

# U.S. Department of Labor Releases FAQ Guidance on Fiduciary Rules

On October 27, 2016, the U.S. Department of Labor (the "DOL") issued guidance on the recently released fiduciary rules, which generally take effect on April 10, 2017. The guidance is set forth in the form of "frequently asked questions" ("FAQs") and is based on questions received by the DOL following the release of the rules. The DOL is expected to release two additional rounds of guidance before the rules take effect.

As discussed in [our prior client briefing](#), on April 6, 2016, the DOL issued final regulations (the "Final Regulations") re-defining the meaning of the term "investment advice fiduciary" under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986. As widely publicized, the Final Regulations expanded the class of advisers and the scope of investment advice that will be subject to the fiduciary standards set forth under ERISA. In connection with the release of the Final Regulations, the DOL also finalized certain exemptions from the prohibited transaction rules under ERISA, which include, most notably, the "Best Interest Contract Exemption" (or "BIC Exemption"). The BIC Exemption provides relief from ERISA prohibited transaction rules, which otherwise prevent an adviser from receiving variable compensation in exchange for providing investment advice. In order to comply with the BIC Exemption, a fiduciary must conclude that the investment advice is in the "best interest" of the plan or IRA and comply with certain impartial conduct standards and other rules.

The newly released FAQs generally confirm the guidance set forth in the Final Regulations. A summary of certain topics addressed in the FAQs is provided below.

- The DOL confirmed that the BIC Exemption is broadly available for recommendations with respect to all asset categories. Under the proposed regulations, the BIC Exemption was only available with respect to certain identified assets.
- Brokers that are directed to execute a transaction by a plan or IRA generally will not be considered a fiduciary, and, therefore, will not be required to rely on the BIC Exemption.
- The DOL noted that while fees based on a fixed percentage of assets under management ("level fees") do not typically raise prohibited transaction concerns, in certain scenarios such arrangements may involve conflicts of interest. An example cited in the FAQs involves the recommendation of a rollover from a plan into a fee-based account that would generate on-going fees for an adviser. Another example cited as potentially raising prohibited transaction concerns is providing advice to switch from a commission-based account to an account charging fees based on a fixed percentage of assets under management. The DOL noted that it considers potential prohibited transactions issues in these instances to be "discrete" and confirmed that "level fee fiduciaries" may cover off these concerns by complying with the streamlined BIC Exemption.
- An adviser generally may not rely on the BIC Exemption if it has discretionary authority over the assets of a plan or an IRA investor. Advisers, including those who are discretionary fiduciaries, however, may rely on the BIC Exemption when advising a participant to rollover their account to an IRA and may continue to provide fiduciary investment advice after the

rollover. In this instance, the adviser must not have or exercise any discretionary authority or control with respect to the decision to rollover the account.

- Financial institutions generally may utilize incentive compensation to pay advisers while remaining compliant with the BIC Exemption. Such arrangements, however, must be carefully designed and only utilize "neutral factors" - such as the time and complexity associated with making recommendations in different product categories - in determining the appropriate amount of incentive compensation to provide with respect to different investment categories. Under the FAQs, a financial institution must also be careful when using payment grids and insure the operation of the grid does not encourage imprudent behavior (e.g., by paying an adviser more for higher commission funds than lower commission funds).
- The FAQs provide that the use of "back-end" bonus arrangements (which provide outsized bonus payments at certain threshold levels or provide retroactive incentives on past transactions as higher goals are achieved) can create "acute conflicts of interest" due to the "all or nothing" nature of the payments. While these bonuses generally will not be compliant with the BIC Exemption, the DOL is allowing these arrangements to continue to the extent such arrangements were entered into before the release of the FAQs and the remaining time period under such arrangement is reasonable. Such "grandfathered" arrangements must be accompanied by supervision policies that specifically address potential conflicts of interest and that otherwise protect investors.
- Under the Final Regulations, so called "robo-advisers" cannot take advantage of the BIC Exemption. As noted in the FAQs, the DOL's position is that the market place for such advice is evolving and other existing statutory exemptions currently provide relief for such advice. However, a robo-adviser may avail itself of the streamlined BIC Exemption (commonly referred to as "BIC-lite") if the adviser is a "level fee" fiduciary. Accordingly, the less onerous requirements of BIC-lite may be relied upon in certain instances, such as when advising a participant to roll over an account from a plan to a fee-based account.
- Financial institutions can continue to compensate advisers using "front-end" awards, which are awards based on an adviser performing on-going services and remaining in good standing. These awards, unlike "back-end" bonus arrangements, are not viewed by the DOL as promoting inappropriate incentives.
- The DOL clarified that financial institutions may simultaneously offer both "level fee" services (using the streamlined BIC-lite requirements), as well commission-based services, which require compliance with the full BIC Exemption. However, financial institutions may not rely on the BIC-lite rules if the adviser or the financial institution is in receipt of third party payments, such as 12b-1 fees or revenue sharing payments (as the adviser or financial institution will not be considered a "level-fee fiduciary" in such instance).
- In certain instances, a level-fee fiduciary must document the reasons why its advice is in the best interest of the investor. For example, in the case of a recommendation to rollover an account from a plan, the adviser must use "diligent and prudent efforts" to obtain and review information regarding the plan, including plan fees and expenses. In the FAQs, the DOL provides that if an adviser is not able to obtain this information, it may rely on other data such as Form 5500 filings or reliable benchmarks. The DOL counsels that in such a scenario, the adviser should explain the limitations of the data it has received and how it determined such data was reliable.
- The FAQs also addressed questions regarding disclosure requirements under the BIC Exemption. The DOL confirmed that model contracts may be used to satisfy website disclosure requirements, provided that such model contracts contain all mandatory terms of customer contracts and fully reflect the express terms of the executed version of such contracts. The DOL warned that while model contracts may be used, the best practice is for a financial institution to make individual customer contracts available on its website.
- The DOL confirmed that "point-of-sale transaction" disclosures are only required for recommendations to purchase investment products, as opposed to recommendations to hold or sell an investment.
- The BIC Exemption provides prohibited transaction relief for compensation received with respect to investments made before the applicability date of the Final Regulations (or made pursuant to a systematic purchase program entered into

before the Final Regulations). However, such "grandfathered" relief is not available for compensation generated by additional investments in such programs. Instead, the DOL clarified that compensation associated with such additional investments would need to comply with the BIC Exemption, or another exemption, to be afforded relief (the existing money in the program would still be granted grandfathered relief). Additionally, the DOL clarified that relief is available on recommendations to sell grandfathered investments.

- The DOL stated that it will embark on a collaborative approach in the implementation of the Final Regulations by assisting plans, fiduciaries and financial institutions who act in good faith, and noted, that while the DOL has broad authority to monitor compliance with the Final Regulations, it prefers a collaborative approach to resolve violations.

The above discussion is only meant to provide a brief summary of the recent DOL guidance. We will provide further discussion as the DOL releases additional guidance. Please contact Robert A. Stone or Atul Jain of our Employee Benefits and Executive Compensation Group if you would like to discuss these matters further.

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