DOL’s Fiduciary Re-Proposal: Caveat Venditor or “Death of a Salesman”?

May 18, 2015

I. Overview and Background

On April 14, 2015, the Department of Labor (“DOL”) released its long awaited re-proposal (the “Re-Proposal”) to expand the definition of fiduciary as it applies to the many providers of services to employee benefit plans subject to the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), and individual retirement accounts (“IRAs”) subject to the Internal Revenue Code of 1986, as amended (the “Code”) (collectively “Plans”). The Re-Proposal applies to not just traditional IRA accounts and annuities, but Archer medical savings accounts, health savings accounts, and Coverdell education savings accounts. The Re-Proposal follows an earlier October 21, 2010 proposal (the “Original Proposal”). The Original Proposal was controversial and generated hundreds of comments, including from members of Congress and Senators from both sides of the political aisle. Although the Original Proposal was ultimately withdrawn, it has now been replaced with the Re-Proposal. In the words of one senior DOL official, “obviously, any regulatory project that aims at the fiduciary definition is going to, kind of, right to the core” of ERISA.

The DOL attempts to divide the Plan world into two groups: Plans that may need additional protection and those that do not. Although some may question whether such additional protections are necessary in the first place, to the extent that one agrees with this premise, improvements will likely be requested in where the dividing line is drawn and which rules will be applicable to each group. This Stroock Special Bulletin seeks to describe the framework and provide salient observations with respect to the Re-Proposal.

Under the Re-Proposal, virtually every conversation with a Plan could potentially be deemed to involve tailored investment advice resulting in many service-providers and

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counterparties to Plans ("Market Participants") who have historically not been viewed as fiduciaries now becoming fiduciaries to such Plans. Sales, marketing and market observations may even be deemed to convey individualized investment advice.

Under ERISA, a fiduciary, including an investment advice fiduciary, has a duty to act solely in the best interests of the Plan assets under its charge or advisement. In addition, the fiduciary generally cannot engage in any self-dealing transaction, even if such transaction was in the best interest of the Plan. For example, in general, the fiduciary cannot cause Plan assets as to which it serves as a fiduciary, to pay it or any of its affiliates any direct or indirect compensation. This legal construct has been in effect since ERISA’s enactment in 1974 and makes sense: a “true” advisor providing tailored advice should not be able to use its authority to earn additional compensation – whether or not conflicts are disclosed. The fiduciary must act for the exclusive benefit of its Plan client.

The DOL’s Re-Proposal greatly expands the reach of this long-held legal standard, effectively resulting in the standard presumptively being applied to all sales personnel, investment bankers dealing with institutional Plan clients, brokers, money managers, trustees, and other service providers dealing with Plans, even if the contacts with the Plan are limited. If such a service provider were deemed to be an investment advice fiduciary, it no longer could earn any compensation – directly or indirectly – arising out of that advice. Such persons could no longer generally sell proprietary or affiliated products and services without violating ERISA and the Code, and without likely incurring substantial excise taxes to boot. So if a sales pitch is considered investment advice, then compensation earned through the sale of the product would be in violation of ERISA.

**What Are Some Likely Business Impacts?**

The Preamble to the Re-Proposal indicates that “advisors” (which under the Re-Proposal will include salespersons and other financial professionals dealing with Plans) will be permitted to sell products and services “as long as they are willing to adhere to basic standards aimed at ensuring that their advice [i.e., including sales and other communications] is in the best interest of their customers.” As more fully described in this *Stroock Special Bulletin*, although this statement appears to be fairly innocuous, and even fair-minded, such a characterization of the Re-Proposal is likely over-simplistic.

The Re-Proposal will:

1. Require almost every bank, broker-dealer, futures commission merchant, money manager, trustee, custodian, mutual fund sponsor, call center, record-keeper or other financial institution dealing with Plans to either:
   - Significantly curtail their written and oral communication with Plans and IRAs (including sales, marketing, responding to most requests for proposals and investment education -- if specific products are mentioned);
   - Comply with one or more new exemptions ("New Exemptions") or new conditions for existing exemptions, that Market Participants may find very challenging to administer and comply with; or
   - Restructure what had previously been a non-fiduciary business into a fee-based fiduciary business model.
The Re-Proposal does exclude some transactions but the exclusions are limited to certain selected transactions with Plans with 100 or more participants or Plans with an independent fiduciary having at least $100 Million of employee benefit plan assets under management, as discussed in more detail in this Bulletin.

2. With respect to the New Exemptions, require Market Participants to:

- **Accept ERISA fiduciary responsibility** (even with respect to IRAs which are not subject to ERISA);
- Sign on to certain “best interest” and “material conflict” provisions which, because they provide no bright lines, may have the effect of encouraging Plans to threaten legal action opportunistically;
- **Restructure most current common compensation arrangements** which simply will not work under the Re-Proposal;
- Warrant not to violate any law or regulation—ERISA or otherwise – with respect to the transaction and agree not to limit class action and other lawsuits;
- Agree to, and abide by, **significant disclosures** (both pre- and post-transaction, including certain annual disclosures as well as disclosures on websites) and record keeping requirements.

3. Potentially impact the access that Plans and IRAs will have to desired products and services on a cost-effective basis.

- **There will likely be fewer investment opportunities for smaller Plans and IRAs.** The results of one study suggested that the expanded definition of fiduciary could “well result in hundreds of thousands of fewer IRAs opened per year,” and that “many IRA holders would have reduced choice of investment professionals, as over one-third of client-facing financial professionals in the industry would not be licensed to help retail investors with their IRA account needs . . .”\(^2\)
- **IRAs and many Plans may be forced to move to so-called fee-based or wrap accounts.** However, smaller accounts that could not afford wrap accounts may be left to navigate through a less accessible market environment.
- **The Re-Proposal effectively results in a de facto list of permissible and impermissible products and services for such Plans and IRAs.** The combination of the expanded fiduciary definition and the new proposed exemptions which only apply to specific transactions effectively produces a DOL mandated “ERISA Eligible” (and by omission, ERISA Ineligible) list of products and services. Transactions not enumerated on the list of permissible products, include municipal bonds, equity securities if not traded on a U.S. exchange, options on securities, foreign issued debt, sovereign debt, foreign currency and most foreign denominated assets, alternative investment funds – with purchases of initial public offerings becoming impractical.

4. Limit financial institutions’ sales of debt and other structured products to Plans and IRAs — unless such sales are to Defined Large Plans — and also potentially **complicate mutual fund fees** (even if such fees are internal to the mutual fund and the mutual fund itself is not subject to ERISA (which it would generally not be)). Such mutual fund fees, including, distribution, 12b-1 and other fees, may be affected by reason of the

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\(^2\) **OLIVER WYMAN REPORT, ASSESSMENT OF THE IMPACT OF THE DEPARTMENT OF LABOR’S PROPOSED “FIDUCIARY” DEFINITION RULE ON IRA CONSUMERS** (April 12, 2011), available at [http://www.dol.gov/ebsa/pdf/WymanStudy041211.pdf](http://www.dol.gov/ebsa/pdf/WymanStudy041211.pdf). This study was conducted in the context of the Original Proposal, which envisioned a similar “broker-free” environment but omitted IRAs from its cost benefit analysis.
Re-Proposal’s impact on brokers and other investment professionals that sell such mutual funds.

**Are There Other Important Impacts of the Re-Proposal?**

Yes, in addition, the Re-Proposal would:

- **Limit the availability of the use of certain prohibited transaction exemptions** because a common condition to almost all of these exemptions is that the non-Plan party doing business with the Plan not be a fiduciary with respect to the assets involved in the transaction.

- **Cause persons giving an appraisal, fairness opinion, or similar statement related to a specified transaction to be considered ERISA fiduciaries when dealing with Plans** unless the appraisal, opinion or statement is provided in connection with ESOP employer securities, with respect to pooled Plan asset funds, or for use with Federal or state reporting requirements.

- **Result in those who provide certain information concerning IRA rollovers or Plan distributions to be considered investment advice fiduciaries.**

- **Reduce the scope of investment education that is not deemed to constitute investment advice.** For example, identifying specific products in materials could, under the Re-Proposal, give rise to investment advice (and thus fiduciary) status.

- **Add new conditions to common existing prohibited transaction class exemptions (“PTCE”) such as PTCE 75-1, PTCE 77-4, PTCE 84-24 and PTCE 86-128.**

**Are All Service Providers Now Presumed to Offer Investment Advice Under the Re-Proposal?**

Effectively, in most cases, yes. Under the **existing** standard, a service provider that holds itself out as providing tailored investment advice to Plan clients, which will be relied upon by the Plan, absent special circumstances, should generally expect that it may be deemed to provide investment advice that renders him or her an ERISA fiduciary. Of course, rather than provide tailored advice, a service provider may instead merely sell or offer products. Or it can act as a counterparty to a transaction with a Plan. Or provide investment education, explaining the objective features of one or more given products, and perhaps emphasize the factors that a Plan may wish to consider in making its own decision. Under the existing standard, such acts could be done without resulting in the service provider becoming a fiduciary.

Under the **Re-Proposal**, all service providers are effectively presumed to be providing investment advice, and thus, such service providers would all be viewed as de facto fiduciaries regardless of the quantum or the nature of the communication. Unless a carve-out is applicable, Market Participants would need to consider which new or revised exemptions may be relied on (if any) in order to engage in sales and other products and services that they may now be able to offer to Plans without becoming a fiduciary.

**Are Carve-Outs Available?**

Yes, but the carve-outs are very limited and contain significant restrictions. The Re-Proposal contains limited carve-outs for (1) certain swaps, (2) platform providers that merely offer products and services without providing product specific information, (3) a limited set of transactions with Defined Large Plans and (4) Market Participants
that merely take securities orders, which are discussed in more detail below.

**With the Re-Proposal Containing Such Significant Changes, Will There Be a Transition Period?**

If finalized in its current form, the Re-Proposal would become applicable a mere eight months after publication. Market Participants will need to have made the appropriate changes in compensation, training, systems and other business restructurings that may be required for compliance by that time.

**II. Investment Advice Fiduciary Test**

Under the current standard, a person becomes an investment advice fiduciary by (1) rendering advice as to the value of securities or other property, or making recommendations as to the advisability of investing in, purchasing or selling securities or other property, (2) on a regular basis to the Plan, (3) pursuant to a mutual agreement, arrangement or understanding, written or otherwise, between such person and the Plan or a fiduciary with respect to the Plan, (4) that such services will serve as a primary basis for investment decisions with respect to Plan assets, and (5) that such person will render individualized investment advice to the Plan.

The Re-Proposal changes the existing five-part test by providing that a person is deemed to be an investment advice fiduciary if the person (1) provides a recommendation as to the advisability of acquiring, holding, disposing or exchanging securities or other property, or a recommendation as to the management of securities or other property, including a recommendation to take a distribution of benefits, recommendation as to the investment or management of securities or other property to be rolled over or otherwise distributed from the Plan or IRA, an appraisal or a recommendation of persons to provide the foregoing recommendations or appraisals and (2) the person directly or indirectly (e.g., through or together with any affiliate) represents or acknowledges that is acting as a fiduciary with respect to the types of investment advice described above; or renders the advice pursuant to a written or verbal agreement, arrangement or understanding (even if not mutual) that the advice is individualized to, or that such advice is specifically directed to, the advice recipient (either the Plan fiduciary, participant or beneficiary) for consideration in making investment or management decisions with respect to securities or other property of the Plan or IRA.

**Analysis—the “Sneeze” Test**

The Re-Proposal would eliminate the current requirements that, in order for investment advice to give rise to fiduciary level status, the investment advice be a primary basis for an investment decision, that the advice be pursuant to a mutual agreement, and that the advice be provided on a regular basis. As a result, any recommendation issued on an understanding by the Plan that the Plan believes is individualized, or an arrangement specifically directed to a Plan (which may not need to be individualized) could now result in the Market Participant being a fiduciary to a Plan.

There need be no reliance by the Plan – not even some quantum less than “a” primary basis for an investment decision—a standard which already gave Plans tremendous power to pursue remedies. “Recommendation,” in turn, means any communication that, based on its content, context and presentation would reasonably be viewed as a
“suggestion” that the “advice” recipient engage in or refrain from taking any particular action. Note that a “recommendation” has really been converted to a “suggestion.” If the Plan is considering whether it wishes to allocate more money to U.S. equities or foreign bonds, is it problematic if a Market Participant “suggests” that a Plan read the Wall Street Journal to review returns and other information?

Consider, for example, the following: A client approaches an investment professional with her own personal account, her child’s trust accounts, and her IRA. Assume further that the investment professional provides a “recommendation” (as defined expansively under the Re-Proposal) to the client that the investment professional intends will relate solely to the non-IRA accounts, but does not communicate that limitation to the client. Finally, assume that without the investment professional’s acquiescence, the client takes the recommendation and then uses it for her IRA. Is the investment professional now a fiduciary with respect to her IRA? It would seem this is possible, given the Preamble’s “[t]he parties need not have a meeting of the minds on the extent to which the [Plan] will actually rely on the [“advice”].” Instead, the threshold is that “the [“advice”] is individualized or specifically directed to [the client].” The deletion of the “mutual” prong of the current standard would appear to unfairly empower the Plan at the expense of the Market Participant.

And what about a Plan that sends out a request for proposal (“RFP”) for investment management services and asks common questions such as the manager’s style, experience, personnel, staffing, compliance and controls and other pertinent information that the Plan decides is “individualized” to its needs. Does responding to the RFP cause the investment manager to be an investment advice fiduciary with respect to the offering of its own services? Is the response “specifically directed” to the requestor?

Similarly, if there is a conversation between a broker and an IRA’s owner concerning various mutual fund products, could the broker be deemed to have “acknowledged” fiduciary status unwittingly? This becomes all the more important because, as the Preamble notes, “[n]one of the carve-outs apply where the [investment professional] represents or acknowledges that it is acting as a fiduciary under ERISA with respect to the advice.” When does a nod of the head in a face-to-face conversation become an acknowledgment?

Because there is no “mutual” agreement requirement as there is under current law, the Re-Proposal invites the Plan client to define the nature of the investment relationship. The consequences of removing the mutuality condition under the Re-Proposal is that the Plan would now be able to make its own, unilateral determination that the Market Participant is acting as a fiduciary – even if the Market Participant does not believe that it is acting as such. While a Market Participant should not be able to claim in “fine print” that it is not providing advice when the facts clearly indicate otherwise, courts in the past have shown significant success in getting beyond the fine print to look at the facts and circumstances of any given relationship. At a minimum, to avoid the very real concern of permitting parties to later re-characterize the nature of a relationship opportunistically, it would seem that if the DOL were not to reinstate the “mutuality” condition, there should at the very least be a requirement of
meaningful reliance on the part of the Plan to confer investment advice fiduciary status.

ERISA has historically stressed the facts and circumstances for determining fiduciary status. As one ERISA case stated “[w]hether or not an individual or entity is an ERISA fiduciary must be determined by focusing on the functions performed, rather than the title held.” At the end of the day, the Re-Proposal appears to signal the abandonment of a functional approach in favor of a presumptive approach. This departure, however, would appear to be consistent with one of the stated aims of proponents of the Re-Proposal, at least as articulated in the lead up to its release:

“If the Department gets the rule right, you won’t have to try to figure out whether your financial “adviser” is really a salesman looking out for his or her own interests or a true adviser looking out for yours.” [Emphasis supplied].

Investment Education: Does it No Longer Make the Grade?

No less important are revisions to Interpretive Bulletin (I.B.) 96-1 which would render commonly understood concepts of investment education to become investment advice as detailed on Chart II. Under existing guidance issued in 1996, certain information including (1) Plan information, (2) general financial, investment and retirement information, (3) asset allocation models, and (4) certain interactive general materials, can be provided to Plan participants without the provider of such information becoming an investment advice fiduciary. The Re-Proposal adds a condition that the information and materials offered must not contain specific products, specific investment managers or other specific property. Such a condition will likely disrupt many established sales and educational practices. In addition, one could argue that limiting the universe of investment education could have the result of decreasing important and needed information for Plans, participants and beneficiaries. The Re-Proposal provides that the following types of investment education will not be deemed investment advice but only where specific identifiable product or manager information is not used:

- **General Investment and Financial Information.** “Information and materials on financial, investment and retirement matters that do not address specific investment products, specific plan or IRA alternatives or distribution options available to the Plan or IRA or to participants, beneficiaries and IRA owners, or specific alternatives or services offered outside the Plan or IRA.”
- **Asset Allocation Models.** “Information and materials (e.g., pie charts, graphs, or case studies) that provide a plan fiduciary, participant or beneficiary, or IRA owner with models of asset allocation portfolios of hypothetical individuals with different time horizons (which may extend beyond an individual’s retirement date) and risk profiles, where: . . . such models do not include or identify any specific investment product or specific alternative available under the plan or IRA . . . .”
- **Interactive Materials.** “Questionnaires, worksheets, software, and similar materials which provide a plan fiduciary, participant or beneficiary, or IRA owners the means to estimate future retirement income needs and assess the impact of different asset allocations on retirement income . . . Where . . . [t]he materials do not include or identify any specific

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Thus, for example, asset allocation models, which many Market Participants utilize to help Plans consider investment alternatives, could no longer include or refer to any specific investment product. All models of returns and comparisons would need to be based on hypothetical products with the Plan client left, presumably, to research on its own any specific products. Under such an approach, it would appear that Market Participants either place a great deal of faith in Plans’ abilities for conceptual abstraction, or assume that the Plans will undertake additional research at their own cost. The DOL appears to believe that “even when accompanied by a statement as to the availability of other investment alternatives, these types of specific asset allocations that identify specific investment alternatives function as tailored, individualized investment recommendations, and can effectively steer recipients to particular investments, but without adequate protections against potential abuse.” Current practices of providing investment options for illustrative purposes, even if accompanied by disclaimers that other investments with comparable risk and reward profiles may be offered by other institutions, would no longer comply with the requirements of investment education under the Re-Proposal. For example, a recordkeeper or broker-dealer that uses interactive materials or written presentations to Plans with a variety of different scenarios, each populated with specific (and often very different) products would likely no longer be permitted to do so.

The changes to this long-held guidance may appear curious, particularly because the DOL has expressed the goal of facilitating financial literacy. The net effect of these substantial changes may be to chill investment firms’ appetite to provide any sort of investment education that could be viewed as crossing the line. Notably, the DOL also expressly declined to exempt “call centers” from the definition of investment advice.

**Appraisals**

With limited exclusions, persons who provide “appraisals” or “fairness opinions” as to securities or other property in connection with a transaction will be deemed to be investment advice fiduciaries under the Re-Proposal. The Re-Proposal excludes appraisals or fairness opinions with respect to employer securities for ESOPs, securities or property held by pooled vehicles deemed to constitute Plan assets, or who provide such appraisals for compliance with ERISA, the Code or other Federal and State regulatory purposes. Since the exclusion only appears to apply to cover pooled vehicles in which one or more unaffiliated Plans are invested, presumably master trusts would not benefit from the exclusion. Further, it is unclear what the policy distinction is for not covering master trusts. It is likely that at least some ordinary course periodic statements and reports to Plan participants, beneficiaries or IRA owners, will also result in investment advice fiduciary status.

Real estate appraisers, certain broker-dealers, valuation agents, and other financial Markets Participants, including, in some instances, and depending on the facts of the transaction or service provided, trustees and custodians, may find themselves to be investment advice fiduciaries under the Re-Proposal.
Read most broadly, it is uncertain whether periodic statements provided by Market Participants for reasons other than Federal and state regulatory legal purposes would technically be excluded from an “appraisal” characterization. This was a concern expressed in comments concerning the Original Proposal. Noticeably, the Preamble indicates that “[t]he carve-out was broadened in this proposal to include valuations provided solely for purposes of compliance with the reporting and disclosure provisions under the Act, the Code, and the regulations, forms and schedules issued thereunder, or any applicable reporting or disclosure requirement under a Federal or state law, or rule or regulation or self-regulatory organization (e.g., FINRA) without regard to the type of asset involved” because the Original Proposal excepted only “disclosure requirements of ERISA, the Code, and the regulations, forms and schedules issued thereunder.”

Rollovers

The Re-Proposal now makes clear that information concerning IRA rollovers will be considered investment advice. While a notice simply describing distribution alternatives from a Plan should not be picked up by this provision, the Re-Proposal does not address when information regarding distributions and rollovers is advice rather than education. If a Market Participant indicates that it simply has rollover accounts, is that enough to render it an investment advice fiduciary? Many service providers have historically offered helpful information to Plan participants as they work through important choices relating to their retirement account balances. Notably, the Financial Industry Regulatory Authority (“FINRA”) issued Notice 13-45 in December 2013, which “remind[ed] firms of their responsibilities when (1) recommending a rollover or transfer of assets in an employer-sponsored retirement plan to an [IRA] or (2) marketing IRAs and associated services.” While FINRA’s proposal engendered several interpretative questions, including about its scope, it did not presume that all communications concerning rollovers would give rise to an ERISA investment advice fiduciary duty, or any other investment advisory duty, nor suggest that it should.

At the end of the day, this change in effectively casting rollover communications as per se investment advice will likely affect many Market Participants, including broker-dealers, call centers, investment managers and record-keepers, who may be concerned that simply describing the relative tax and other objective (or even factual) differences that may be present between a given Plan and an IRA (i.e., the products that are offered under the Plan versus the products and services that may be made available under an IRA) will be enough to confer investment advice fiduciary status. It is possible that many individuals considering a rollover may not obtain even basic information for fear by the Market Participant of a fiduciary taint.

Finally, even if one provides “investment advice” in connection with a rollover, it is not clear if any prohibited transaction exemption (including the New Exemptions) would cover fees associated with the IRA (e.g., account maintenance fees etc.)—a result which could leave many IRAs and Market Participants more rocked than rolled.

III. Carve-outs

As mentioned above, the Re-Proposal carves out certain limited transactions from investment
advice fiduciary status. Each of these carve-outs is described in more detail below.

**Counterparty Transactions with Defined Large Plans**

In order to rely on this carve-out, a financial institution must be dealing with (1) a Plan with 100 or more participants which is managed by a fiduciary with management and control over the assets of the Plan which is independent of the counterparty or (2) a Plan that is represented by a fiduciary with management and control over the assets of the Plan and that is independent of the counterparty which has—or the counterparty knows or reasonably should know has -- at least $100 Million in “benefit plan” assets under management (a “Defined Large Plan”). Note, IRAs are excluded from the definition of Defined Large Plan.

In order to rely on the Defined Large Plan carve-out, a financial institution must:

- Be engaging in a counterparty transaction **in an arm’s length sale, purchase, loan or bilateral contract** or be proposing to enter into such a sale, purchase, loan or bilateral contract;

- **Not receive a fee or other compensation** directly from the plan, or plan fiduciary, **for the provision of investment advice (as opposed to other services)** in connection with the transaction.

- Receive an **up-front written representation** from an independent plan fiduciary that the fiduciary is acting for the Plan (unless the institution knows or reasonably believes that the independent fiduciary has at least $100 Million in benefit plan assets under management);

- If the institution knows or reasonably believes that the independent fiduciary has at least $100 Million in benefit plan assets under management, fairly informs the independent fiduciary of the existence and nature of the institution’s financial interests in the transaction, or, if the Plan has 100 or more participants, fairly informs the independent fiduciary that the institution is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity and knows or reasonably believes that the independent fiduciary has sufficient expertise to evaluate the transaction.

The Fact Sheet accompanying the Re-Proposal indicates that this carve-out is intended to exempt “large employer-based plans [that] are managed by financial experts who are themselves fiduciaries” because such fiduciaries have a “duty to look out for the participants’ best interest.” In light of the DOL’s reasoning behind this carve-out, the DOL should be receptive to comments and clarification consistent with this aim. In this regard, below are just a few points for which further clarification may be sought:

- How and when will it be determined whether a Plan meets the requisite number of participants? For example, with respect to a platform on which a Plan trades periodically, does a Market Participant need to assure that on or prior to entering into each and every “buy” or “sell” of any given position that the Plan in question had 100 or more participants? What happens when a Plan with over 100 participants is divided because of a corporate spinoff resulting in at least one of the Plans falling below 100? Presumably, representations from the Plan at the time of the initial entering into of any contract would be dispositive.
• How does the 100 or more participant test apply to master trusts, where, for example, the trust contains the assets of multiple Plans, all sponsored by a common or affiliated company, only some of which technically have 100 or more participants?

• What type of benefit plan assets are included in the determination of $100 million of benefit plan assets under management? Is it limited to just Plans and/or IRAs? Notably, the asset requirement is different than the asset requirement for being a qualified professional asset manager ("QPAM") which is based on $85 million of assets under management and refers to total third party assets not just benefit plan assets under management.

A Better Boundary?

Although the DOL is on the right track of identifying those large “already-protected” Plans as being appropriate for a carve-out, the DOL could define that universe differently. For example, perhaps the DOL could include that any Plan represented by a large, sophisticated entity that would be able to meet the QPAM assets under management test ($85 Million of total assets under its authority), and Plans able to rely on one or more commonly used investor-based exemptions – such as PTCE 84-14, PTCE 90-1, PTCE 91-38, PTCE 95-60 or PTCE 96-23 – as eligible for the carve-out, as Plans are presumed to work with someone with sophistication having a “duty to look out for the participants’ best interest.”

With respect to IRAs and Plan participants, perhaps the DOL could take the Securities and Exchange Commission’s long standing characterization of “accredited investor” as presumptive of a level of sophistication not warranting either additional protection or diminution in the availability of products and services. Perhaps using that demarcation, along with an acknowledgment in writing that the Plan or IRA owner understands that the Market Participant is not acting as its fiduciary, would better allocate the relative costs and benefits associated with the Re-Proposal.

Given that the Fact Sheet to the Re-Proposal is predicated on providing relief to the “many middle-class families, and especially IRA owners, to advice that may not be in their best interest,” there should likely be some reasonable standard of distinguishing among Plan and IRA owners who meet other presumptive tests of financial literacy and commercial sophistication. As the Fact Sheet implies, one might suggest that such a line be drawn somewhere within a middle income level that is presumed to have sufficient financial understanding. After all, if such individuals are able to understand that the “automotive specialist” who sells them their car is not their “car advisor fiduciary,” much the same ought to be true of individuals with some level of sophistication with respect to the investment professionals with whom they come into contact and who make it clear that they are not acting as fiduciaries.

Availability to Investment Advice Recipient Fiduciaries

Because this Defined Large Plans carve-out relates to assets under management, it does not appear to apply to consultants – even those who would be viewed as investment advice fiduciaries – and even where such consultants have substantial assets under advisement. Extending this carve-out to such consultants – who, if not already subject to ERISA’s broad best interest and prohibited transaction rules, would likely be deemed to be so
by reason of the Re-Proposal – could also be consistent with the policy behind this carve-out.

Similar concerns could apply to institutions that provide services to investment advice fiduciaries. Take, for example, a provider of analytics to a financial institution, that in turn provides investment advisory services to its clients – including to Plans. Assume further that in the case of Plans, the financial institution receiving the analytics is (or will be by virtue of the Re-Proposal) an investment advice fiduciary. Often times analytics providers do not even know how the materials they provide will be used (indeed, whether there are any Plans involved at all), but assume that in this hypothetical, the analytics provider had some knowledge that the recipient institution might then provide the information to Plan and non-Plan accounts. Could the analytics provider’s sale of its materials fall outside of the carve-out because the recipient financial institution is only an investment advice fiduciary and does not have management and control over any Plans involved? If so, and it is not clear that it is so, the net effect may be to limit such helpful materials to those fiduciaries who interact directly with Plans. Given that there is already a fiduciary responsible to act under ERISA (i.e., the advice recipient hiring the analytics provider), such a result would appear unnecessary. In an attempt to remove any doubts, the DOL could assure that the sale of products and services to a fiduciary – whether by reason of providing investment advice or discretionary management (especially a large or sophisticated one) – would not itself confer fiduciary authority, absent an agreement by the parties in writing to the contrary.

Written Contracts

As a practical matter, the requirement of a prior written representation may prove challenging and perhaps unduly burdensome. As the DOL was made aware during the process of its release and inclusion of comments occasioned by its Section 408(b)(2) disclosure regulations, some businesses simply do not employ written contracts, and to do so would be extremely burdensome and operationally inefficient. Further, given the extensive breadth of the terms “recommendation” and “investment advice” under the Re-Proposal, many institutions may be concerned that any written or oral communication they may have with a client could be construed as either a recommendation or investment advice. Because the Defined Large Plan carve-out requires that the written comfort be provided “prior to” the provision of any newly-deemed investment advice, it will likely force Market Participants to require an up-front contract in advance of any prefatory substantive conversations. Absent any changes, one could expect a chilling effect on even the most introductory of conversations. Ultimately, such actions could have a detrimental effect for the Plans.

Of course, many contracts come in multiple parts and can serve or cover a number of different products and services. One potential challenge to satisfying the contract requirement is that it may never be clear which among these many contracts is the “right” contract that would need to be executed in advance of the provision of any pre-trade “recommendation.” If one contract is executed in advance of the counterpart that has the
necessory provisions, could any pre-trade “recommendations” fall outside of the carve-out? Such a requirement could put undue pressure on Market Participants as to the ordering of the execution of documents, a detail that may be unnecessary in light of the purported sophistication assumed by those Plans able to take advantage of this carve-out.

Waiter, I’d Like Some Service(s) Here!

Could the carve-out be read to include principal transactions, but exclude services? This gap was highlighted in comment to the “Sellers’ Exception” under the Original Proposal. Failing to include “services” might mean that a futures commission merchant facing an otherwise highly sophisticated Plan, even if represented by a large independent QPAM, could fall outside this carve-out for futures transactions executed on an agency basis. Other services, such as custody, and investment banking, may also not fit squarely within the carve-out under such a reading. Could it also mean that an investment manager cannot sell its investment management services to a Defined Large Plan, by, say, responding to an RFP?

Although it is doubtful that the DOL was consciously trying to preclude agency transactions in futures contracts – particularly because, for example, comparatively more complicated instruments such as swaps are excluded under a separate carve-out – further clarification of this point would be helpful. Similarly, one would expect that the DOL did not mean to limit the Counterparty carve-out to prevent a service provider from selling its own investment management services – particularly because one would expect that the DOL views with favor Market Participants that affirmatively wish to assume fiduciary responsibility and live under both ERISA, and as applicable, the Code. The DOL may wish to separately clarify that conversations or materials in connection with or leading to selling one’s services to a Plan for fiduciary work, should be excepted, along with other ongoing client relation-related conversations in connection with the maintenance or expansion of an existing fiduciary relationship.

Not Receive a Fee in Connection with the Transaction

The Preamble to the Re-Proposal notes:

The changes are designed to ensure that the carve-out appropriately distinguishes incidental advice as part of an arm’s length transactions with no expectation of trust or acting in the customer’s best interest, from those instances of advice where customers may be expecting unbiased investment advice that is in their best interest . . . [The S]eller’s carve-out is unavailable to an adviser if the plan directly pays a fee for investment advice. If a plan expressly pays a fee for advice, the essence of the relationship is advisory, and the statute clearly contemplates fiduciary status. Thus, a service provider may not charge the plan a direct fee to act as an adviser, and then disclaim responsibility as a fiduciary adviser by asserting that he or she is merely an arm’s length counterparty. [Emphasis supplied].

This is likely intended to make clear that where an institution provides investment advice and then provides counterparty transactional execution, the institution would not be able to disclaim fiduciary status with respect to the “paid for” advice and transactions that may then flow from it. Institutions that provide investment advice to Plans...
in one context and then effect transactions elsewhere arising out of that advice will need to carefully consider the implications of this condition.

The Value of Information Flow

Of course, although some commercial relationships are of limited duration, many often involve the sale of both products and services that may be affected over time. Many sophisticated Plans have long-standing relationships with Market Participants in which Market Participants offer thought leadership. Often times, additional insights, ideas, views on market and other developments and the like, are offered as an additional benefit to existing clients without any compensation or linkage to further business, but rather as a matter of good business sense. Goodwill being goodwill, such insights and materials are not “priced” into a given product or service and they are not included in any contract (e.g., “with your purchase you also receive 10 free consultations and an oil change”) because they are not viewed as such. Indeed, they often are provided on an ad hoc basis. Although the carve-out indicates that there must be a counterparty transaction, or that the Market Participant be “proposing” to enter into such a counterparty transaction, concerns could arise that some of this information could somehow technically fall outside a literal reading of the carve-out if the term “proposing” is construed narrowly. No doubt, commentators will make the point that it should not be – particularly in the context of Defined Large Plans, where sophistication is presumed – but the concern remains.

Similarly, communications and ideas that may be presented to a Defined Large Plan for consideration relating to a Defined Large Plan carve-out transaction in one year but which the Plan decides to effect in a future year should also be afforded the benefit of the carve-out. Idea generation is often a two way street, and many Market Participants and Plans—particularly Defined Large Plans—regard the dynamic exchange of ideas essential to capturing value. One would expect that the Defined Large Plan carve-out be clarified to assure that sophisticated Plans continue to receive the benefit of such idea exchanges without any unnecessary chill.

Swaps

In 2013, the DOL issued a much anticipated advisory opinion that clarified certain aspects of ERISA as applied to the newly evolving world of cleared swaps mandated by the Dodd-Frank Act and regulated by the Commodity and Exchange Act (“CEA”) and Securities Exchange Act (“Exchange Act”). Advisory Opinion 2013-01A indicated that clearing brokers would not be deemed to exercise fiduciary authority to the extent they exercised certain close out rights that might be anticipated by the governing agreements to the swap, and provided the underlying transaction was governed by an applicable prohibited transaction exemption.

The Re-Proposal provides deference to the Dodd-Frank regulatory framework. However, although it is clear that this carve-out applies to bilateral swaps, it is not clear whether this carve-out technically applies to cleared swaps. Because the carve-out refers only to “bilateral” swaps, it is possible to conclude that the carve-out doesn’t

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References to “Dodd-Frank” and the “Dodd-Frank Act” herein are to the Dodd-Frank Wall Street Reform and Consumer Protection Act (2010).
cover such transactions, since a cleared swap involves not only an ultimate counterparty but also several other intermediaries, some of whom may act as agent for the Plan. And, yet, providing comfort that a clearing broker was not a fiduciary by reason of the exercise of its rights in respect of a cleared swap was a central point of Advisory Opinion 2013-01A.

Independent of this concern, it is also important to note that the carve-out refers to swap transactions between a Plan and a “counterparty.” However, a clearing broker may or may not be the same entity as the counterparty. No less important is the fact that the carve-out only appears to apply to Plans as defined in Section 3(3) of ERISA, which does not include pooled vehicles subject to ERISA’s fiduciary responsibility provisions, such as bank collective trusts or Plan asset hedge funds. It is assumed that this omission was unintentional as there is no policy reason to differentiate between single Plans and Plan asset vehicles for this purpose.

There are likely good reasons why these omissions are likely unintentional – even though their correction is equally important – especially when viewed against the backdrop of recent history. In addition to the 2013 swaps relief concerning clearing brokers (among other items), there were separate concerns about whether compliance with Dodd-Frank’s Business Conduct Rules would compel violations of ERISA – specifically, whether “recommendations” as broadly defined under those rules would be considered “investment advice” under ERISA.

The DOL had in the past helpfully indicated through a letter to the Commodity Futures Trading Commission (“CFTC”) that it would not confer fiduciary authority under the existing fiduciary standard “solely” by reason of compliance with Dodd-Frank’s Business Conduct rules. One would presume that the Re-Proposal did not intend to limit that position or otherwise limit Plans’ access to swaps contrary to Congress’ clear intent under Dodd-Frank. Consistent with such an intent, the same letter to the CFTC indicated that the DOL was committed to:

[E]nsuring that any changes to the current ERISA fiduciary advice regulation are carefully harmonized with the final business conduct standards, as adopted by the CFTC and the SEC, so that there are no unintended consequences for swap dealers and major swap participants who comply with these business conduct standards. [Emphasis supplied].

In addition, the Preamble to the Final Business Conduct Rules promulgated by the CFTC indicated that:

[The CFTC] understands from the DOL that compliance with the business conduct standards statutory provisions and [CFTC] rules will not, by itself, cause a swap dealer or major swap participant to be an ERISA fiduciary to an ERISA plan. . . . Thus, the [CFTC] has determined that issues and concerns raised by commenters regarding ERISA requirements have been addressed appropriately.  

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7 In a letter to CFTC Chairman Gary Gensler dated April 28, 2011, Assistant Secretary Borzi noted that “[t]he Department’s proposed regulation is not broadly intended “to impose ERISA fiduciary obligations on persons who are merely counterparties to plans in arm’s length commercial transactions.” It also noted that “the proposed DOL regulation is not
Because the DOL indicated that it did not wish to “upend” counterparty expectations of not being deemed to act as fiduciaries, one would expect comments on the Re-Proposal to seek some clarification on this carve-out.

**Platform Providers Only**

Institutions that only market and make available platforms of investment alternatives such as mutual funds, bank collective funds, and other products to Plans that are selected and monitored by a Plan fiduciary, will not be deemed to be “investment advice” fiduciaries. A similar carve-out is for persons who “merely identif[y] investment alternatives that meet objective criteria specified by the Plan fiduciary (e.g., stated parameters concerning expense ratios, size of fund, type of asset, credit quality)” or that “merely provide[ ] objective financial data and comparisons with independent benchmarks to the Plan fiduciary.” This exception, however, does not apply to IRAs or Plan participants.

Clarification may also be sought as to the limitations of the carve-out. “Merely identify” is a very narrow standard. Could the provider include performance reports or other objective materials? Could it use its own benchmarks, if broadly available? Or would the platform provider not be able to update performance or provide objective metrics and other tools unless specifically directed by the Plan fiduciary?

**Order Taker Only**

The Fact Sheet and the Preamble make clear that merely taking an order from a Plan to fill or execute a securities transaction will not be considered investment advice and the broker will not be considered an investment advice fiduciary. However, it is not always so simple. Conversations often are dynamic, and what begins as a sales direction may lead to questions from the Plan and answers “directed to” the Plan. These may give rise to inadvertent investment advice fiduciary status, and brokers and other Market Participants will need to be very careful in their conversations with Plans to avoid such inadvertent fiduciary status:

As under the current rules, _when a customer calls a broker and tells the broker exactly what to buy or sell without asking for advice_, that transaction does not constitute investment advice. In such circumstances, the broker has no fiduciary responsibility to the client.\(^8\) [Emphasis supplied].

Employees

A limited carve-out to the investment advice fiduciary standards applies to employees of the Plan sponsor to the extent the employee provides investment advice or related services. For this carve-out to apply, the employee must not receive any additional compensation for services with respect to the Plan. Plan sponsors will want to consider the application of this carve-out, particularly with respect to those employees whose functions do not solely consist of providing Plan related administration or other assistance with Plan fiduciaries.

IV. Exemptions New and Old

If a financial institution does not fit within one of the carve-outs and has communications with Plans that may be presumed to rise to the level of investment advice, it must then rely on one or more prohibited transaction exemptions to conduct business with a Plan. The DOL’s Re-Proposal includes two New Exemptions and changes to many other common exemptions.

While it is too early to determine, it would not be surprising if financial institutions find that the two New Exemptions prove too burdensome to even attempt a maiden voyage. For example, the principal effect of the Principal Transaction Exemption, described below, may well be to cause Market Participants not to rely on it at all, and instead “trade away.” Trading away, of course, is likely costlier for the Plan. Similar challenges associated with the Best Interest Contract Exemption (the other of the two New Exemptions) may cause many Market Participants to convert their businesses to a fee-based fiduciary or wrap-fee model.

With slight variation, central to all of these exemptions is the concept of Impartial Conduct Standards. This standard requires that the institution and individual representative act in the best interest of the Plan – including with the care, skill, prudence and diligence typically exercised by ERISA fiduciaries – but without regard to the financial or other interests of the financial institution and individual representative. This standard calls to mind an ERISA observation by one of the nation’s leading legal thinkers, Supreme Court Justice Stephen Breyer:

. . . there’s something I’m missing in how this statute [ERISA] works. My difficulty is probably something very basic. I don’t understand how the -- you read the statute, and it seems to say you can’t buy services from somebody who sells you services. . . . It seems to say you can’t buy computers from a computer servicing company. . . . It seems to say you can’t buy investments from a stockbroker, and yet I thought that’s their job. And so there’s something basic I’m not understanding.9

In that case, Justice Breyer did not have the benefit of considering the prohibited transaction exemptions (such as PTCE 75-1) which would permit stockbrokers to “do their job.” Oddly enough, however, his observations could find a conceptual home as applied to the Re-Proposal because the net effect of the conditions of relief to the exemptions necessary for people to “do their job” is that they may not be able to.

It is important to note that these New Exemptions provide relief only under the self-

dealing prohibited transaction provisions under ERISA and the Code. And because several existing prohibited transaction exemptions will be changed or revoked under the Re-Proposal, it may be that for certain transactions covered by these New Exemptions, additional relief would still be required under another exemption for “per se” prohibited transactions under Section 406(a) of ERISA – such as Section 408(b)(2) of ERISA, which in turn requires not only certain substantive requirements but also detailed disclosure conditions.

A summary of the elements of this standard and some observations are detailed below. As with many other aspects of the Re-Proposal, many questions remain unanswered. The Impartial Conduct Standards raise concerns, for example, that any sale of proprietary or affiliated product would have a difficult time overcoming a presumption that the individual did not act in the Plan’s best interest if, say, another third party offered a comparable product at or near the same cost. This would appear to be the case even if the affiliate’s product was at an objectively reasonable cost to the Plan. Separately, could a Market Participant have a difficult time merely offering its own product where there is no comparable product, or one that is offered by a third party but at a higher price, because the “advice” must be provided without regard to the financial or other interests of the individual representative, financial institution or affiliates?

<table>
<thead>
<tr>
<th>Impartial Conduct Standards</th>
<th>Requirements</th>
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<tbody>
<tr>
<td>Provide advice that is in the best interest of the Plan including 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 Plan, without regard to the financial or other interests of the individual representative, financial institution, affiliate, or any other party.</td>
<td>Standards may be sufficiently vague as to invite potential opportunistic legal challenges by Plans. Although ERISA Plans are currently subject to the “care, skill, prudence and diligence” standard, IRAs are not. The incorporation of this standard here results in the extension of the ERISA statutory standard to IRAs. The representation with respect to the total compensation to be received is an ongoing representation raising many challenges. • Many institutions may find this condition alone a dangerous precedent: usually a client needs to make a determination whether compensation is reasonable.</td>
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<tr>
<td>Not sell a product unless all compensation (or in the case of the Principal Exemption, the sale price) received in connection with the transaction is reasonable compensation in relation to the total services provided to the Plan.</td>
<td></td>
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<tr>
<td>Requirements</td>
<td>Comments/Observations</td>
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<tr>
<td>Statements about the products and services offered, fees, “Material Conflicts” “and any other matters relevant to a Plan's investment decisions” will not be misleading.”</td>
<td>• There are many interpretative issues with the “reasonable compensation” requirement, particularly as it intersects with a “best interest” standard. For example, can an institution satisfy both the “reasonable compensation” and “best interest” standard if it wishes to recommend mutual fund A over mutual fund B, where mutual fund A has better performance and has a lower “all in” cost to the Plan, but where mutual fund B pays the institution slightly less than the revenue share in fund A?</td>
</tr>
<tr>
<td>“Material Conflict” exists when a person has a financial interest that could affect the exercise of his best judgment in rendering advice.</td>
<td>• Equally, does the “without regard to the financial interests of . . .” raise similar independent concerns?</td>
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<tr>
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<td>• Could a Market Participant demonstrate compliance with either prongs of the standard by selling its affiliate’s product?</td>
</tr>
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<td>• “Reasonable in relation to total services” is yet another potential slippery slope. Does this mean a Plan cannot buy best-in-class mutual funds that has a de minimis sub-TA fee because the Plan does its own sub-accounting?</td>
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<td>• It is unclear if the DOL is attempting to include the adoption of the ERISA fiduciary standard rules under Section 404 of ERISA so as to provide it with Section 409 excise tax powers on counterparties.</td>
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Note that the definition of “Material Conflict” is substantially similar to 29 CFR 2550.408b-2(e) (“may affect” vs. “could affect”). This also assumes that the institution is able to both identify and develop mitigation procedures for any such “could affect best judgment” conflicts.

**QUERY:** Does disclosure cure the conflict?
Compensation

As part of the policies and procedures required to be adopted to avoid Material Conflicts the DOL focuses extensively on the nature and structure of compensation. The Preamble to the Re-Proposal includes five examples of “broad approaches to [individual employee] compensation structures that could help satisfy the contractual warranty regarding the policies and procedures [concerning Material Conflicts]” and also components of effective policies and procedures an institution could consider in respect of an individual’s compensation.

The compensation structures that the DOL proposes are:

- **Independently certified and unbiased computer models** created by an independent third party;

- **Asset-based compensation**, by which the institution pays the individual a percentage of the assets involved in the relationship – which does not vary by the type of product or service sold;

- **Fee offset mechanisms**, where payments received from the Plan and third parties in connection with the sale of products and services are subject to an “all in” fee. Where the receipt of third party payments exceed this established all in fee, the amounts are rebated back to the Plan;

- Differential payments based on “neutral factors” that are based on the time and expertise necessary to provide prudent advice on the product or other reasonable and objective neutral factors;

- A general **alignment of interest** compensation structure in which the policies and procedures are designed to “align” the interests of both investment firm and individual employee.

The DOL also suggests that the following could be effective for measuring risk based individual compensation arrangements:

- Avoiding compensation thresholds for the individual that enable him or her to **increase his or her compensation “disproportionately”** through incremental increases in sales;

- Monitoring thresholds of compensation, such as high payout percentages, back-end bonuses, participation in recognition groups etc. (“such as a President’s Club”) as individuals approach them;

- Maintaining **neutral grids** that pay the individual a flat fee regardless of what is sold;

- Refraining from providing higher compensation or other rewards for sales of proprietary products or other products from which the financial institution receives revenue sharing;

- **Stringently monitoring** recommendations around key liquidity events (such as a rollover) in an individual participant’s investment lifecycle; and

- Developing metrics for good and bad behavior and **clawbacks of deferred compensation** where the individual does not properly manage conflicts.

The Preamble notes that “[c]ertainly, one way for a financial institution to comply is to adopt a ‘level-fee’ structure, in which compensation for [individuals] does not vary based on the particular investment product recommended. But the exemption does not mandate such a structure.” [Emphasis supplied]. Practically speaking, however, a careful examination of the DOL’s suggested alternatives and risk measuring tips would lead one to conclude that the DOL is strongly indicating that departures from a fee-
leveling and/or fee offset model will have, at a minimum, a largely uphill battle in demonstrating compliance with this aspect of the Impartial Conduct Standards.

It is true that the DOL does not mandate any specific compensatory structure, but by seemingly giving voice to only one basic model, it forces Market Participants to either adopt that model, or gamble on being right about other structures that they believe should comply, but which might not comply. This is especially true because the Re-Proposal gives very little guidance on how one could develop an alternative approved compensatory model, including one that takes into account “neutral factors” such as a professional’s time and expertise. There is no guidance on what the “neutral factors” are, so it is difficult to derive any specific comfort.

For example, the DOL notes that as an abstract concept, compensation structures that align the interests of both employee and firm would be permitted. But how could one confirm that there is an alignment of interest between the investment firm and the individual employee, when there are no standards by which to judge such an “alignment”? Even if they could be aligned, how can they be measured? And even if they can be measured, how would they meet the “without regard to the financial interests” test? Assume a common structure in which an individual’s and firm’s interests may be aligned: increased compensation based on volume of sales. While it can be said that the individual and the firm may be aligned, is it also the case that the interests between the individual and the firm, on the one hand, and the client Plan on the other hand, are aligned? Although the Preamble indicates that one can have such sales-based incremental increases in compensation, it also indicates that such increases should not be “disproportionate.” Market Participants may be left to guess what is “disproportionate” in the context of incremental increases in sales. They also may be left guessing how permitted incremental increases in compensation squares with the Preamble’s separate suggestion that the institution refrain from providing higher compensation for sales of proprietary product or other product from which the institution receives a revenue share (i.e., effectively, all fees).

Similar concerns can be raised with respect to revenue-sharing arrangements, which must pass the “compensation must be reasonable for the services provided” test. Taken in their totality, such payments often lower fees for all that use a given Market Participant’s platform. But even though they may benefit all users, in the aggregate, would a Market Participant be at risk of a claim that the “reasonable compensation” test is not met in relation to the total services provided to a specific Plan? For example, would a Market Participant be assured that it would pass this “compensation must be reasonable in light of the total services provided” test for a best-in-class mutual fund that charges 12b-1 and subTA fees, where the large Plan contemplating an investment after sales discussions with an investment professional doesn’t have need for sub-accounting services?

Most potentially disturbing is what one hopes is merely an unintentional and undesired implication. Taken to its logical (but likely unintended) conclusion, could price differences for reasonably situated services provided to similarly situated clients become presumptively suspect? Would it matter that the fees were the result of arm’s-length negotiations? Even if the answer is “no” to the
first question and “yes” to the second, the Market Participant would still be left facing how to divine the appropriate combination of “total services” off-of-which the arm’s length pricing is keyed. For example, is it applied to the total services provided by the individual investment professional? The total services provided by the individual division or business line in which the individual is employed? The entity directly doing business with the Plan? Or that entity and all of its affiliates?

That the road signs appear to point in one direction is further reinforced by the Preamble’s express note that the Re-Proposal would preserve the “SunAmerica” Advisory Opinion. That guidance applied to a service provider that offers a package of its own funds and an independent investment adviser or offered a computer model, which makes recommendations to Plan participants as to how their Plan assets should be invested. In that guidance, as articulated in the Re-Proposal in discussing the “independently certified computer model” example, “the [DOL] 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 the 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].”

Separately, the Preamble also makes reference to certain fee-offset arrangements such as those under Advisory Opinions 97-15A and 2005-10A. Because a “fiduciary investment adviser could provide investment advice to a 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,” those are examples of compensatory arrangements that “may result in avoidance of prohibited transactions altogether.”

In the face of the materials contained in the Preamble and the prior advisory opinions, it is questionable whether any financial services institutions would feel comfortable developing a compensation model that diverges from the SunAmerica model or a fee level or offset paradigm. In a world of fixed income credits, mutual fund loads, sales charges, trailers and different commissions for different types of securities, one would think that the Re-Proposal has given no directive other than a fee level model. Thus, in practice, query whether financial institutions will agree with the DOL’s Fact Sheet that indicates “[c]ommon forms of compensation in use today in the financial services industry, such as commissions and revenue sharing, will be permitted under this exemption, whether paid by the client or a third party such as a mutual fund.”

At the end of the day, the uncertainties with respect to alternatives other than a fee-leveling or neutral construct could cause most affected Market Participants to re-consider their existing business models and practices. This is especially daunting considering that the Re-Proposal will be effective a mere eight months after it has been published as final.

**The Best Interest Contract Exemption**

The Best Interest Contract Exemption is, according to the DOL, intended to be a broad principle-based exemption. The DOL, in its Fact Sheet, states that:

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10 Advisory Opinion 2001-09A.
This new approach contrasts with existing [prohibited transaction exemptions], which tend to be limited to much narrower categories of specific transactions under more prescriptive and less flexible conditions. The “best interest contract exemption” will allow firms to continue to set their own compensation practices so long as they, among other things, commit to putting their client’s best interest first and disclose any conflicts that may prevent them from doing so.\textsuperscript{11}

Regardless of the DOL’s intent, Market Participants will likely find that adhering to this exemption will be difficult. Although the exemption indicates that it still allows certain investment professionals, financial institutions, their affiliates and related entities to receive compensation – including continuing commission-based arrangements – once the costs of adapting business models to comply with the burdensome conditions of the exemption are evaluated, many Market Participants may determine that the exemption is too difficult. As described in this article, the Best Interest Contract Exemption is likely the only exemption available to newly presumed investment advice fiduciaries to earn 12b-1 fees, revenue share and other trailing mutual fund commissions. A more detailed overview of this exemption is provided in Chart III.

Generally, the Best Interest Contract Exemption requires that the financial institution and its individual representative enter into a contract with the Plan whereby the financial institution and its individual representative (1) agree to adhere to the Impartial Conduct Standards, (2) provide certain warranties that (a) the financial institution and the individual investment professional will comply with all applicable federal and state laws regarding the rendering of investment “advice”, the purchase, sale and holding of any permissible product sold to the Plan, and the payment of compensation related thereto, (b) the institution has adopted written policies and procedures designed to mitigate the impact of Material Conflicts and ensure that individuals adhere to the Impartial Conduct Standards, (c) in formulating its policies and procedures, the institution has specifically identified Material Conflicts and adopted measures to prevent them from causing violations of the Impartial Standards of Conduct, and (d) neither the financial institution (nor to the best of its knowledge), its affiliates may use quotas, appraisals, performance or personnel actions, bonuses, contest, special awards, differential compensation or other actions or incentives to the extent they would encourage individuals to make recommendations not in best interest of Plan, (3) make certain disclosures, and (4) affirmatively state that the investment professional and the financial institution are investment advice fiduciaries pursuant to the Re-Proposal.

As detailed in Chart III, some of the elements of the Best Interest Contract Exemption raise a number of questions. In addition to the areas highlighted specifically below, Market Participants may wish to focus on the following. Would an acknowledgment that the Market Participant is acting as a fiduciary by reason of providing investment advice (described in (4) in the immediately preceding paragraph) unintentionally subject “recommendations” (which now may include many ordinary course conversations not typically regarded as “advice”) to the Investment

\textsuperscript{11} Fact Sheet available at http://www.dol.gov/protectyoursavings/FactSheetCIOI.pdf.
Advisers Act? As to item 2(a) in the immediately preceding paragraph, could a Plan have a cause of action against a financial institution because the exemption requires that the financial institution and the individual investment professional agree to comply with applicable federal and state laws? The Preamble notes that “[d]e 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” [emphasis supplied]. That may cause some Market Participants to wonder if any quantum above “de minimis” violations could result in the vitiation of the availability of the exemption.

**Limited Universe of Plans**

The Best Contract Exemption applies only to a limited universe of Plans. The exemption only applies to (1) IRAs, (2) Plans that are not Defined Large Plans which are not self-directed (i.e., fewer than 100 participants) and (3) Plan participants of participant directed Plans. In addition, only a financial institution that is a fiduciary solely by reason of providing investment advice may rely on the exemption.

**Limited Universe of “Approved” Assets**

Not only is the universe of covered Plans limited, so is the universe of covered assets. Permitted enumerated assets under the exemption (collectively, “BIC Approved List”) include: bank deposits, CDs, U.S. registered mutual fund shares, interests in bank collective funds or insurance company separate accounts, ETFs, registered corporate debt, certain agency debt securities, U.S. Treasuries, insurance and annuity contracts (including GICs), and exchange traded equity securities—but only if traded on a U.S. exchange. Expressly excluded from the covered assets under the exemption are: security futures, puts, calls, straddles or other options or privileges of buying an equity security or selling a security without being bound to do so. In addition, publicly traded equity securities not traded on a U.S. exchange, municipal bonds, futures contracts, sovereign debt, private alternative funds, such as private equity funds, hedge funds and real estate funds along with structured notes and products, foreign denominated assets are also likely not covered by this exemption.

Because the exemption effectively only covers agency transactions, a Plan’s ability to participate in initial public offerings would also likely be compromised. A Plan could not buy principal from the Market Participant with which it deals and it is unlikely that other unaffiliated Market Participants with which the Plan has no real relationship would allocate a portion of their lots—or at least not without significant costs. Finally, the exemption would not appear to apply to “advice” (as broadly defined under the Re-Proposal) given in connection with IRA rollovers.

As a threshold matter, the delineation of permitted (and thus impermissible) assets would appear inconsistent with ERISA and the Code’s general statutory architecture and its historical operation not to impose any “permitted lists” for Plans and IRAs. Although ERISA (and the Code under Section 4975 of the Code) govern relationships, they do not generally prescribe or proscribe particular products or transactions. The DOL notes in the Preamble that “[a]s proposed, the exemption is limited to otherwise prohibited compensation generated by investments that are commonly purchased by Plans, participant and beneficiary accounts, and IRAs.” [Emphasis
supplied]. It is interesting that the DOL has indicated what it believes is or is not “common” for any given Plan or IRA. Separately, although the DOL claims “many investment types and strategies that [are not deemed commonly purchased by Plans and IRAs and ] would not be covered by the exemption can be obtained through pooled investment funds, such as mutual funds, that are covered by the exemption.” Query whether that will turn out to be true and if so, at what cost.

More fundamentally, one does note an ironic tension by even establishing such a BIC Approved List: the DOL wants Market Participants relying on the exemption to act in a Plan’s best interest and yet it appears to substitute its best judgment of what is in the Plan’s best interest by consciously limiting the products and services that are covered. Ever since its enactment, one of the hallmarks of ERISA has been that there has been no “legal list” or “approved list” of assets or products and services: fiduciaries were left to act in the exclusive benefit and with “an eye single to the interests” of the Plans and participants and beneficiaries in their charge under the “highest [standards] known to the law.”12 More to the point, Congress already proscribed certain limited assets for IRAs – such as collectibles and certain insurance contracts. It is true that the Re-Proposal’s framework does not establish any de jure “legal list,” but is DOL’s Re-Proposal structure creating a de facto legal list of impermissible assets beyond Congress’ original intent?

Limitations on the Universe of BIC Approved List Assets Must Be Disclosed

Either the institution must offer a broad range of investment options that enables an individual to make “recommendations” with respect to all asset classes necessary to serve the Plan’s best interests, or the institution may limit the products it offers for sale to only proprietary products (or another subset) – but only if it makes a written finding that (a) doing so serves the best interest of the Plan, (b) compensation received doesn’t exceed reasonable compensation, (c) before the giving of any “recommendation,” the individual provides notice to the Plan of such limitations, and (d) the individual tells the Plan if it does not “recommend” a broad range of investment options. A written finding may raise a number of complicated issues for institutions, but more fundamentally, institutions may have a valid commercial reason for not permitting the sale of competing products aside from a best interest condition.

Written Contract

To rely on this exemption, the parties must contractually agree to act in a Plan’s best interests (discussed in detail above), including the Impartial Conduct Standards, and must also acknowledge fiduciary status. A potential trap for the unwary would appear to be the requirement that a financial institution must expressly acknowledge fiduciary status with respect to an IRA under the Code. In addition, prior to any “recommendation,” the investment professional or financial institution must enter into a written contract with the eligible Plan or participants, which contains extensive disclosure as described further in Chart III, including the total costs (such as acquisition costs, ongoing costs, disposition costs, loads, commission or mark-ups,

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account opening fees, ongoing costs for pooled vehicles and other direct charges paid by the Plan) and material conflicts. Given that a recommendation may include ordinary sales or marketing, this condition likely requires that any institution seeking to rely on this exemption must provide a written contract up front in advance of any communication that could be construed as a “recommendation” or “advice.”

**Exculpation Limited**

The financial institution must also agree not to limit class actions and certain other law suits. One might legitimately wonder whether by this interesting feature the DOL affirmatively wants to encourage class action lawsuits, or use the plaintiffs’ bar as a willing enforcement partner not on the government’s payroll. This exculpation provision is certainly unusual, if not unprecedented, and reflects more, in our view, than a mere desire that institutions comply with all laws.

**Disclosures**

The disclosures connected with this exemption are numerous and burdensome—as described further in Chart III. On top of any required pre-trade (and trade-by-trade) transaction disclosures, investment professionals and financial institutions will also need to provide extensive annual disclosure in a single and “succinct” document they must provide to the retirement investor. In addition, the investment professional or financial institution is required to maintain a webpage that is freely accessible to the public and includes information on direct and indirect material compensation for each permitted asset that a Plan is able to purchase, hold or sell through the investment professional or financial institution or is purchased, held or sold by a Plan within the previous 365 days. And lastly, if the investment professional or financial institution intends to rely on this exemption, they must disclose that intention to the DOL in writing prior to receiving any compensation in reliance of the exemption. The information technology implications of such disclosures are likely staggering – with one footnote apparently vitiating the availability of the exemption.

**Recordkeeping**

Institutions should be aware that certain recordkeeping requirements would also be required, including as they pertain to compensation and fees. This may give the DOL and IRS access to proprietary trade secrets or confidential competitive information.

**Market Related Impacts**

Although not subject to ERISA, the effects of the Best Interest Contract Exemption may have a profound effect on mutual funds (along with other products and services). If investment professionals and their firms decide to adapt to the Best Interest Contract Exemption, it may have significant flow-through impacts on mutual fund fee structures, including 12b-1 fees, sub-TA fees and other payments.

**The Principal Transaction Exemption**

The second new exemption is for a limited set of principal transactions, as further detailed in Chart IV. As with the Best Interest Contract Exemption, many of the conditions for relief could be challenging at best, and require close examination. To the extent the new conditions are so challenging, institutions may ultimately decide to move to an “agency” model, so that trades affected by the institution providing the
execution for the Plan would buy or sell “away” to another unaffiliated institution.

Only Certain Debt

The Principal Transaction Exemption applies to the purchase or sale of certain debt securities in a principal transaction between a financial institution that is a fiduciary solely by reason of providing investment advice, and a Plan, participant or beneficiary account or IRA. Specifically the exemption applies to **U.S. dollar denominated debt** securities purchased or sold for cash but only if

- Not issued by the financial institution or its affiliates;
- Not offered in any initial offering as to which institution participates in any underwriting syndicate or placement agent,
- The debt possess no greater than moderate credit risk; and
- The debt is “sufficiently liquid that the debt security could be sold at or near fair market value within a reasonably short period of time.”

Several Observations

- A financial institution’s own “plain vanilla” debt would not be covered under this exemption, as well as structured products such as market access notes and/or equity-linked notes. Some of these products are common to permit Plans (and others) access to investments that are impermissible to them merely by reason of foreign country regulatory restrictions.
- The “no greater than moderate risk” begs several questions. What does “moderate” mean? Unlike prior DOL guidance (i.e., the so-called “Underwriters’ Exemption” for mortgage-backed securities), the Re-Proposal does not include ratings (or any other) indicator of appropriate credit risk.

Separately, how would “moderate” be determined and at what point during the life of the instrument? Would a “mark-to-moderate” calculation need to be done on a daily basis?

- The “sufficiently liquid” is also fraught with complexity. Presumably, this would eliminate any “recommendation” for distressed debt as an asset class, even if the strategy is intended to take advantage of favorable opportunities arising from changes in capitalization and/or restructuring. As with the prior point, the question also is when “sufficiently liquid” is determined. Would an institution fail to meet the exemption if, months after purchase, the issue held by the Plan becomes illiquid in a free-fall scenario, even though it was highly liquid when bought? Many of these questions require careful consideration.

Pricing Requirements

The exemption also requires that the purchase or sale meet certain price requirements. Specifically, the investment professional and financial institution must reasonably believe the price is at least as favorable to the Plan as the price would be outside of the principal transaction and is at least as favorable as the contemporaneous price for the debt security or a similar security if a price is not available offered by two ready and willing counterparties that are not affiliates. It is uncertain whether the “ready and willing” requirement would be met by certain automated trading systems, and so the impact to best execution and pricing to Plans which require this exemption could be unfavorable. Similarly, although the exemption does not make it expressly clear, the “price outside of the principal transaction” is likely intended to capture the price of the security plus any commission.
Impartial Conduct Standards and Disclosure

As with the Best Interest Contract Exemption, to take advantage of the Principal Transaction Exemption the parties must contractually agree to act in the Plan’s best interest and abide by the Impartial Conduct Standards, discussed above. In addition, prior to engaging in the transaction, the investment professional or financial institution must enter into a written contract with the retirement investor which contains extensive disclosure, including material conflicts. This exemption also includes annual disclosures and disclosures on request.

Required pre-trade disclosure may raise a chicken-and-egg problem because disclosure of two ready-and-willing counterparties’ bids must apparently be received and approved by the Plan, during which time the information may have become stale since the bids were first given. The information to be disclosed by a Market Participant includes mark-ups and mark-downs even though Rule 10b-10 of the Securities Exchange Act of 1934 does not technically require such disclosure.

Changes to Existing Prohibited Transaction Exemptions

The Re-Proposal also includes a number of changes to existing PTCEs. In some cases these changes are to provide for additional relief in light of the expanded definition of fiduciary, whereas in others, to provide either additional standards or to revoke part or all of existing relief. Generally, a common change with respect to existing PTCEs is the adoption of the Impartial Conduct Standard. A key consequence of this addition would be to effectively import a standard of ERISA fiduciary prudence as a condition to reliance on the exemption, and, quite notably, further shift any burden of proof of compliance with the exemption to the financial institution.

Of course, such standards would not apply to IRAs but for their inclusion here. The exemptions impacted by the addition of an Impartial Conduct Standard include those for principal transactions in securities with U.S. banks and registered broker-dealers (PTCE 75-1), purchases by Plans of securities in underwritings in which the fiduciary is a part of (but not a manager of) the syndicate, and certain market-making transactions (PTCE 75-1), commissions received by certain insurance agents for the sale of annuities and mutual fund principal underwriters when selling mutual funds (PTCE 84-24), fiduciaries executing transactions in securities on an agency basis for reasonable commissions (PTCE 86-128), investment advisers directing Plan assets under their charge or under advisement to invest in certain open-end mutual funds sponsored or maintained by an affiliate (PTCE 77-4).

A second important point is that although these exemptions would confer so-called Section 406(b) relief – which would resolve the inherent conflict of a fiduciary acting in a manner that could benefit itself – there is the separate question of Section 406(a) relief, which exempts transactions with parties in interest or disqualified persons even if not fiduciaries. Most of these exemptions have been used only for the non-fiduciary exemption relief, but if most service providers are deemed to be fiduciaries, the relief will migrate accordingly, leaving open a potential hole under Section 406(a) that needs to be filled. Section 408(b)(2) and the big “investor based exemptions” (PTCE 84-14, PTCE 90-1, PTCE 91-38, PTCE 95-60, and PTCE 96-23) are the most likely candidates for Section 406(a) relief.
See Charts V, VI, VII and VIII for details on the changes to existing prohibited transaction exemptions.

As discussed further discussed in Charts V-VIII:

- PTCE 75-1, Part I for agency transactions in securities with broker-dealers and banks would be revoked, with the Best Interest Contract Exemption or PTCE 86-128 and Section 408(b)(2) serving as the exemptions for such transactions;

- PTCE 84-24 would be revoked for fees and commissions earned in respect of IRA purchases of variable annuity contracts and other annuity contracts that constitute securities and with respect to transactions of mutual fund shares; for other insurance products, the service provider could earn sales commissions, renewal fees and trailers, but would not be able to receive payments like revenue share, marketing payments, or payments other than from the insurance company or its affiliates;

- PTCE 86-128 would be revoked for “investment advice only fiduciary” IRAs, but the reporting and other conditions required for Plans would be required for discretionary IRAs. This means that investment advice only IRAs – which would include most brokers who may be deemed to provide “investment advice” under the Re-Proposal’s broad definition – would need to comply with the Best Interest Contract Exemption for commissions associated with any purchase or sale of securities transactions effected as agent. In addition to importing the Impartial Conduct Standard, that exemption would, as a practical matter, require some model of fee neutrality or offset.

- PTCE 86-128 would replace PTCE 75-1, II(2) so as to allow an investment advice fiduciary to act as principal in selling mutual fund shares to Plans (including IRAs) but would only apply if the fiduciary was a U.S. registered broker-dealer and only if the mutual fund was not affiliated with the institution (i.e., the institution was not the principal underwriter or an affiliate of the mutual fund). The commissions that could be earned in respect of such purchases and sales (even if effected as a riskless principal) would be ordinary front-end sales loads, and not 12b-1 fees, sub-TA fees, revenue sharing payments or other payments;

- Although PTCE 86-128 has been clarified so that it covers purchase and sales of securities through an affiliated broker on an agency basis for a commission and riskless principal transactions in mutual funds, it has narrowed the definition of permitted “commissions” that may be retained. In connection with the purchase or sale of mutual fund interests, only sales loads may be retained, and thus the Best Interest Contract Exemption may permit additional compensation, including, trailers, 12b-1 fees and other commissions—assuming compliance with that exemption. In fact, it would appear that the Best Interest Contract Exemption is the only exemption under which presumed investment advice fiduciaries may receive 12b-1 fees and other commissions.

- PTCE 75-1, Part V has been amended to provide certain relief for certain extensions of credit arising because of a “failed trade.”

V. Do Other Regulators Have Jurisdiction?

The DOL, specifically the Employee Benefits Security Administration, has oversight over the fiduciary responsibility and prohibited transaction rules of ERISA. However, the DOL is not the only regulator that has oversight over Market Participants that interact with Plans. The Securities and Exchange Commission (“SEC”), the Commodity Futures Trading Commission (“CFTC”), the Federal Reserve and other Federal
and state financial markets regulators all have overlapping regimes to which many Market Participants are subject.

As with ERISA’s fiduciary rules, many of these rules are designed to protect entities or individuals interacting with Market Participants. For example, under rules enforced by the SEC, U.S. registered broker-dealers may not cause clients to enter into securities transaction by means of any manipulative, deceptive or fraudulent device or contrivance, and must deal with clients “fairly,” make a “suitability” determination which is determined on a reasonable basis, is customer specific, and quantitative. Broker-dealers also have a duty to obtain best execution for their clients and disclose certain conflicts. Similarly, U.S. registered investment advisers must not act in a manner designed to manipulate or defraud or deceive clients or prospective clients, engage in courses of conduct that will have such effect, and have various affirmative fiduciary duties including duties of loyalty, determine suitability, best execution, and a duty to disclose certain material facts.

In addition, the Dodd-Frank Act directed the SEC to study the need for establishing a new, uniform, federal fiduciary standard of care for brokers and investment advisers providing personalized investment advice. The Dodd-Frank Act further authorized the SEC to establish such a standard if it saw fit. As the SEC continues to develop such a study, many commentators – and Members of Congress – have questioned whether DOL might wish to wait to coordinate any such standard, so as to avoid the confusion and undue burden to clients and market participants alike that likely would result from conflicting regimes.

Most would not dispute that there are substantial benefits to coordination among the agencies on an issue as important as the definition of “fiduciary” and the scope of its application. Such coordination is especially important when taking into account the different missions of these organizations and a desire to assure that any rulemaking takes account of both legal and practical considerations.

For example, although the DOL’s mission is to assure the security of the retirement, health and other workplace related benefits of America’s workers and their families, the mission of the CFTC is to protect market users and the public from fraud, manipulation, abusive practices and systemic risk related to derivatives that are subject to the CEA and to foster open, competitive and financially sound markets. The SEC has a similar mandate to protect investors and secure the functioning of the market.

In the face of such mandates by Dodd-Frank and initiatives by other regulators, many have questioned the necessity of the DOL’s Re-Proposal, especially when viewed against the backdrop of the enforcement priorities of other regulators. For example, each of the SEC’s and FINRA’s 2015 examination priorities included themes centered on “Protecting Retail Investors and Investors Saving for Retirement”,

13 Curiously, the DOL in the Original proposal noted that it was “uncertain” as to (i) “whether, and to what extent, service provider costs would increase . . . and if so, whether the increased cost would be passed on to plans,” (ii) “the number of transactions that would have to be restructured,” and (iii) “whether the service provider market will shrink because some service providers would view the increased costs and liability exposure . . . as outweighing the benefit of continuing to service the ERISA plan market.”

“Individual Retirement Account (IRA) Rollovers (and Other ‘Wealth Events’),” “Senior Investors,” and “Putting Customer Interests First” (FINRA). Based on comments from SEC Commissioner Gallagher, who colorfully indicated he had not been consulted by the DOL, and even suggested that the coordination was merely a “check the box” exercise, questions remain about exactly how much coordination there has been among agencies, notwithstanding any protestations to the contrary.

VI. Comment Period

The comment period for the Re-Proposal ends on or about July 20, 2015. The requirements of the Re-Proposal will generally become applicable eight months after publication.

For More Information

Steven W. Rabitz  
212.806.6568  
srabitz@stroock.com

Marissa J. Holob  
212.806.5650  
mholob@stroock.com

Abbey L. Keppler  
212.806.5845  
akeppler@stroock.com

Michael A. Wiseman  
212.806.6495  
mwiseman@stroock.com

http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2015.pdf. Retail investors of all ages face a complex and evolving set of options when determining how to invest their money, including retirement funds.” “Financial professionals serving retail investors are increasingly choosing to operate as an investment adviser or as a dually registered investment adviser/broker-dealer, rather than solely as a broker-dealer. Unlike broker-dealers, which typically charge investors a commission or mark-up on purchases and sales of securities, investment advisers employ a variety of fee structures for the services offered to clients, including fees based on assets under management, hourly fees, performance-based fees, wrap fees, and unified fees. Where an adviser offers a variety of fee arrangements, we will focus on recommendations of account types and whether they are in the best interest of the client at the inception of the arrangement and thereafter, including fees charged, services provided, and disclosures made about such relationships.” Id.

FINANCIAL INDUSTRY REGULATORY AUTHORITY, REGULATORY EXAMINATION AND PRIORITIES LETTER (2015), available at http://www.finra.org/sites/default/files/p602239.pdf. “A central failing FINRA has observed is firms not putting customers’ interests first. The harm caused by this may be compounded when it involves vulnerable investors (e.g., senior investors) or a major liquidity or wealth event in an investor’s life (e.g., an inheritance or Individual Retirement Account rollover). Poor advice and investments in these situations can have especially devastating and lasting consequences for the investor.” Id.

Commissioner Gallagher’s spirited comments are worth providing, as reported: “[d]espite all the work the SEC staff has undertaken on” this standard, “not Coordination among the agencies, in part because of their different mission statements and mandates, could likely lead to a more balanced, practical approach.

15 FINANCIAL INDUSTRY REGULATORY AUTHORITY, REGULATORY EXAMINATION AND PRIORITIES LETTER (2015), available at http://www.finra.org/sites/default/files/p602239.pdf. “A central failing FINRA has observed is firms not putting customers’ interests first. The harm caused by this may be compounded when it involves vulnerable investors (e.g., senior investors) or a major liquidity or wealth event in an investor’s life (e.g., an inheritance or Individual Retirement Account rollover). Poor advice and investments in these situations can have especially devastating and lasting consequences for the investor.” Id.

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List of Charts

DOL’s Fiduciary Re-Proposal: Caveat Venditor or “Death of a Salesman”? 

- **Chart I**: Definition of “Investment Advice Fiduciary” – Comparison of Current Standard, Original Proposal and Re-Proposal
- **Chart II**: Definition of “Investment Education”
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- **Chart IV**: Principal Transactions in Debt Securities Class Exemption
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# DOL’s Fiduciary Re-Proposal: Caveat Venditor or “Death of a Salesman”?

## CHART I

### Definition of “Investment Advice Fiduciary”

Comparison of Current Standard, Original Proposal and Re-Proposal.

<table>
<thead>
<tr>
<th>Current Standard</th>
<th>Original Proposal</th>
<th>The person acknowledges it is acting as a fiduciary (need not be in writing); or</th>
</tr>
</thead>
<tbody>
<tr>
<td>A person is an investment advice fiduciary by the rendering of any advice as to the value of securities or other property, or making recommendations as to the advisability of investing in, purchasing or selling securities or other property:</td>
<td>A person is an investment advice fiduciary by providing advice or making recommendations as to the advisability of investing in, purchasing, holding, or selling securities or other property, or advice or recommendations as to management of securities or other property or providing an appraisal or fairness opinion concerning the value of securities or other property, and any of the following three columns applies:</td>
<td>The person is a registered investment adviser.</td>
</tr>
<tr>
<td>• “On a regular basis” to the plan</td>
<td>• “Is pursuant to an agreement, arrangement or understanding [even if not mutual], written or otherwise, between such person and the plan, a plan fiduciary, or a plan participant or beneficiary;</td>
<td></td>
</tr>
<tr>
<td>• Pursuant to a mutual agreement, arrangement or understanding, written or otherwise, between such person and the plan or a fiduciary with respect to the plan,</td>
<td>• That such advice may be considered in connection with making investment or management decisions with respect to plan assets,” and</td>
<td></td>
</tr>
<tr>
<td>• That such services will serve as a primary basis for investment decisions with respect to plan assets, and</td>
<td>• That such advice “will be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary;” or</td>
<td></td>
</tr>
<tr>
<td>• That such person will render individualized investment advice to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.”</td>
<td></td>
<td></td>
</tr>
<tr>
<td>[Emphasis supplied throughout.]</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**However:** A counterparty/service provider will not be deemed to be an investment advice fiduciary if “such person can demonstrate that the recipient of the advice knows, or, under the circumstances, reasonably should know, that the person is providing the advice or making the recommendation in its capacity as a purchaser or seller of a security or other property, or as an agent of, or appraiser for, such a purchaser or seller, whose interests are adverse to the interests of the plan or its participants or beneficiaries, and that the person is not undertaking to provide impartial investment advice.” (The “Sellers’ Exception”)}
**Re-Proposed Standard**

A person is an investment advice fiduciary if such person “provides, directly to a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner the following types of advice in exchange for a fee or other compensation, whether direct or indirect:

- A **recommendation** as to the **advisability of** acquiring, holding, disposing or **exchanging** securities or other property, or a recommendation as to the management of 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 the plan or IRA**;

- **NOTE:** “Recommendation” means any communication that, based on context and presentation would reasonably be viewed as a “suggestion” that the advice recipient engage in or refrain from taking any particular action.

- **NOTE:** Does not apply to mere “order taking.”

- “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”---**EXCEPT** for:
  - Employer securities of an employee stock ownership plans (“ESOPs”),
  - Pooled investment “plan asset” funds, and
  - **Compliance with reporting and disclosure requirements** under a “Federal or state law, rule or regulation or self-regulatory organization rule or regulation”;

**OR**

- A **recommendation of a person** who is also going to receive a fee or other compensation for providing any of the types of advice described in the above bullet points;

**AND**

The person **directly or indirectly** (e.g., through or together with any affiliate),---

- Represents or acknowledges that is acting as a fiduciary with respect to the types of investment advice described above; or

- Renders 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.

**However:** Certain carve-outs (as described herein) may apply.
DOL’s Fiduciary Re-Proposal: Caveat *Venditor* or “Death of a Salesman”?

### CHART II

**Definition of “Investment Education”**

<table>
<thead>
<tr>
<th>Exemption Applies To:</th>
<th>Current Interpretive Bulletin 96-1, § 2509.96-1</th>
<th>Re-Proposal Education Exemption § 2510.3-21(b)(6)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A person is not an “investment advice” fiduciary with regard to furnishing the following categories of information and materials to a participant or beneficiary in a participant-directed individual account pension plan, irrespective of (i) who provides the information, (ii) the frequency with which the information is shared, (iii) the form in which the information and materials are provided, (iv) or whether an identified category of information and materials is furnished alone or in combination with other identified categories of information and materials.</td>
<td>A person shall not be an “investment advice” fiduciary solely by reason of furnishing or making available any of the following categories of investment-related information and materials to a plan, plan fiduciary, participant or beneficiary, IRA or IRA owner irrespective of (i) who provides or makes available the information and materials, (ii) the frequency with which the information and materials are provided, (iii) the form in which the information and materials are provided, (iv) or whether an identified category of information and materials is furnished or made available alone or in combination with other categories of information and materials (described in paragraphs (1) through (4)), <em>provided that</em> the information and materials <em>do not include</em> (standing alone or in combination with other materials) recommendations with respect to specific investment products or specific plan or IRA alternatives, or recommendations on investment, management, or value of a particular security or securities, or other property.</td>
</tr>
</tbody>
</table>

(1) **Plan Information.**

(i) Information and materials that inform a participant or beneficiary about the benefits of plan participation, the benefits of increasing plan contributions, the impact of preretirement withdrawals on retirement income, the terms of the plan, or the operation of the plan; or (ii) information such as that described in 29 CFR 2550.404c-1(b)(2)(i) on investment alternatives under the plan (e.g., descriptions of investment objectives and philosophies, risk and return characteristics, historical return information, or related prospectuses), and may include information relating to the benefits of plan or IRA participation, or (iii) the benefits of increasing plan or IRA contributions, (iv) the impact of preretirement withdrawals on retirement income, (v) retirement income needs, (vi) varying forms of distributions, including rollovers.
generic asset class (e.g., equities, bonds, or cash) of the investment alternatives. The information and materials described above relate to the plan and plan participation, without reference to the appropriateness of any individual investment option for a particular participant or beneficiary under the plan. annuitization and other forms of lifetime income payment options, (vii) advantages, disadvantages and risks of different forms of distributions, or (viii) describe investment objectives and philosophies, risk and return characteristics, historical return information or related prospectuses of investment alternatives under the plan or IRA.

(2) General Financial and Investment [and Retirement] Information.

Information and materials that inform a participant or beneficiary about: (i) General financial and investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment; (ii) historic differences in rates of return between different asset class (e.g., equities, bonds, or cash) based on standard market indices; (iii) effects of inflation; (iv) estimating future retirement income needs; (v) determining investment time horizons; and (vi) assessing risk tolerance.

The information and materials described above are general financial and investment information that have no direct relationship to investment alternatives to participants and beneficiaries under a plan or to individual participants or beneficiaries.

Information and materials on financial, investment and retirement matters that do not address specific investment products, specific plan or IRA alternatives or distribution options available to the plan or IRA or to participants, beneficiaries and IRA owners, or specific alternatives or services offered outside the plan or IRA, and inform the plan fiduciary, participant or beneficiary, or IRA owner about: (i) general financial and investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment; (ii) historic differences in rates of return between different asset classes based on standard market indices; (iii) effects of inflation; (iv) estimating future retirement income needs; (v) determining investment time horizons; (vi) assessing risk tolerance; (vii) retirement-related risks (e.g., longevity risks, market/interest rates, inflation, health care and other expenses); and (viii) general methods and strategies for managing assets in retirement (e.g., systematic withdrawal payments, annuitization, guaranteed minimum withdrawal benefits), including those offered outside the plan or IRA.

(3) Asset Allocation Models.

Information and materials (e.g., pie charts, graphs, or case studies) that provide a participant or beneficiary with models, available to all plan participants and beneficiaries, of asset allocation portfolios of hypothetical individuals with different time horizons and risk profiles, where: (i) such models are based on generally accepted investments theories that take into account the historic returns of different asset classes (e.g., equities, bonds, or cash) over define periods of time horizons (which may extend beyond an individual’s retirement date) and risk profiles, where: (i) such models are based on generally accepted investments theories that take into account the historic returns of different asset classes.
time; (ii) all material facts and assumptions on which such models are based (e.g., retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, and rates of return) accompany the models; (iii) to the extent that an asset allocation model identifies any specific investment alternative available under the plan, the model is accompanied by a statement indicating that other investment alternatives having similar risk and return characteristics may be available under the plan and identifying where information on those investment alternatives may be obtained; and (iv) the asset allocation models are accompanied by a statement indicating that, in applying particular asset allocation models to their individual situations, participants or beneficiaries should consider their other assets, income, and investments (e.g., equity in a home, IRA investments, savings accounts, and interests in other qualified and non-qualified plans) in addition to their interests in the plan.

Because the information and materials described above would enable a participant or beneficiary to assess the relevance of an asset allocation model to his or her individual situation, the furnishing of such information would not constitute a “recommendation” within the meaning of 29 CFR 2510.3-21(c)(1)(i) and, accordingly, would not constitute “investment advice” for purposes of section 3(21)(A)(ii) of ERISA. This result would not, in the view of the Department, be affected by the fact that a plan offers only one investment alternative in a particular asset class identified in an asset allocation model.

(4) Interactive Investment Materials.

Questionnaires, worksheets, software, and similar materials which provide a participant or beneficiary the means to estimate future retirement income needs and assess the impact of different asset allocations on retirement income, where:

(i) Such materials are based on generally accepted investment theories that take into account the historic returns of (e.g., equities, bonds, or cash) over defined periods of time; (ii) all material facts and assumptions on which such models are based (e.g., retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, and rates of return) accompany the models; (iii) such models do not include or identify any specific investment product or specific alternative available under the plan or IRA; and (iv) the asset allocation models are accompanied by a statement indicating that, in applying particular asset allocation models to their individual situations, participants, beneficiaries, or IRA owners should consider their other assets, income, and investments (e.g., equity in a home, Social Security benefits, individual retirement plan investments, savings accounts and interest in other qualified and non-qualified plans) in addition to their interests in the plan or IRA, to the extent those items are not taken into account in the model or estimate.
different asset classes (e.g., equities, bonds, or cash) over defined periods of time; (ii) there is an objective correlation between the asset allocations generated by the materials and the information and data supplied by the participant or beneficiary; (iii) all material facts and assumptions (e.g., retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, and rates of return) which may affect a participant’s or beneficiary’s assessment of the different asset allocations accompany the materials or are specified by the participant or beneficiary; (iv) **to the extent that an asset allocation generated by the materials identifies any specific investment alternative available under the plan, the asset allocation is accompanied by a statement indicating that other investment alternatives having similar risk and return characteristics may be available under the plan and identifying where information on those investment alternatives may be obtained;** and (v) the materials either take into account or are accompanied by a statement indicating that, in applying particular asset allocations to their individual situations, participants or beneficiaries should consider their other assets, income, and investments (e.g., equity in a home, IRA investments, savings accounts, and interests in other qualified and non-qualified plans) in addition to their interests in the plan.

The information provided through the use of the above-described materials enables participants and beneficiaries independently to design and assess multiple asset allocation models, but otherwise these materials do not differ from asset allocation models based on hypothetical assumptions. Such information would not constitute a “recommendation” within the meaning of 29 CFR 2510.3-21(c)(1)(i) and, accordingly, would not constitute “investment advice” for purposes of section 3(21)(A)(ii) of ERISA. or beneficiary, or IRA owners to evaluate distribution options, products or vehicles by providing information under paragraphs (b)(6)(i) and (ii) of this section; questionnaires, worksheets, software, and similar materials that provide a plan fiduciary, participant or beneficiary, or IRA owner the means to estimate a retirement income stream that could be generated by an actual or hypothetical account balance, where: (i) Such materials are based on generally accepted investment theories that take into account the historic returns of different asset classes (e.g., equities, bonds, or cash) over defined periods of time; (ii) There is an objective correlation between the asset allocations generated by the materials and the information and data supplied by the participant, beneficiary or IRA owner; (iii) **There is an objective correlation between the income stream generated by the materials and the information and data supplied by the participant, beneficiary or IRA owner;** (iv) All material facts and assumptions (e.g., retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, rates of return and other features and rates specific to income annuities or systematic withdrawal plan) that may affect a participant’s, beneficiary’s or IRA owner’s assessment of the different asset allocations or different income streams accompany the materials or are specified by the participant, beneficiary or IRA owner; (v) **The materials do not include or identify any specific investment alternative available or distribution option available under the plan or IRA, unless such alternative or option is specified by the participant, beneficiary or IRA owner;** and (vi) The materials either take into account other assets, income and investments (e.g., equity in a home, Social Security benefits, individual retirement account/ annuity investments, savings accounts, and interests in other qualified and non-qualified plans) or are accompanied by a statement indicating that, in applying particular asset allocations to their individual situations, or in assessing the adequacy of an
| Materials Not Described Herein | The Department notes that the information and materials described in subparagraphs (1)-(4) above merely represent examples of the type of information and materials which may be furnished to participants and beneficiaries without such information and materials constituting “investment advice.” In this regard, the Department recognizes that there may be many other examples of information, materials, and educational services which, if furnished to participants and beneficiaries, would not constitute “investment advice.” Accordingly, no inferences should be drawn from subparagraphs (1)-(4), above, with respect to whether the furnishing of any information, materials or educational services not described therein may constitute “investment advice.” Determinations as to whether the provision of any information, materials or educational services not described herein constitutes the rendering of “investment advice” must be made by reference to the criteria set forth in 29 CFR 2510.3-21(c)(1). |
| Fiduciary by Designation or Recommendation of Another to Provide Investment Advice | A person is a fiduciary with regard to the designation of a person(s) to provide investment educational services or investment advice to plan participants and beneficiaries, and must therefore act prudently and solely in the interest of the plan participants and beneficiaries, both in making the designation(s) and in continuing such designation(s). [Covered under the re-proposed definition of investment advice fiduciary; if a person “recommends” another that provides investment advice to the Plan, then the recommending person is a fiduciary with respect to those services.] | estimated income stream, participants, beneficiaries or IRA owners should consider their other assets, income, and investments in addition to their interests in the plan or IRA.
DOL’s Fiduciary Re-Proposal: Caveat Venditor or “Death of a Salesman”?

CHART III

<table>
<thead>
<tr>
<th>Best Interest Contract (“BIC”) Class Exemption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conditions</td>
</tr>
<tr>
<td>“BIC Approved List”:</td>
</tr>
<tr>
<td>• Bank deposits, CDs, U.S. registered mutual fund shares, interests in bank collective funds or insurance company separate accounts, ETFs (including REITs), registered corporate debt, certain U.S. agency debt securities (e.g., Fannie, Freddie), U.S. Treasuries, insurance and annuity contracts (including GICs) and exchange traded equity securities.</td>
</tr>
</tbody>
</table>

The Preamble notes “As proposed, the exemption is limited to otherwise prohibited compensation generated by investments that are *commonly purchased* by [Plans and IRAs].” (Emphasis supplied).

### De Facto Legal Lists?

As a threshold matter, the delineation of permitted (and thus impermissible) assets would appear to fly in the face of ERISA’s (and Congress’) intent to not impose any “permitted lists” for Plans and IRAs. ERISA (and Section 4975 of the Code) govern relationships, but generally do not prescribe or proscribe particular products or transactions. Indeed, the Code proscribes a limited number of assets (i.e., certain collectibles and insurance policies), further evidence that expansions of a de facto permitted list runs afoul of Congressional intent and established practice. Under ERISA, of course, since fiduciaries are already required to act “solely” in the best interest of a Plan, Congress no doubt elected not to provide any prescribed “legal list.”

- The DOL notes in the Preamble that “[a]s proposed, the exemption is limited to otherwise prohibited compensation generated by investments that are *commonly purchased* by Plans, participant and beneficiary accounts, and IRAs.” (Emphasis supplied).

- Questions may arise over what is or is not “common” for any given Plan or IRA and whether it is most appropriate for the DOL to indicate 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.”

- Perhaps a more efficient alternative would be to leave the BIC Approved List assets, but also provide a broader exception for those Plans, IRAs and representatives thereof that are financially sophisticated.

### Excluded Assets and Transactions

Security futures, puts, calls, straddles “or other options or
privileges of buying an equity security or selling a security without being bound to do so” are expressly excluded.

In addition, it would appear that municipal bonds, foreign equity securities, all principal transactions, foreign currency denominated assets, sovereign debt, investments in private (alternative) funds such as private equity funds, hedge funds and real estate funds, along with structured notes, non-agency sponsored mortgage backed securities and asset backed securities, and foreign currency (spot or hedging) are not within the exemption. Similarly, because extensions of credit are not included, it would appear that “short” positions would be questionable.

**IRA Rollovers.** IRA rollover accounts are also not covered among BIC Approved List assets, leaving one to wonder whether an individual who is deemed to provide rollover “advice” has any prohibited transaction exemption available to her in respect of fees and services provided to the IRA. Finally, services provided to a Plan sponsor (assisting a Plan sponsor establish an investment menu for a 401(k) Plan) may not be included—especially for Defined Large Plans.

**Other Observations.** Certain cash sweep products may be covered to the extent consistent with the term “deposits” and elsewhere, it would appear that variable and fixed annuities would be covered under the term “annuity contract.” The reference to “mutual funds” would presumably include both open and closed end mutual funds.

**IPOs.** However, even though U.S. domestic equities are included as BIC Approved List assets, Plans may have limitations participating in initial public offerings (“IPOs”) because availability may be limited as a practical matter to the financial institution with which the Plan has the relationship, and would be effected on a principal basis, and thus would not technically be covered. When one considers the limitations of the Principal Transaction Exemption, this could be unfortunate.

**Foreign Denominated Assets.** An institution would need to be concerned about offering foreign denominated securities because the client could not then convert dividends, interest or proceeds in
**Reliance on the exemption.**

**PTCE 86-128.** This exemption would appear to permit agency cross transactions in securities which are otherwise permitted under PTCE 86-128, but without some of PTCE 86-128's additional reporting conditions. In addition, because this exemption is limited to investment advice fiduciaries only, it would appear that a Market Participant deemed an investment advice fiduciary could be compensated for the sale of third party products (mutual funds) while discretionary managers could not.

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<table>
<thead>
<tr>
<th>Eligible Plans:</th>
<th>Plans which have fewer than 100 participants and which are self-directed would not be included. This could be particularly problematic for such Plans to the extent they did not have $100 Million and thus could not avail themselves of the “Counterparty” carve-out with respect to sales, purchases, loans or bilateral contracts.</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Plan participants of participant directed Plans</td>
<td></td>
</tr>
<tr>
<td>• IRAs</td>
<td></td>
</tr>
<tr>
<td>• Plans that have fewer than 100 participants and which are not self-directed.</td>
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</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Written Contract:</th>
<th>This means that a contract may have to be entered into before any substantive conversation has begun. If one contract is executed in advance of the counterpart which has the necessary provisions, could any pre-trade “recommendations” fall outside of the carve-out?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required prior to provision of “advice.”</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Warranties:</th>
<th>Does the requirement that the institution comply with all applicable federal and state laws give a Plan plaintiff a cause of action at common law? The Preamble does note that “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).” The Preamble notes that de minimis violations of such laws are “unlikely” to violate the exemption’s other standards, leaving open the question as to whether slight but more-than-de-minimis violations could result in the vitiation of the exemption.</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Institution must comply with all applicable federal and state laws related to the services and/or transactions.</td>
<td>Note that the requirement is that the institution adopt policies and procedures . . . . to ensure that (i.e., not “take steps reasonably designed to mitigate” or “take commercially reasonable steps” etc.) the investment professionals adhere to the Impartial Conduct Standards. Similarly, note that in</td>
</tr>
<tr>
<td>• The financial institution has adopted written policies and procedures designed to mitigate the impact of material conflicts of interest—and has identified material conflicts of interest and adopted measures ensured that investment professionals adhere to the Impartial Conduct Standards.</td>
<td></td>
</tr>
<tr>
<td>• In formulating its policies and procedures, the institution has specifically identified Material Conflicts and adopted measures to prevent them from causing violations of the Impartial Standards of Conduct.</td>
<td></td>
</tr>
<tr>
<td>• Neither the institution nor any affiliate or related entity uses quotas, appraisals, performance or personnel actions, bonuses,</td>
<td></td>
</tr>
</tbody>
</table>

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contests, special awards, differential compensation or other actions or incentives to the extent they would tend to encourage personnel to give advice not in the best interest of the Plan.

- The written contract with the client must disclose material conflicts of interest.

formulating its policies and procedures, the institution must have “adopted measures to prevent them from causing violations” (i.e., not “take reasonable steps to mitigate”, or “take such steps to prevent reasonably foreseeable violations,” etc.) of the Impartial Standards of Conduct.

The prohibitions on “quotas, appraisals, performance or personnel actions . . . . differential compensation or other actions . . . .” would appear to be very hard to interpret as justifying most commission-based compensatory arrangements and point to a fee-offset or fee neutral structure.

The condition suggests that an institution both define and mitigate perceived conflicts of interest. It is not clear by what standard(s).

<table>
<thead>
<tr>
<th>Impartial Conduct Standard (including Best Interest Standard) is applicable.</th>
<th>*See narrative summary.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial institution must be a fiduciary solely by reason of providing “investment advice.”</td>
<td>*See narrative summary. Could such an acknowledgment then sweep any discussions into “investment advice” to be regulated under the Investment Advisers Act?</td>
</tr>
<tr>
<td>Required Disclosures—including Mark-Ups—to Plans</td>
<td>*See narrative summary. The concept of “mark-ups” for agency transactions may be misplaced.</td>
</tr>
<tr>
<td>Pre-Trade Point of Sale Detailed Disclosure. Prior to the execution of the purchase of a Permitted BIC Asset, the person furnishes to the Plan a chart that provides, with respect to each asset “recommended” the “Total Cost” to the Plan for 1, 5 and 10 year periods under certain assumptions. A model chart is provided but need not be used.</td>
<td>Pre-Trade Point of Sale Disclosure: This effectively means pre-trade disclosure on a trade-by-trade basis unless the specific Permitted BIC Asset has been recommended more than once within a 12 month period and the marginal cost has not materially changed.</td>
</tr>
<tr>
<td>“Total Cost” includes acquisition costs (e.g., any loads, commissions, mark-ups, and account opening fees), ongoing costs for pooled vehicles (e.g., amounts attributable to a mutual fund expense ratio and account fees) and disposition costs (e.g., surrender fees, back-end loads, mark-downs and account closing fees), and other direct charges paid by the Plan.</td>
<td>“Total Cost”: It is not clear why this includes mark-ups and mark-downs along with other acquisition costs like loads and commissions. Mark-ups and mark-downs are used almost exclusively on principal transactions—which are not BIC Approved List assets. Separately, account opening fees make no sense in the context of individual securities or most of the BIC Approved List assets generally.</td>
</tr>
</tbody>
</table>
**Annual Disclosure.** Must be a “succinct [and] single” disclosure identifying each product bought or sold and the price at which bought or sold, a statement of total dollar amount of all fees and expenses paid by the Plan with respect to such products, along with a statement of all compensation received by the individual and the financial institution received as a result.

**Annual Disclosure:** The reference to “single” for the Annual Disclosure would appear to contrast with the DOL’s current approach with respect to the Section 408(b)(2) disclosure rules. Separately, it is unclear how such detailed disclosure can be “succinct” especially where transactions may be robust – ignoring the fact that the “asks” for any such report are quite detailed, indeed.

**Webpage.** Institution must maintain a “machine readable” webpage with direct and indirect material compensation payable to the individual and the financial institution and its affiliate with respect to each Permitted BIC Asset (or, if uniform across a class of assets, the class of assets) that a Plan, is able to purchase, hold, or sell through the Adviser “or purchased, held, or sold within the last 365 days” by “a” Plan; and “the source of the compensation, and how the compensation varies within and among the [Permitted BIC Asset].”

**Webpage:** Either the DOL envisions a world in which only mutual funds are sold or it does not appreciate that Plans may purchase a host of other assets, including individual securities. Requiring that the webpage include that the institution disclose each Permitted BIC Asset (or, if uniform across a class of assets, the class of assets) that a Plan, is able to purchase, hold, or sell through the Adviser “or purchased, held, or sold within the last 365 days” by “a” Plan; and “the source of the compensation, and how the compensation varies within and among the [Permitted BIC Asset]” would be a truly Herculean undertaking.

The “machine readable” requirement may be particularly burdensome for some financial institutions.

**Required Disclosures to DOL.** Financial institutions seeking to rely on this exemption must notify the Department of Labor in writing prior to their receipt of compensation and must keep certain records.

**Required Disclosures to DOL.** There does not appear to be a stated reason why the DOL wants institutions relying on this exemption to notify the DOL. Perhaps the DOL wishes to investigate or analyze data concerning compliance with the exemption and wants a list of participating institutions at the ready.

**Supplemental Disclosure.** In addition, the financial institution would be required to maintain and provide, upon request, certain information to the DOL relating to “inflows,” “outflows,” “holdings” and “returns” of any Permitted BIC Asset.

- “Inflows,” “outflows” and “holdings” includes for each Permitted BIC Asset acquired, sold or held, as applicable, at the institution level, for each quarter, the aggregate number and identity of shares or other units purchased, sold, or held (as applicable), the aggregate dollar amount invested and the cost to the Plan or participant (by reason of the purchase,
sale or holding, as applicable), the revenue received by the financial institution and its affiliates—*disaggregated by source*—and the identity of each revenue source and the reasons for the compensation.

- “Returns” means at the institutional level, for each quarter, the name of the individual representative, the beginning of quarter and end of quarter values of the Plan (or participant’s) “portfolio”, and each external cash flow to or from the portfolio and the date on which it occurred.

**Range of Investment Options.** Either the institution must offer a broad range of investment options which enables an individual to make “recommendations” with respect to all asset classes necessary to serve the Plan’s Best Interests, or, the institution may limit the products for sales to proprietary products (or another subset) but only if it makes a *written finding* that doing so (a) *serves the Best Interest* of the Plan, (b) compensation received *doesn’t exceed* reasonable compensation, (c) before the giving of any “recommendation”, the individual provides notice to the Plan of such limitations, and (d) the individual tells the Plan if it does not “recommend” a broad range of investment options.

**Recordkeeping.** Institutions need to maintain records for six years to provide broad access to DOL, the Internal Revenue Service (“IRS”) and Plans.

**Recordkeeping.** Institutions should be aware that such broad access may give the DOL and IRS access to proprietary trade secrets or confidential competitive information.

**Contract Must Limit Exculpation Provisions.** The written contract must not contain an *exculpatory provision* that disclaims or otherwise limits the financial institution’s violations of the contract’s terms, and must not permit the Plan to *waive or limit its right to bring or participate in a class action or other representative action* in a contract dispute with the financial institution or the individual representative.

**Special Rule for Insurance Products.** Also covers the purchase of an insurance or annuity contract based on an individual’s advice where such

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**Range of Investment Options.** A written finding may raise a number of complicated issues for institutions, but more fundamentally, institutions may have a *valid commercial reason* for not permitting the sale of competing products.

One might legitimately wonder whether the DOL affirmatively wants to encourage class action lawsuits. This exculpation provision is somewhat unprecedented and reflects more, in our view, than a mere desire that institutions comply with all laws.
insurance or annuity contract is issued by a person unrelated to the individual or institution if the transaction is effected by the insurance company in the ordinary course of its business, the total of all fees is reasonable, the purchase is for cash, the transaction is at least as favorable to the Plan as an arm’s length transaction with an unrelated party.

<table>
<thead>
<tr>
<th>Sources of Liability if Best Interest Conflict Exemption Required to Be Met—But Failed to Be Met:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Sections 502(a)(2) and (3) of ERISA.</td>
</tr>
<tr>
<td>• Plan fiduciaries and participants may sue to recover any loss in value to the Plan, or to obtain disgorgement of wrongful profits.</td>
</tr>
<tr>
<td>• In connection with suits by the DOL for Plans (other than IRAs)</td>
</tr>
<tr>
<td>• Excise taxes for nonexempt prohibited transactions.</td>
</tr>
<tr>
<td>• 15 percent of the “amount involved” for each year (or part of year) the transaction is outstanding and not corrected.</td>
</tr>
<tr>
<td>• Possibility of additional 100 percent excise tax if there is failure to timely respond to a notice of deficiency from the Internal Revenue Service.</td>
</tr>
<tr>
<td>• <strong>Contractual liability</strong> to plan participants and IRA owners.</td>
</tr>
</tbody>
</table>
**DOL’s Fiduciary Re-Proposal: Caveat Venditor or “Death of a Salesman”?**

**CHART IV**

<table>
<thead>
<tr>
<th>Principal Transactions in Debt Securities Class Exemption</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Conditions</strong></td>
</tr>
<tr>
<td>Eligible Securities/Transactions:</td>
</tr>
<tr>
<td>U.S. dollar denominated debt securities purchased or sold <em>for cash</em> but only if:</td>
</tr>
<tr>
<td>• <em>NOT issued by the financial institution or its affiliates</em>, or offered in any initial offering as to which the institution participates <em>in any underwriting syndicate or as placement agent</em>.</td>
</tr>
<tr>
<td>• The obligation “<em>possesses no greater than a moderate credit risk</em>”; and “[i]s sufficiently liquid so that it <em>could</em> be sold <em>at or near its fair market value</em> within a reasonably short period of time.”</td>
</tr>
<tr>
<td><strong>Impartial Conduct Standard (including Best Interest Standard) is applicable.</strong></td>
</tr>
<tr>
<td><strong>Financial institution must be a fiduciary solely by reason of providing “investment advice.”</strong></td>
</tr>
<tr>
<td><strong>Pricing Requirements:</strong></td>
</tr>
<tr>
<td>• The individual and institution must reasonably</td>
</tr>
</tbody>
</table>
believe that the purchase or sale is at least as favorable to the Plan than the price available to the Plan in a transaction that is not a principal transaction.

- The individual and institution must reasonably believe that the purchase or sale is at least as favorable to the Plan as the contemporaneous price for the debt security, or a similar security if a price is not available with respect to the same security, and must be at least as favorable to the Plan as the price offered by two ready and willing unaffiliated counterparties.

- When comparing the price offered by the counterparties, the financial institution may take into account a commission as part of the resulting price to the Plan, including mark-ups or mark-downs.

**Contract Must Limit Exculpation Provisions.**
The written contract must not contain an exculpatory provision that disclaims or otherwise limits the liability of the individual or financial institution for a violation of the contract’s terms, and must not permit the Plan to waive or limit its right to bring or participate in a class action or other representative action in a contract dispute with the financial institution or the individual representative.  
See comments and observations for the Best Interest Contract Exemption.

**Additional Disclosure Requirements:**

- **Pre-execution:** Statement that the purchase or sale of the security will be executed as a principal transaction between the institution and the Plan and any available pricing information regarding the security including two third party quotes.

- **Confirmation.** Written confirmation of the transaction is in accordance with Rule 10b-10 under the Securities Exchange Act of 1934 that also includes disclosure of the mark-up, mark-down, or other payment to the individual, institution or affiliate.

- **Certain Annual Disclosure.** The institution must report the principal transactions engaged in, the prevailing market price at which the debt security was purchased or sold, and the applicable mark-up or mark-down and a statement that permission is

Plan in a transaction that is not a principal transaction. Presumably, this would mean the price at which another dealer would execute, including any commissions.

“At least as favorable . . . [as] offered by two ready and willing unaffiliated counterparties.” Institutions that rely on automated trading or pricing systems may need to determine whether this alone will be sufficient for purposes of satisfying this condition.
terminable at will.

- **Additional Disclosure Upon Request.**
  The financial institution must keep certain additional information upon request. **NOTE:** The Re-Proposal does not identify what this may entail.

**Sources of Liability if Exemption Required to Be Met—But Failed to Be Met:**

- **Sections 502(a)(2) and (3) of ERISA.**
  - Plan fiduciaries and participants may sue to recover any loss in value to the Plan, or to obtain disgorgement of wrongful profits.
  - In connection with suits by the DOL for Plans (other than IRAs)

- **Excise taxes for nonexempt prohibited transactions.**
  - 15 percent of the “amount involved” for each year (or part of year) the transaction is outstanding and not corrected.
  - Possibility of additional 100 percent excise tax if there is failure to timely respond to a notice of deficiency from the Internal Revenue Service.

- **Contractual liability** to plan participants and IRA owners.
DOL’s Fiduciary Re-Proposal: Caveat **Venditor** or “Death of a Salesman”?

**CHART V**

<table>
<thead>
<tr>
<th>Changes to Existing Prohibited Transaction Exemptions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Existing Exemption</strong></td>
</tr>
<tr>
<td>PTCE 75-1, Part I: Agency transactions in securities.</td>
</tr>
<tr>
<td>PTCE 75-1, Part II(1): Principal transactions in securities with U.S. registered broker-dealers or banks.</td>
</tr>
<tr>
<td>PTCE 75-1, Part II(2): Fiduciaries selling shares in principal transactions to Plans, if fiduciary is not a principal underwriter for or affiliated with the mutual fund.</td>
</tr>
<tr>
<td>PTCE 75-1, Part III: Permits Plans to purchase securities from a member of an underwriting syndicate other than the fiduciary, when the fiduciary is also a member of the syndicate.</td>
</tr>
<tr>
<td>PTCE 75-1, Part IV: Permits Plans to purchase securities from a fiduciary (or affiliate) that is a market maker with respect to such securities.</td>
</tr>
<tr>
<td>PTCE 77-4: Relief for Plan’s purchase of open-end U.S. registered mutual funds where the mutual fund investment adviser (or affiliate) is also a fiduciary to the Plan and is not the employer of employees covered by the plan.</td>
</tr>
<tr>
<td>PTCE 80-83:</td>
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<tr>
<td>-------------------------------------------------</td>
</tr>
<tr>
<td>Provides relief for a fiduciary causing a Plan to purchase a security when the proceeds of the securities issuance may be used by the issuer to retire or reduce debt to the fiduciary or its affiliate.</td>
</tr>
<tr>
<td>PTCE 83-1:</td>
</tr>
<tr>
<td>Provides relief for the sale to a Plan of certain certificates in an initial issuance of mortgage backed securities when the sponsor, trustee or insurer of the mortgage pool is a fiduciary to the Plan with respect to the assets invested in such certificates.</td>
</tr>
<tr>
<td>PTCE 84-24:</td>
</tr>
<tr>
<td>Permits pension consultants, insurance agents, brokers, and mutual fund principal underwriters to receive commissions in connection with transactions involving insurance or annuity contracts or mutual fund shares as a result of fiduciary advice they give in connection with these transactions. Also permits insurance companies and mutual fund principal underwriters who are fiduciaries or parties in interest to sell insurance or annuity contracts or mutual fund shares, as applicable, to Plans or IRAs.</td>
</tr>
</tbody>
</table>
| PTCE 86-128:                                    | Provides additional relief under Section 408(b)(3) (payments from third parties)—but only for receipts of brokerage commissions from other party in an agency cross transaction, receipts of sales loads from a mutual funds shares by a Plan or a *managed* (not advised) IRA. Note, however, while the exemption covers "commissions," it now *carves out* from its ambit "12b–1 fees, revenue sharing payment, marketing fee, administrative fee, sub–TA fee or sub–accounting fee."

_Broadens definition of “affiliate” for purposes of the exemption—no longer “controlled” affiliates._ | Revoked with respect to advised (not discretionary) IRAs. Intended to be eligible for coverage under the Best Interest Contract Exemption. Exemption does not apply for IRAs where fiduciary is an investment advice fiduciary. Market Participants may be limited to collect only up front commissions and sales loads under this exemption. By contrast, the Best Interest Contract Exemption may be more flexible for agency cross transactions. | None. |
New mutual fund transaction exemption for U.S. registered broker-dealers acting as principal.

Fiduciaries must comply with *Impartial Conduct Standards*, and:

- Requires the notice and disclosure and reporting requirements applicable to Plans to now also apply to discretionary IRA accounts.
- IRA definition is broadened to include items described in Code sections 4975(e)(1)(B) through (F), including a health savings account under 223(d) of the Code.

New mutual fund transaction exemption for U.S. registered broker-dealers acting as principal where:

- terms are as favorable as arms-length transactions,
- broker-dealer complies with Best Interest and Material Conflict requirements,
- all compensation is “reasonable in relation to the total services” provided,
- transactions are not “excessive” in either amount or frequency,
- broker-dealer is not a principal underwriter for or affiliated with the mutual fund, and is not a trustee (other than a nondiscretionary trustee, unless other conditions are met), an administrator of the plan, or an employer any of whose employees are covered by the plan,
- enhanced reporting requirements and advance authorization for transactions by an independent fiduciary.

*Impartial Conduct Standards* include that IRA fiduciaries must now act with duties of care, skill, prudence and diligence, and in the sole interest of the IRA.
DOL’s Fiduciary Re-Proposal: Caveat Venditor or “Death of a Salesman”?

**CHART VI**

**Mutual Fund Related Exemptions After Giving Effect to Re-Proposal**

<table>
<thead>
<tr>
<th>Permitted Compensation</th>
<th>PTCE 77-4</th>
<th>PTCE 86-128</th>
<th>Best Interest Contract Exemption</th>
<th>PTCE 84-24</th>
</tr>
</thead>
<tbody>
<tr>
<td>Affiliated Mutual Funds Permitted?</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes (if no discretionary authority); no relief for IRAs.</td>
</tr>
<tr>
<td>Unaffiliated Mutual Funds Permitted?</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Fee Offset Expressly Required?</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Impartial Conduct Standards Required?</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Proprietary mutual fund investment management fee (subject to offset) and permitted internal mutual fund administrative fees.</td>
<td></td>
<td></td>
<td>Commissions (initial, renewal and trail) or upfront sales loads paid by plan/mutual fund/insurance company only (no 12b-1 fees, revenue sharing payments, administrative or marketing fees)</td>
<td>Proprietary mutual fund investment management fee (subject to offset) and permitted internal mutual fund administrative fees</td>
</tr>
<tr>
<td>Agency cross securities transactions.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agency in securities: commissions consistent with exemption</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agency cross: other side commissions (but additional conditions).</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mutual funds: Sales loads only (no 12b-1 fees, revenue sharing payments, marketing fees, administrative fees, sub-TA fees or sub accounting fees).</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
DOL’s Fiduciary Re-Proposal: Caveat *Venditor* or “Death of a Salesman”?

**CHART VII**

<table>
<thead>
<tr>
<th>Plan Relationships Covered</th>
<th>Best Interest Contract Exemption* (May also Require Section 408(b)(2) Relief)</th>
<th>PTCE 86-128* *(May also Require Section 408(b)(2) Relief)</th>
<th>PTCE 84-24</th>
<th>PTCE 77-4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Advisory only and only for:</strong></td>
<td>• IRAs; • Participant Directed Plan Participants; and • Plans with less than 100 participants</td>
<td>• Advisory (except IRAs); • Discretionary</td>
<td>Advisory only (except IRAs for mutual funds, variable annuities and other annuities which are securities federal securities law)</td>
<td>• Advisory; • Discretionary</td>
</tr>
<tr>
<td><strong>Agency/Riskless Principal/Principal</strong></td>
<td>Agency transactions in: Bank deposits CDs U.S. mutual fund shares (proprietary and third party) CIT shares Insurance company pooled separate accounts ETFs (including ETF REITs) U.S registered corporate debt U.S. Agency Debt (Fannie, Freddie) U.S. Treasuries Insurance and annuity contracts Publicly traded equity securities</td>
<td>• Agency transactions in securities; • Agency cross transactions in securities • Riskless principal transactions in third party mutual funds</td>
<td>Agency; transactions with mutual funds and purchases of insurance products</td>
<td>Purchases and sales of affiliated open-end mutual funds</td>
</tr>
</tbody>
</table>
DOL’s Fiduciary Re-Proposal: Caveat *Venditor* or “Death of a Salesman”?

**CHART VIII**

The chart below highlights particular transactions and which selected exemptions may be available after giving effect to the Re-Proposal. The chart does not apply to Defined Large Plans and is not intended to be exhaustive in its content, nor does it consider existing exemptions that the Re-Proposal does not seek to amend.

**“ERISA Exemption Squares”**

<table>
<thead>
<tr>
<th>IRAs Investment Advice Only</th>
<th>Non-self-directed Plans with fewer than 100 participants; Plan participants of participant directed Plans</th>
<th>IRAs (Discretionary)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal transactions in securities</td>
<td>Principal Transaction Exemption</td>
<td></td>
</tr>
<tr>
<td>Agency transactions in securities</td>
<td>Best Interest Contract</td>
<td>Best Interest Contract (if investment advice only); PTCE 86-128</td>
</tr>
<tr>
<td>Purchases of affiliated mutual funds</td>
<td>Best Interest Contract; PTCE 77-4</td>
<td>Best Interest Contract (if investment advice only); PTCE 77-4; and PTCE 84-24</td>
</tr>
<tr>
<td>Purchases of third party mutual funds</td>
<td>Best Interest Contract</td>
<td>Best Interest Contract (if investment advice only); PTCE 86-128</td>
</tr>
<tr>
<td>Purchases of variable annuities and other insurance contracts under securities law</td>
<td>Best Interest Contract</td>
<td>Best Interest Contract (if investment advice only); PTCE 84-24</td>
</tr>
<tr>
<td>Purchases of other insurance contracts (not securities)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Publicly traded equity securities (if not a U.S. exchange).</td>
<td>Relief may not be available</td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>Municipal bonds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Options on publicly traded equities or indices</td>
<td></td>
<td></td>
</tr>
<tr>
<td>U.S. exchange traded futures contracts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sovereign debt</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unregistered bonds (i.e., 144A)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non USD denominated bonds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt issued by financial institution (or affiliate) which is presumed to provide investment advice.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign currency (including for dividends, interest etc.)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments in alternative funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment management services</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
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