend its 1975 rule that defines when a person who provides investment advice to an employee benefit plan or IRA becomes a fiduciary. A copy of the ICR may be obtained by contacting the PRA addressee shown below or at <http://www.RegInfo.gov>.

The Department has submitted a copy of the PTE to the Office of Management and Budget (OMB) in accordance with 44 U.S.C. 3507(d) for review of its information collections.

The Department and OMB are particularly interested in comments that:

- Evaluate whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- Evaluate the accuracy of the agency's estimate of the burden of the collection of information, including the validity of the methodology and assumptions used;
- Enhance the quality, utility, and clarity of the information to be collected; and
- Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, *e.g.*, permitting electronic submission of responses.

Comments should be sent to the Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503; Attention: Desk Officer for the Employee Benefits Security Administration. OMB requests that comments be received within 30 days of publication of the proposed PTE to ensure their consideration.

PRA Addressee: Address requests for copies of the ICR to G. Christopher Cosby, Office of Policy and Research, U.S. Department of Labor, Employee Benefits Security Administration, 200 Constitution Avenue, NW., Room N-5718, Washington, DC 20210. Telephone (202) 693-8410; Fax: (202) 219-5333. These are not toll-free numbers. ICRs submitted to OMB also are available at <http://www.RegInfo.gov>.

As discussed in detail below, the PTE would require financial institutions and their advisers to enter into a contractual arrangement with retirement investors making investment decisions on behalf of the plan or IRA (i.e., plan participants or beneficiaries, IRA owners, or small plan sponsors (or employees, officers or directors thereof)), and make certain disclosures to the retirement investors and the Department in order to receive relief from ERISA's prohibited transaction rules for the receipt of compensation as a result of a financial institution's and its adviser's advice (i.e., prohibited compensation). Financial institutions would be required to maintain records necessary to prove that the conditions of the exemption have been met. These requirements are ICRs subject to the Paperwork Reduction Act.

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

- Disclosures distributed electronically will be distributed via means already used by respondents in the normal course of business and the costs arising from electronic distribution will be negligible;
- Financial institutions will use existing in-house resources to prepare the contracts and disclosures, adjust their IT systems, and maintain the recordkeeping systems necessary to meet the requirements of the exemption;
- A combination of personnel will perform the tasks associated with the ICRs at an hourly wage rate of \$125.95 for a financial manager, \$30.42 for clerical personnel, \$79.67 for an IT professional, and \$129.94 for a legal professional;⁵⁰

⁵⁰ The Department's estimated 2015 hourly labor rates include wages, other benefits, and overhead, and are calculated as follows: mean wage from the 2013 National Occupational Employment Survey (April 2014, Bureau of Labor Statistics <http://www.bls.gov/news.release/pdf/ocwage.pdf>); wages as a percent of total compensation

- Approximately 2,800 financial institutions⁵¹ will take advantage of this exemption and they will use this exemption in conjunction with transactions involving nearly all of their clients that are small defined benefit and defined plans, participant directed defined contribution plans, and IRA holders.⁵²⁵³ Eight percent of financial institutions (approximately 224) will be new firms beginning use of this exemption each year.

Contract, Disclosures, and Notices

In order to receive prohibited compensation under this PTE, Section II requires financial institutions and advisers to enter into a written contract with retirement investors affirmatively stating that they are fiduciaries under ERISA or the Code with respect to any recommendations to the retirement investor to purchase, sell or hold specified assets, and that the financial institution and adviser will give advice that is in the best interest of the retirement investor.

Section III(a) requires the adviser to furnish the retirement investor with a disclosure prior to the execution of the purchase of the asset stating the total cost of investing in the asset.

Section III(b) requires the adviser or financial institution to furnish the retirement investor with an annual statement listing all assets purchased or sold during the year, as well as the associated

from the Employer Cost for Employee Compensation (June 2014, Bureau of Labor Statistics <http://www.bls.gov/news.release/ecec.t02.htm>); overhead as a multiple of compensation is assumed to be 25 percent of total compensation for paraprofessionals, 20 percent of compensation for clerical, and 35 percent of compensation for professional; annual inflation assumed to be 2.3 percent annual growth of total labor cost since 2013 (Employment Costs Index data for private industry, September 2014 <http://www.bls.gov/news.release/eci.nr0.htm>).

⁵¹ As described in the regulatory impact analysis for the accompanying rule, the Department estimates that approximately 2,619 broker dealers service the retirement market. The Department anticipates that the exemption will be used primarily, but not exclusively, by broker-dealers. Further, the Department assumes that all broker-dealers servicing the retirement market will use the exemption. Beyond the 2,619 broker-dealers, the Department estimates that almost 200 other financial institutions will use the exemption.

⁵² The Department welcomes comment on this estimate.

⁵³ For purposes of this analysis, “IRA holders” include rollovers from ERISA plans.

fees and expenses paid by the plan, participant or beneficiary account, or IRA, and the compensation received by the financial institution and the adviser. Section III(c) requires the financial institution to maintain a publicly available webpage displaying the compensation (including its source and how it varies within asset classes) that would be received by the adviser, the financial institution and any affiliate with respect to any asset that a plan, participant or beneficiary account, or IRA could purchase through the adviser.

If the financial institution limits the assets available for sale, Section IV requires the financial institution to furnish the retirement investor with a written description of the limitations placed on the menu. The adviser must also notify the retirement investor if it does not recommend a sufficiently broad range of assets to meet the retirement investor's needs.

Finally, before the financial institution begins engaging in transactions covered under this PTE, Section V(a) requires the financial institution to provide notice to the Department of its intent to rely on this proposed PTE.

Legal Costs

The Department estimates that drafting the PTE's contractual provisions, the notice to the Department, and the limited menu disclosure will require 60 hours of legal time for financial institutions during the first year that the financial institution uses the PTE. This legal work results in approximately 168,000 hours of burden during the first year and approximately 13,000 hours of burden during subsequent years at an equivalent cost of \$21.8 million and \$1.7 million respectively.

IT Costs

The Department estimates that updating computer systems to create the required disclosures, insert the contract provisions into existing contracts, maintain the required records,

and publish information on the website will require 100 hours of IT staff time for financial institutions during the first year that the financial institution uses the PTE.⁵⁴ This IT work results in approximately 280,000 hours of burden during the first year and approximately 22,000 hours of burden during subsequent years at an equivalent cost of \$22.3 million and \$1.8 million respectively.

Production and Distribution of Required Contract, Disclosures, and Notices

The Department estimates that approximately 21.3 million plans and IRAs have relationships with financial institutions and are likely to engage in transactions covered under this PTE.

The Department assumes that financial institutions already maintain contracts with their clients. Therefore, the required contractual provisions will be inserted into existing contracts with no additional cost for production or distribution.

The Department assumes that financial institutions will send approximately 24 point-of-sale transaction disclosures each year to 37,000 small defined benefit plans and small defined contribution plans that do not allow participants to direct investments. All of these disclosures will be sent electronically at de minimis cost. Financial institutions will send two point-of-sale transaction disclosures each year to 1.1 million defined contribution plans participants and 20.2 million IRA holders. These disclosures will be distributed electronically to 75 percent of defined contribution plan participants and IRA holders. Paper copies of the disclosure will be given to 25 percent of defined contribution plan participants and IRA holders. Further, 15 percent of the paper copies will be mailed, while the other 85 percent will be hand-delivered during in-person

⁵⁴ The Department assumes that nearly all financial institutions already maintain websites and that updates to the disclosure required by Section III(c) could be automated. Therefore, the IT costs required by Section III(c) would be almost exclusively start-up costs. The Department invites comment on these assumptions.

meetings. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution will cost approximately \$1.3 million. Paper distribution will also require one minute of clerical time to print the disclosure and one minute of clerical time to mail the disclosure, resulting in 204,000 hours at an equivalent cost of \$6.2 million annually.

The Department estimates that 21.3 million plans and IRAs will receive an annual statement. Small defined benefit and defined contribution plans that do not allow participants to direct investments will receive a ten page statement electronically at de minimis cost. Defined contribution plan participants and IRA holders will receive a two page statement. This statement will be distributed electronically to 38 percent of defined contribution plan participants and 50 percent of IRA holders. Paper statements will be mailed to 62 percent of defined contribution plan participants and 50 percent of IRA holders. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution will cost approximately \$6.3 million. Paper distribution will also require two minutes of clerical time to print and mail the disclosure, resulting in 359,000 hours at an equivalent cost of \$10.9 million annually.

For purposes of this estimate, the Department assumes that nearly all financial institutions using the PTE will limit their investment menus in some way and provide the limited menu disclosure. Accordingly, during the first year of the exemption the Department estimates that all of the 21.3 million plans and IRAs would receive the one-page limited menu disclosure. In subsequent years, approximately 1.7 million plans and IRAs would receive the one-page limited menu disclosure. Small defined benefit and defined contribution plans that do not allow participants to direct investments would receive the disclosure electronically at de minimis cost. The disclosure would be distributed electronically to 75 percent of defined contribution plan participants and IRA holders. Paper copies of the disclosure would be given to 25 percent of

defined contribution plan participants and IRA holders. Further, 15 percent of the paper copies would be mailed, while the other 85 percent would be hand-delivered during in-person meetings. The Department estimates that electronic distribution would result in de minimis cost, while paper distribution would cost approximately \$922,000 during the first year and approximately \$74,000 in subsequent years. Paper distribution would also require one minute of clerical time to print the disclosure and one minute of clerical time to mail the disclosure, resulting in 244,000 hours in the first year and 20,000 hours in subsequent years at an equivalent cost of \$7.4 million and \$595,000 respectively. If, as seems likely, many financial institutions choose not to limit the universe of investment recommendations, we would expect the actual costs to be substantially smaller.

Finally, the Department estimates that all of the 2,800 financial institutions would mail the required one-page notice to the Department during the first year and approximately 224 new financial institutions would mail the required one-page notice to the Department in subsequent years. Producing and distributing this notice would cost approximately \$1,500 during the first year and approximately \$100 in subsequent years. Producing and distributing this notice would also require 2 minutes of clerical time resulting in a burden of approximately 93 hours during the first year and approximately 7 hours in subsequent years at an equivalent cost of \$2,800 and \$200 respectively.

Recordkeeping Requirement

Section V(b) requires financial institutions to maintain investment return data in a manner accessible for examination by the Department for six years. Section V(c) and (d) requires financial institutions to maintain or cause to be maintained for six years and disclosed upon request the records necessary for the Department, Internal Revenue Service, plan fiduciary,

contributing employer or employee organization whose members are covered by the plan, and participants, beneficiaries and IRA owners to determine whether the conditions of this exemption have been met in a manner that is accessible for audit and examination.

Most of the data retention requirements in Section V(b) are consistent with data retention requirements made by the SEC and FINRA. In addition, the data retention requirements correspond to the six year statute of limitations in Section 413 of ERISA. Insofar as the data retention time requirements in Section V(b) are lengthier than those required by the SEC and FINRA, the Department assumes that retaining data for an additional time period is a de minimis additional burden.

The records required in Section V(c) and Section V(d) are generally kept as regular and customary business practices. Therefore, the Department has estimated that the additional time needed to maintain records consistent with the exemption will only require about one-half hour, on average, annually for a financial manager to organize and collate the documents or else draft a notice explaining that the information is exempt from disclosure, and an additional 15 minutes of clerical time to make the documents available for inspection during normal business hours or prepare the paper notice explaining that the information is exempt from disclosure. Thus, the Department estimates that a total of 45 minutes of professional time per Financial Institution would be required for a total hour burden of 2,100 hours at an equivalent cost of \$198,000.

In connection with this recordkeeping and disclosure requirements discussed above, Section V(d)(2) and (3) provide that financial institutions relying on the exemption do not have to disclose trade secrets or other confidential information to members of the public (i.e., plan fiduciaries, contributing employers or employee organizations whose members are covered by the plan, participants and beneficiaries and IRA owners), but that in the event a financial

institution refuses to disclose information on this basis, it must provide a written notice to the requester advising of the reasons for the refusal and advising that the Department may request such information. The Department's experience indicates that this provision is not commonly invoked, and therefore, the written notice is rarely, if ever, generated. Therefore, the Department believes the cost burden associated with this clause is de minimis. No other cost burden exists with respect to recordkeeping.

Overall Summary

Overall, the Department estimates that in order to meet the conditions of this PTE, 2,800 financial institutions will produce 86 million disclosures and notices during the first year of this PTE and 66.4 million disclosures and notices during subsequent years. These disclosures and notices will result in 1.3 million burden hours during the first year and 620,000 burden hours in subsequent years, at an equivalent cost of \$68.9 million and \$21.4 million respectively. The disclosures and notices in this exemption will also result in a total cost burden for materials and postage of \$8.6 million during the first year and \$7.7 million during subsequent years.

These paperwork burden estimates are summarized as follows:

Type of Review: New collection (Request for new OMB Control Number).

Agency: Employee Benefits Security Administration, Department of Labor.

Titles: (1) Proposed Best Interest Contract Exemption.

OMB Control Number: 1210-NEW.

Affected Public: Business or other for-profit.

Estimated Number of Respondents: 2,800.

Estimated Number of Annual Responses: 85,985,156 in the first year and 66,394,985 in subsequent years.

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

Estimated Total Annual Burden Hours: 1,256,862 during the first year and 619,766 in subsequent years.

Estimated Total Annual Burden Cost: \$8,582,764 during the first year and \$7,733,247 in subsequent years.

General Information

The attention of interested persons is directed to the following:

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

(2) Before an exemption may be granted under ERISA section 408(a) and Code section 4975(c)(2), the Department must 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 the plan and IRA owners;

(3) If granted, the proposed exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the exemption; and

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

Written Comments

The Department invites all interested persons to submit written comments on the proposed exemption to the address and within the time period set forth above. All comments received will be made a part of the record. Comments should state the reasons for the writer's interest in the proposed exemption. Comments received will be available for public inspection at the above address.

Proposed Exemption

Section I – Best Interest Contract Exemption

(a) In general. ERISA and the Internal Revenue Code prohibit fiduciary advisers to employee benefit plans (Plans) and individual retirement plans (IRAs) from receiving compensation that varies based on their investment recommendations. Similarly, fiduciary advisers are prohibited from receiving compensation from third parties in connection with their advice. This exemption permits certain persons who provide investment advice to Retirement

Investors, and their associated financial institutions, affiliates and other related entities, to receive such otherwise prohibited compensation as described below.

(b) Covered transactions. This exemption permits Advisers, Financial Institutions, and their Affiliates and Related Entities to receive compensation for services provided in connection with a purchase, sale or holding of an Asset by a Plan, participant or beneficiary account, or IRA, as a result of the Adviser's and Financial Institution's advice to any of the following "Retirement Investors:"

- (1) A participant or beneficiary of a Plan subject to Title I of ERISA with authority to direct the investment of assets in his or her Plan account or to take a distribution;
- (2) The beneficial owner of an IRA acting on behalf of the IRA; or
- (3) A plan sponsor as described in ERISA section 3(16)(B) (or any employee, officer or director thereof) of a non-participant-directed Plan subject to Title I of ERISA with fewer than 100 participants, to the extent it acts as a fiduciary who has authority to make investment decisions for the Plan.

As detailed below, parties seeking to rely on the exemption must contractually agree to adhere to Impartial Conduct Standards in rendering advice regarding Assets; warrant that they have adopted policies and procedures designed to mitigate the dangers posed by Material Conflicts of Interest; disclose important information relating to fees, compensation, and Material Conflicts of Interest; and retain documents and data relating to investment recommendations regarding Assets. The exemption provides relief from the restrictions of ERISA section 406(a)(1)(D) and 406(b) and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(D), (E) and (F). The Adviser and Financial Institution must comply with the conditions of Sections II-V to rely on this exemption.

(c) Exclusions. This exemption does not apply if:

- (1) The Plan is covered by Title I of ERISA, and (i) the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the Plan, or (ii) the Adviser or Financial Institution is a named fiduciary or plan administrator (as defined in ERISA section 3(16)(A)) with respect to the Plan, or an affiliate thereof, that was selected to provide advice to the Plan by a fiduciary who is not Independent;
- (2) The compensation is received as a result of a transaction in which the Adviser is acting on behalf of its own account or the account of the Financial Institution, or the account of a person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Financial Institution (i.e., a principal transaction);
- (3) The compensation is received as a result of investment advice to a Retirement Investor generated solely by an interactive website in which computer software-based models or applications provide investment advice based on personal information each investor supplies through the website without any personal interaction or advice from an individual Adviser (i.e., “robo advice”); or
- (4) The Adviser (i) exercises any discretionary authority or discretionary control respecting management of the Plan or IRA assets involved in the transaction or exercises any authority or control respecting management or disposition of the assets, or (ii) has any discretionary authority or discretionary responsibility in the administration of the Plan or IRA.

Section II – Contract, Impartial Conduct, and Other Requirements

- (a) Contract. Prior to recommending that the Plan, participant or beneficiary account, or IRA purchase, sell or hold the Asset, the Adviser and Financial Institution enter into a written contract with the Retirement Investor that incorporates the terms required by Section II(b)-(e).
- (b) Fiduciary. The written contract affirmatively states that the Adviser and Financial Institution are fiduciaries under ERISA or the Code, or both, with respect to any investment recommendations to the Retirement Investor.
- (c) Impartial Conduct Standards. The Adviser and the Financial Institution affirmatively agree to, and comply with, the following:
- (1) When providing investment advice to the Retirement Investor regarding the Asset, the Adviser and Financial Institution will provide investment advice that is in the Best Interest of the Retirement Investor (i.e., advice that reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party);
 - (2) When providing investment advice to the Retirement Investor regarding the Asset, the Adviser and Financial Institution will not recommend an Asset if the total amount of compensation anticipated to be received by the Adviser, Financial Institution, Affiliates and Related Entities in connection with the purchase, sale or holding of the Asset by the Plan, participant or beneficiary account, or IRA, will exceed reasonable compensation in relation to the total services they provide to the Retirement Investor; and

(3) The Adviser's and Financial Institution's statements about the Asset, fees, Material Conflicts of Interest, and any other matters relevant to a Retirement Investor's investment decisions, will not be misleading.

(d) Warranties. The Adviser and Financial Institution affirmatively warrant the following:

- (1) The Adviser, Financial Institution, and Affiliates will comply with all applicable federal and state laws regarding the rendering of the investment advice, the purchase, sale and holding of the Asset, and the payment of compensation related to the purchase, sale and holding of the Asset;
 - (2) The Financial Institution has adopted written policies and procedures reasonably designed to mitigate the impact of Material Conflicts of Interest and ensure that its individual Advisers adhere to the Impartial Conduct Standards set forth in Section II(c);
 - (3) In formulating its policies and procedures, the Financial Institution has specifically identified Material Conflicts of Interest and adopted measures to prevent the Material Conflicts of Interest from causing violations of the Impartial Conduct Standards set forth in Section II(c); and
 - (4) Neither the Financial Institution nor (to the best of its knowledge) any Affiliate or Related Entity uses quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives to the extent they would tend to encourage individual Advisers to make recommendations that are not in the Best Interest of the Retirement Investor.
- Notwithstanding the foregoing, the contractual warranty set forth in this Section II(d)(4) does not prevent the Financial Institution or its Affiliates and Related Entities

from providing Advisers with differential compensation based on investments by Plans, participant or beneficiary accounts, or IRAs, to the extent such compensation would not encourage advice that runs counter to the Best Interest of the Retirement Investor (e.g., differential compensation based on such neutral factors as the difference in time and analysis necessary to provide prudent advice with respect to different types of investments would be permissible).

(e) Disclosures. The written contract must specifically:

- (1) Identify and disclose any Material Conflicts of Interest;
- (2) Inform the Retirement Investor that the Retirement Investor has the right to obtain complete information about all the fees currently associated with the Assets in which it is invested, including all of the direct and indirect fees paid payable to the Adviser, Financial Institution, and any Affiliates; and
- (3) Disclose to the Retirement Investor whether the Financial Institution offers Proprietary Products or receives Third Party Payments with respect to the purchase, sale or holding of any Asset, and of the address of the website required by Section III(c) that discloses the compensation arrangements entered into by Advisers and the Financial Institution.

(f) Prohibited Contractual Provisions. The written contract shall not contain the following:

- (1) Exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms; and
- (2) A provision under which the Plan, IRA or Retirement Investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution.

Section III – Disclosure Requirements

(a) Transaction Disclosure.

(1) Disclosure. Prior to the execution of the purchase of the Asset by the Plan, participant or beneficiary account, or IRA, the Adviser furnishes to the Retirement Investor a chart that provides, with respect to each Asset recommended, the Total Cost to the Plan, participant or beneficiary account, or IRA, of investing in the Asset for 1-, 5- and 10-year periods expressed as a dollar amount, assuming an investment of the dollar amount recommended by the Adviser and reasonable assumptions about investment performance that are disclosed.

The disclosure chart required by this section need not be provided with respect to a subsequent recommendation to purchase the same investment product if the chart was previously provided to the Retirement Investor within the past twelve months and the Total Cost has not materially changed.

(2) Total Cost. The “Total Cost” of investing in an Asset means the sum of the following, as applicable:

(A) Acquisition costs. Any costs of acquiring the Asset that are paid by direct charge to the Plan, participant or beneficiary account, or IRA, or that reduce the amount invested in the Asset (e.g., any loads, commissions, or mark-ups on Assets bought from dealers, and account opening fees, if applicable).

(B) Ongoing costs. Any ongoing (e.g., annual) costs attributable to fees and expenses charged for the operation of an Asset that is a pooled investment fund (e.g., mutual fund, bank collective investment fund, insurance company pooled separate account) that reduces the Asset’s rate of return (e.g., amounts attributable

to a mutual fund expense ratio and account fees). This includes amounts paid by the pooled investment fund to intermediaries, such as sub-TA fees, sub-accounting fees, etc.

(C) Disposition costs. Any costs of disposing of or redeeming an interest in the Asset that are paid by direct charge to the Plan, participant or beneficiary account, or IRA, or that reduce the amounts received by the Plan, participant or beneficiary account, or IRA (e.g., surrender fees, back-end loads, etc., that are always applicable (i.e., do not sunset), mark-downs on assets sold to dealers, and account closing fees, if applicable).

(D) Others. Any costs not described in (A)-(C) that reduce the Asset's rate of return, are paid by direct charge to the Plan, participant or beneficiary account, or IRA, or reduce the amounts received by the Plan, participant or beneficiary account, or IRA (e.g., contingent fees, such as back-end loads that phase out over time (with such terms explained beneath the table)).

(3) Model Chart. Appendix II to this exemption contains a model chart that may be used to provide the information required under this Section III(a). Use of the model chart is not mandatory. However, use of an appropriately completed model chart will be deemed to satisfy the requirements of this Section III(a).

(b) Annual Disclosure. The Adviser or Financial Institution provides the following written information to the Retirement Investor, annually, within 45 days of the end of the applicable year, in a succinct single disclosure:

(1) A list identifying each Asset purchased or sold during the applicable period and the price at which the Asset was purchased or sold;

- (2) A statement of the total dollar amount of all fees and expenses paid by the Plan, participant or beneficiary account, or IRA (directly and indirectly) with respect to each Asset purchased, held or sold during the applicable period; and
- (3) A statement of the total dollar amount of all compensation received by the Adviser and Financial Institution, directly or indirectly, from any party, as a result of each Asset sold, purchased or held by the Plan, participant or beneficiary account, or IRA during the applicable period.

(c) Webpage.

- (1) The Financial Institution maintains a webpage, freely accessible to the public, which shows the following information:

(A) The direct and indirect material compensation payable to the Adviser, Financial Institution and any Affiliate for services provided in connection with each Asset (or, if uniform across a class of Assets, the class of Assets) that a Plan, participant or beneficiary account, or an IRA is able to purchase, hold, or sell through the Adviser or Financial Institution, and that a Plan, participant or beneficiary account, or an IRA has purchased, held, or sold within the last 365 days. The compensation may be expressed as a monetary amount, formula or percentage of the assets involved in the purchase, sale or holding; and

(B) The source of the compensation, and how the compensation varies within and among Assets.

- (2) The Financial Institution's webpage provides access to the information in (1)(A) and (B) in a machine readable format.

Section IV – Range of Investment Options

- (a) General. The Financial Institution offers for purchase, sale or holding, and the Adviser makes available to the Plan, participant or beneficiary account, or IRA for purchase, sale or holding, a range of Assets that is broad enough to enable the Adviser to make recommendations with respect to all of the asset classes reasonably necessary to serve the Best Interests of the Retirement Investor in light of its investment objectives, risk tolerance, and specific financial circumstances.
- (b) Limited Range of Investment Options. Section (a) notwithstanding, a Financial Institution may limit the Assets available for purchase, sale or holding based on whether the Assets are Proprietary Products, generate Third Party Payments, or for other reasons, and still rely on the exemption, provided that:
- (1) The Financial Institution makes a specific written finding that the limitations it has placed on the Assets made available to an Adviser for purchase, sale or holding by Plans, participant and beneficiary accounts, and IRAs do not prevent the Adviser from providing advice that is in the Best Interest of the Retirement Investor (i.e., advice that reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party) or otherwise adhering to the Impartial Conduct Standards;
 - (2) Any compensation received in connection with a purchase, sale or holding of the Asset by a Plan, participant or beneficiary account, or an IRA, is reasonable in

- relation to the value of the specific services provided to the Retirement Investor in exchange for the payments and not in excess of the services' fair market value;
- (3) Before giving investment recommendations to Retirement Investors, the Adviser or Financial Institution gives the Retirement Investor clear written notice of the limitations placed on the Assets that the Adviser may offer for purchase, sale or holding by a Plan, participant or beneficiary account, or an IRA. Notice is insufficient if it merely states that the Financial Institution or Adviser "may" limit investment recommendations based on whether the Assets are Proprietary Products or generate Third Party Payments, or for other reasons, without specific disclosure of the extent to which recommendations are, in fact, limited on that basis; and
- (4) The Adviser notifies the Retirement Investor if the Adviser does not recommend a sufficiently broad range of Assets to meet the Retirement Investor's needs.
- (c) ERISA plan participants and beneficiaries. Some Advisers and Financial Institutions provide advice to participants in ERISA-covered participant directed individual account Plans in which the menu of investment options is selected by an Independent Plan fiduciary. In such cases, provided the Adviser and Financial Institution did not provide investment advice to the Plan fiduciary regarding the composition of the menu, the Adviser and Financial Institution do not have to comply with Section IV(a)-(c) in connection with their advice to individual participants and beneficiaries on the selection of Assets from the menu provided. This exception is not available for advice with respect to investments within open brokerage windows or otherwise outside the Plan's designated investment options.

Section V –Disclosure to the Department and Recordkeeping

- (a) EBSA Disclosure. Before receiving compensation in reliance on the exemption in Section I, the Financial Institution notifies the Department of Labor of the intention to rely on this class exemption. The notice will remain in effect until revoked in writing by the Financial Institution. The notice need not identify any Plan or IRA.
- (b) Data Request. The Financial Institution maintains the data that is subject to request pursuant to Section IX in a manner that is accessible for examination by the Department for six (6) years from the date of the transaction subject to relief hereunder. No party, other than the Financial Institution responsible for complying with this paragraph (b), will be subject to the taxes imposed by Code section 4975(a) and (b), if applicable, if the data is not maintained or not available for examination as required by paragraph (b).
- (c) Recordkeeping. The Financial Institution maintains for a period of six (6) years, in a manner that is accessible for examination, the records necessary to enable the persons described in paragraph (d) of this Section to determine whether the conditions of this exemption have been met, except that:
- (1) If such records are lost or destroyed, due to circumstances beyond the control of the Financial Institution, then no prohibited transaction will be considered to have occurred solely on the basis of the unavailability of those records; and
 - (2) No party, other than the Financial Institution responsible for complying with this paragraph (c), will be subject to the civil penalty that may be assessed under ERISA section 502(i) or the taxes imposed by Code section 4975(a) and (b), if applicable, if the records are not maintained or are not available for examination as required by paragraph (d), below.

- (d) (1) Except as provided in paragraph (d)(2) of this Section, and notwithstanding any provisions of ERISA section 504(a)(2) and (b), the records referred to in paragraph (c) of this Section are unconditionally available at their customary location for examination during normal business hours by:
- (A) Any authorized employee or representative of the Department or the Internal Revenue Service;
 - (B) Any fiduciary of a Plan that engaged in a purchase, sale or holding of an Asset described in this exemption, or any authorized employee or representative of such fiduciary;
 - (C) Any contributing employer and any employee organization whose members are covered by a Plan described in paragraph (d)(1)(B), or any authorized employee or representative of these entities; or
 - (D) Any participant or beneficiary of a Plan described in paragraph (B), IRA owner, or the authorized representative of such participant, beneficiary or owner;
- and
- (2) None of the persons described in paragraph (d)(1)(B)-(D) of this Section are authorized to examine privileged trade secrets or privileged commercial or financial information, of the Financial Institution, or information identifying other individuals.
- (3) Should the Financial Institution refuse to disclose information on the basis that the information is exempt from disclosure, the Financial Institution must, by the close of the thirtieth (30th) day following the request, provide a written notice advising the requestor of the reasons for the refusal and that the Department may request such information.

Section VI – Insurance and Annuity Contract Exemption

- (a) In general. In addition to prohibiting fiduciaries from receiving compensation from third parties and compensation that varies on the basis of the fiduciaries' investment advice, ERISA and the Internal Revenue Code prohibit the purchase by a Plan, participant or beneficiary account, or IRA of an insurance or annuity product from an insurance company that is a service provider to the Plan or IRA. This exemption permits a Plan, participant or beneficiary account, or IRA to purchase an Asset that is an insurance or annuity contract in accordance with an Adviser's advice, from a Financial Institution that is an insurance company and that is a service provider to the Plan or IRA. This exemption is provided because purchases of insurance and annuity products are often prohibited purchases and sales involving insurance companies that have a pre-existing party in interest relationship to the Plan or IRA.
- (b) Covered transaction. The restrictions of ERISA section 406(a)(1)(A) and (D), and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A) and (D), shall not apply to a fiduciary's causing the purchase of an Asset that is an insurance or annuity contract by a non-participant-directed Plan subject to Title I of ERISA that has fewer than 100 participants, participant or beneficiary account, or IRA, from a Financial Institution that is an insurance company and that is a party in interest or disqualified person, if:
- (1) The transaction is effected by the insurance company in the ordinary course of its business as an insurance company;

- (2) The combined total of all fees and compensation received by the insurance company and any Affiliate is not in excess of reasonable compensation under the circumstances;
- (3) The purchase is for cash only; and
- (4) The terms of the purchase are at least as favorable to the Plan, participant or beneficiary account, or IRA as the terms generally available in an arm's length transaction with an unrelated party.

(c) Exclusion: The exemption in this Section VI does not apply if the Plan is covered by Title I of ERISA, and (i) the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the Plan, or (ii) the Adviser and Financial Institution is a named fiduciary or plan administrator (as defined in ERISA section 3(16)(A)) with respect to the Plan, or an affiliate thereof, that was selected to provide advice to the plan by a fiduciary who is not Independent.

Section VII – Exemption for Pre-Existing Transactions

(a) In general. ERISA and the Internal Revenue Code prohibit Advisers, Financial Institutions and their Affiliates and Related Entities from receiving variable or third-party compensation as a result of the Adviser's and Financial Institution's advice to a Plan, participant or beneficiary, or IRA owner. Some Advisers and Financial Institutions did not consider themselves fiduciaries within the meaning of 29 CFR section 2510-3.21 before the applicability date of the amendment to 29 CFR section 2510-3.21 (the Applicability Date). Other Advisers and Financial Institutions entered into transactions involving Plans, participant or beneficiary accounts, or IRAs before the Applicability Date, in accordance with the terms of a prohibited transaction exemption that has since been amended. This

exemption permits Advisers, Financial Institutions, and their Affiliates and Related Entities, to receive compensation, such as 12b-1 fees, in connection with the purchase, sale or holding of an Asset by a Plan, participant or beneficiary account, or an IRA, as a result of the Adviser's and Financial Institution's advice, that occurred prior to the Applicability Date, as described and limited below.

(b) Covered transaction. Subject to the applicable conditions described below, the restrictions of ERISA section 406(a)(1)(D) and 406(b) and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(D), (E) and (F), shall not apply to the receipt of compensation by an Adviser, Financial Institution, and any Affiliate and Related Entity, for services provided in connection with the purchase, holding or sale of an Asset, as a result of the Adviser's and Financial Institution's advice, that was purchased, sold, or held by a Plan, participant or beneficiary account, or an IRA before the Applicability Date if:

- (1) The compensation is not excluded pursuant to Section I(c) of the Best Interest Contract Exemption;
- (2) The compensation is received pursuant to an agreement, arrangement or understanding that was entered into prior to the Applicability Date;
- (3) The Adviser and Financial Institution do not provide additional advice to the Plan regarding the purchase, sale or holding of the Asset after the Applicability Date; and
- (4) The purchase or sale of the Asset was not a non-exempt prohibited transaction pursuant to ERISA section 406 and Code section 4975 on the date it occurred.

Section VIII – Definitions

For purposes of these exemptions:

- (a) "Adviser" means an individual who:

- (1) Is a fiduciary of a Plan or IRA solely by reason of the provision of investment advice described in ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B), or both, and the applicable regulations, with respect to the Assets involved in the transaction;
- (2) Is an employee, independent contractor, agent, or registered representative of a Financial Institution; and
- (3) Satisfies the applicable federal and state regulatory and licensing requirements of insurance, banking, and securities laws with respect to the covered transaction.

(b) “Affiliate” of an Adviser or Financial Institution means –

- (1) Any person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution. For this purpose, “control” means the power to exercise a controlling influence over the management or policies of a person other than an individual;
- (2) Any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution; and
- (3) Any corporation or partnership of which the Adviser or Financial Institution is an officer, director or employee or in which the Adviser or Financial Institution is a partner.

(c) An “Asset,” for purposes of this exemption, includes only the following investment products:

bank deposits, certificates of deposit (CDs), shares or interests in registered investment companies, bank collective funds, insurance company separate accounts, exchange-traded REITs, exchange-traded funds, corporate bonds offered pursuant to a registration statement under the Securities Act of 1933, agency debt securities as defined in FINRA Rule 6710(1) or

its successor, U.S. Treasury securities as defined in FINRA Rule 6710(p) or its successor, insurance and annuity contracts, guaranteed investment contracts, and equity securities within the meaning of 17 CFR section 230.405 that are exchange-traded securities within the meaning of 17 CFR 242.600. Excluded from this definition is any equity security that is a security future or a put, call, straddle, or other option or privilege of buying an equity security from or selling an equity security to another without being bound to do so.

(d) Investment advice is in the “Best Interest” of the Retirement Investor when the Adviser and Financial Institution providing the advice act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.

(e) “Financial Institution” means the entity that employs the Adviser or otherwise retains such individual as an independent contractor, agent or registered representative and that is:

(1) Registered as an investment adviser under the Investment Advisers Act of 1940 (15 USC 80b-1 et seq.) or under the laws of the state in which the adviser maintains its principal office and place of business;

(2) A bank or similar financial institution supervised by the United States or state, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 USC 1813(b)(1))), but only if the advice resulting in the compensation is provided through a trust department of the bank or similar financial institution or savings association which is subject to periodic examination and review by federal or state banking authorities;

- (3) An insurance company qualified to do business under the laws of a state, provided that such insurance company:
- (A) Has obtained a Certificate of Authority from the insurance commissioner of its domiciliary state which has neither been revoked nor suspended,
 - (B) Has undergone and shall continue to undergo an examination by an Independent certified public accountant for its last completed taxable year or has undergone a financial examination (within the meaning of the law of its domiciliary state) by the state's insurance commissioner within the preceding 5 years, and
 - (C) Is domiciled in a state whose law requires that actuarial review of reserves be conducted annually by an Independent firm of actuaries and reported to the appropriate regulatory authority; or
- (4) A broker or dealer registered under the Securities Exchange Act of 1934 (15 USC 78a et seq.).
- (f) "Independent" means a person that:
- (1) Is not the Adviser, the Financial Institution or any Affiliate relying on the exemption,
 - (2) Does not receive compensation or other consideration for his or her own account from the Adviser, the Financial Institution or Affiliate; and
 - (3) Does not have a relationship to or an interest in the Adviser, the Financial Institution or Affiliate that might affect the exercise of the person's best judgment in connection with transactions described in this exemption.
- (g) "Individual Retirement Account" or "IRA" means any trust, account or annuity described in

Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

- (h) A “Material Conflict of Interest” exists when an Adviser or Financial Institution has a financial interest that could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor regarding an Asset.
- (i) “Plan” means any employee benefit plan described in section 3(3) of the Act and any plan described in section 4975(e)(1)(A) of the Code.
- (j) “Proprietary Product” means a product that is managed by the Financial Institution or any of its Affiliates.
- (k) “Related Entity” means any entity other than an Affiliate in which the Adviser or Financial Institution has an interest which may affect the exercise of its best judgment as a fiduciary.
- (l) “Retirement Investor” means –
 - (1) A participant or beneficiary of a Plan subject to Title I of ERISA with authority to direct the investment of assets in his or her Plan account or to take a distribution,
 - (2) The beneficial owner of an IRA acting on behalf of the IRA, or
 - (3) A plan sponsor as described in ERISA section 3(16)(B) (or any employee, officer or director thereof), of a non-participant-directed Plan subject to Title I of ERISA that has fewer than 100 participants, to the extent it acts as a fiduciary with authority to make investment decisions for the Plan.
- (m) “Third-Party Payments” mean sales charges when not paid directly by the Plan, participant or beneficiary account, or IRA, 12b-1 fees and other payments paid to the Financial

Institution or an Affiliate or Related Entity by a third party as a result of the purchase, sale or holding of an Asset by a Plan, participant or beneficiary account, or IRA.

Section IX - Data Request

Upon request by the Department, a Financial Institution that relies on the exemption in Section I shall provide, within a reasonable time, but in no event longer than six (6) months, after receipt of the request, the following information for the preceding six (6) year period:

(a) Inflows. At the Financial Institution level, for each Asset purchased, for each quarter:

- (1) The aggregate number and identity of shares/units bought;
- (2) The aggregate dollar amount invested and the cost to the Plan, participant or beneficiary account, or IRA associated with the purchase;
- (3) The revenue received by the Financial Institution and any Affiliate in connection with the purchase of each Asset disaggregated by source; and
- (4) The identity of each revenue source (e.g., mutual fund, mutual fund adviser) and the reason the compensation was paid.

(b) Outflows. At the Financial Institution level for each Asset sold, for each quarter:

- (1) The aggregate number of and identity of shares/units sold;
- (2) The aggregate dollar amount received and the cost to the Plan, participant or beneficiary account, or IRA, associated with the sale;
- (3) The revenue received by the Financial Institution and any Affiliate in connection with the sale of each Asset disaggregated by source; and
- (4) The identity of each revenue source (e.g., mutual fund, mutual fund adviser) and the reason the compensation was paid.

(c) Holdings. At the Financial Institution level for each Asset held at any time during each quarter:

- (1) The aggregate number and identity of shares/units held at the end of such quarter;
- (2) The aggregate cost incurred by the Plan, participant or beneficiary account, or IRA, during such quarter in connection with the holdings;
- (3) The revenue received by the Financial Institution and any Affiliate in connection with the holding of each Asset during such quarter for each Asset disaggregated by source; and
- (4) The identity of each revenue source (e.g., mutual fund, mutual fund adviser) and the reason the compensation was paid.

(d) Returns. At the Retirement Investor level:

- (1) The identity of the Adviser;
- (2) The beginning-of-quarter value of the Retirement Investor's Portfolio;
- (3) The end-of-quarter value of the Retirement Investor's Portfolio; and
- (4) Each external cash flow to or from the Retirement Investor's Portfolio during the quarter and the date on which it occurred.

For purposes of this subparagraph (d), "Portfolio" means the Retirement Investor's combined holding of assets held in a Plan account or IRA advised by the Adviser.

(e) Public Disclosure. The Department reserves the right to publicly disclose information provided by the Financial Institution pursuant to subparagraph (d). If publicly disclosed, such information would be aggregated at the Adviser level, and the Department would not disclose any individually identifiable financial information regarding Retirement Investor accounts.

Signed at Washington, DC, this 14th day of April, 2015.

Phyllis C. Borzi,

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

Appendix I Financial Institution ABC - Website Disclosure Model Form

Type of Investment	Provider, Name, sub-type	Transactional			Ongoing			Affiliate	Special Rules
		Charges To investor	Compensation To firm	Compensation To adviser	Charges To investor	Compensation To firm	Compensation To adviser		
Non-Proprietary Mutual Fund (Load Fund)	XYZ MF Large Cap Fund, Class A Class B Class C	[•]% sales load as applicable	[•]% dealer concession	[•]% of transactional fee Extent considered in annual bonus	[•]% expense ratio	[•]% 12b-1 fee, revenue sharing (paid by fund/ affiliate)	[•]% of ongoing fees Extent considered in annual bonus	N/A	Breakpoints (as applicable) Contingent deferred shares charge (as applicable)
Proprietary Mutual Fund (No load)	ABC MF Large Cap Fund	No upfront charge	N/A	N/A	[•]% expense ratio	[•]% asset-based annual fee for shareholder servicing (paid by fund/ affiliate)	[•]% of ongoing fees Extent considered in annual bonus	[•]% asset-based investment advisory fee paid by fund to affiliate of Financial Institution	N/A
Equities, ETFs, Fixed Income		\$(•) commission per transaction	\$(•) commission per transaction	[•]% of commission Extent considered in annual bonus	N/A	N/A	N/A Extent considered in annual bonus	N/A	N/A
Annuities (Fixed and Variable)	Insurance Company A	No upfront charge on amount invested	\$(•) commission (paid by insurer)	[•]% of commission Extent considered in annual bonus	[•]% M&E fee [•]% underlying expense ratio	\$(•) Ongoing trailing commission (paid by underlying investment providers)	[•]% of ongoing fees Extent considered in annual bonus	N/A	Surrender charge

Appendix II Financial Institution XZY - Transaction Disclosure Model Chart

	YOUR INVESTMENT	TOTAL COST OF YOUR INVESTMENT IF HELD FOR:		
		1 year	5 years	10 years
Asset 1				
Asset 2				
Asset 3				
Account fees				
Total				

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