

PUBLICATION

New Fiduciary Duty Rule: What You Need to Do Now

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On April 6, 2016, the U.S. Department of Labor (DOL) released its Final Fiduciary Duty Rule. The effective date for the rule is June 7, 2016, which is 60 days after its Federal Register publish date of April 8. The rule takes effect in part in April 2017, with full implementation in January 2018.

The rule updates and expands the coverage of the DOL's prior rule governing the obligations of advisers to retirement accounts. As a result, both broker-dealers and investment advisers must re-evaluate the services they provide to clients relating to retirement accounts to ensure compliance with the new rule. These are obviously significant changes that require careful review to ensure compliance. All firms providing covered investment advice will need to amend their policies and procedures to ensure they will be in compliance on or before the effective date of the final rule. Additionally, firms will need to develop other documents, such as new disclosures and contract provisions that will be mandated under the new regulations.

Significant Changes from the Proposed Rule:

It is important to understand that the final rule is different from the proposal. In response to more than 3,100 comment letters and four days of public meetings about the April 2015 proposed rule, the final rule includes several significant changes from the proposed rule. Some of these significant revisions include:

- **Best Interest Contract Exemption:** The BIC Exemption, which allows advisers to continue to collect commissions, is now available for any type of instrument an adviser might recommend, not just those limited instruments listed in the proposed rule. The final BIC Exemption also includes provisions that allow for the recommendation of proprietary products. The DOL streamlined the disclosure requirements in the final BIC Exemption. For example, requirements to include projections, as well as the annual disclosure requirement, have been eliminated in the final rule.
- **Principal Transaction Exemption:** Municipal securities, ABS and new issue securities are still excluded from the list of assets that are allowed under the Principal Transaction Exemption. However, UITs, CDs and agency MBS have been included in the list of allowable assets under the Principal Transaction Exemption.
- **Counterparty Exception:** The final rule also includes a revised version of the "counterparty" carve-out that excludes certain communications with plan fiduciaries from being considered fiduciary investment advice. For example, communications with certain plan fiduciaries who are licensed financial professionals (broker-dealers, registered investment advisers, banks, etc.) or plan fiduciaries who have at least \$50 million under management (as opposed to \$100 million in the proposed rule), will not be considered fiduciary investment advice and thus not subject to the rules, provided certain conditions are met.
- **Education Materials:** The final rule clearly describes the types of information and activities that constitute non-fiduciary investment education, including plan information and general financial, investment and retirement information.

Steps You Should Take Now:

There are several actions firms can take now to prepare for the DOL's fiduciary duty rule implementation.

1. **Review Your Accounts.** The final rule covers recommendations to an ERISA-covered employee benefit plan (Plan) or an Individual Retirement Account (IRA), including Plans, Plan fiduciaries, Plan participants and beneficiaries and IRA owners. Firms should endeavor to identify all such accounts that may trigger fiduciary obligations under the final rule.
2. **Assess Availability of BIC Exemption.** Under the Best Interest Contract (BIC) Exemption, advisers are allowed to continue receiving commission-based compensation so long as they meet specific conditions intended to ensure that the firms mitigate conflicts of interest and that they and their individual advisers provide investment advice that is in the best interests of their customers. The exemption requires the firm to acknowledge fiduciary status for itself and its advisers. The firm and advisers must adhere to basic standards of impartial conduct, including giving prudent advice that is in the customer's best interest, avoiding making misleading statements and receiving no more than reasonable compensation. The firm must also have policies and procedures designed to mitigate harmful impacts of conflicts of interest and must disclose basic information about their conflicts of interest and the cost of their advice. To comply with the BIC Exemption, firms should review and revise their policies and procedures to adhere to the specific requirements set forth in the BIC Exemption and begin the process of revising their customer contracts. If you determine you are not going to attempt to comply with the BIC Exemption, you must then consider alternatives for your customers such as converting them to wrap-fee accounts.
3. **Assess Applicability of Exceptions and Exemptions.** Acknowledging that the proposed categories of investment advice, standing alone, could sweep in certain relationships that are not appropriately considered fiduciary in nature, the DOL included a number of specific carve-outs in its final rule. These exceptions are only available to the extent that the firm does not otherwise acknowledge it is a fiduciary under ERISA. These exceptions from covered investment advice include the following:
 - (i) communications meeting the definitions of investor education and general communications;
 - (ii) certain communications relating to platform providers;
 - (iii) transactions with independent Plan fiduciaries with financial expertise;
 - (iv) communications made by advisers to ERISA-covered employee benefit plans in swap or security-based swap transactions; and
 - (v) certain communications from employees of plan sponsors, affiliates, employee benefit Plans, employee organizations or Plan fiduciaries.

Firms must also assess the prohibited transaction exemptions (PTEs) that are applicable to their business. The final rule amends several existing PTEs that are regularly relied upon by financial services advisers. Additionally, the final rule adds two new PTEs: the BIC Exemption (discussed above) and the Principal Transactions Exemption. The Principal Transactions Exemption permits investment advice fiduciaries to sell or purchase certain recommended debt securities and other investments out of their own inventories to or from Plans and IRAs. As with the BIC exemption, the Principal Transactions Exemption requires, among other things, that investment advice fiduciaries adhere to certain impartial conduct standards, including obligations to act in the customer's best interest, avoid misleading statements and seek to obtain the best execution reasonably available under the circumstances for the transaction.

4. **Review Your Education Materials.** The final rule describes the types of information and activities that constitute non-fiduciary investment education, including Plan information and general financial, investment and retirement information. Firms should review educational materials to make sure they don't cross the line into noncompliance with the final rule.

Additional Assistance:

If you have any questions in the meantime regarding the DOL's Fiduciary Duty Rule or any other securities-related issues, or need assistance in evaluating your company's contracts or policies and procedures, please contact any of the attorneys in Baker Donelson's Broker-Dealer/Registered Investment Adviser group.