

Chapman Client Alert

April 6, 2016

Current Issues Relevant to Our Clients

Department of Labor Adopts Final Rules on Fiduciary Advice Definition and Conflict of Interest Rule

Today the U.S. Department of Labor (the “DOL”) released its highly anticipated final rule to define the term “fiduciary” and address conflicts of interest in providing investment advice to retirement accounts. The final rule requires those who provide retirement investment advice to employee benefit plans and individual retirement accounts (“IRAs”) to abide by a fiduciary standard. The DOL also released related exemptions that provide requirements that must be satisfied to prevent prohibited transactions under the Employee Retirement Income Security Act of 1974 (“ERISA”).

Under the existing rules under ERISA, broker-dealers are generally not “fiduciaries” and IRAs are not subject to ERISA’s fiduciary duty requirements. The new rule changes these two key concepts. First, under the new rule broker-dealers will generally be deemed to be fiduciaries with respect to advice provided to retirement accounts. Second, IRAs will be covered by ERISA’s fiduciary duty requirements. This means that broker-dealers providing advice to IRAs will generally be subject to ERISA’s fiduciary standards rather than the typical “suitability” standard, including that advice must be prudent and that it must be in the best interest of the account and the investor. As fiduciaries, broker-dealers will also be subject to ERISA’s prohibited transaction rules with the two key components being a prohibition on receiving variable compensation (such as commissions, sales loads and 12b-1 fees) and a prohibition on engaging in principal transactions with a client account. To address certain issues related to these prohibitions, the final rulemaking also includes two new prohibited transaction exemptions, the Best Interest Contract Exemption (“BIC”) and the Principal Transactions Exemption, and amendments to certain existing exemptions. The BIC permits fiduciaries to receive variable compensation that would otherwise qualify as a prohibited transaction provided certain requirements are satisfied. The Principal Transactions Exemption permits certain advisers and financial institutions to engage in the purchase and sale of certain securities in principal transactions with investors in employee benefit plans or IRAs provided certain requirements are satisfied.

The final rulemaking appears to significantly expand the scope and feasibility of the previously-proposed BIC. While the expanded BIC generally does not provide an exemption for all principal transactions with client accounts, it does permit certain riskless principal transactions, including transactions in units of unit investment trusts (“UITs”) and other products. The final Principal Transactions Exemption covers certain debt securities but was also expanded to cover all principal trading in UITs and certificates of deposit. We will continue to review the new rule and exemptions and will publish additional information in future Client Alerts.

Compliance with the new requirements will be required one year after the final rule is published in the Federal Register (i.e., April 2017). The BIC and the Principal Transactions Exemption will become available on the April 2017 applicability date. Both exemptions provide for a transition period from the April 2017 date to January 1, 2018. The final rule release and all of the related exemption releases are available [here](#). The releases specifically

addressing the general conflicts of interest rule, the BIC and the Principal Transactions Exemption are available [here](#), [here](#) and [here](#). The DOL fact sheet on the final rule is available [here](#). A DOL chart illustrating certain changes from the proposed rule is available [here](#). The DOL FAQs on the final rule are available [here](#).

[For More Information](#)

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