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New Department of Labor Regulation

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New Regulation. On April 8, 2016, the U.S. Department of Labor (“DOL”) issued its long-awaited [final regulation](#) redefining what constitutes “investment advice” that makes the advice provider a “fiduciary” to plans, plan participants and IRA owners under ERISA and the prohibited transaction excise tax rules of Internal Revenue Code (“Code”) section 4975. The final regulation becomes applicable on April 10, 2017. In conjunction with the regulation, the DOL issued the new best interest contract exemption (“BIC Exemption”), which conditionally allows these “fiduciaries” to receive direct and indirect (e.g., brokerage or insurance commissions, 12b-1 fees and revenue sharing) compensation for their services.

This change applies to investment advisers that give advice to “separate account” clients. It does not apply to investment advisers to a private investment fund, even if the fund is a “plan assets” fund, if the investment adviser only manages the fund’s portfolio on a discretionary basis and does not provide any advice to the investors in the fund.

The redefinition itself does not affect the fiduciary status of investment advisers who already acknowledge that status. However, investment advisers that are fiduciaries with respect to retirement plan assets will be required to comply with the BIC Exemption in order to be compensated for advice services. The BIC Exemption imposes a set of conditions on investment advisers that are “Level Fee Fiduciaries” (i.e., those whose compensation is based on a set fee or fixed percentage of the value of assets), and additional conditions on investment advisers whose compensation varies with the particular investment recommended.

Level Fee Fiduciary. For a Level Fee Fiduciary, the BIC Exemption conditions are:

- The individual providing the advice (the “associated person”) is an employee, independent contractor, agent or representative of a “Financial Institution” (a federally- or state-registered investment adviser, bank, insurance company, registered broker-dealer or IRA custodian).
- The investment adviser discloses in writing its and the associated person’s fiduciary status.
- The investment adviser and associated person comply with “Impartial Conduct Standards,” which require that the advice be in the “Best Interest” of the investor. A fiduciary acts in the “Best Interest” when it acts with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with

such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the investor, without regard to the financial or other interests of the fiduciary, any affiliate or other party.

- Compensation received by the fiduciary and its affiliates is not in excess of “reasonable” compensation, within the meaning of ERISA and the Code prohibited transaction rules.

- The fiduciary's statements about recommended investments, fees and compensation, material conflicts of interest, and any other matters relevant to investment decisions, are not materially misleading at the time they are made. A “material conflict of interest” exists when a fiduciary has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to the investor.

- In the case of a recommendation to roll over funds from an ERISA Plan to an IRA, the Financial Institution provides written documentation of the reasons why it considered the recommendation to be in the best interest of the investor. The BIC Exemption details what that documentation must include.

An investment adviser that is a “fiduciary” and charges a “Level Fee” should review its form of client agreement and the standard ways it documents client advice about retirement plan assets, to determine if any changes are needed to ensure compliance with these conditions.

Non-Level Fee Fiduciary. If the investment adviser is not a “Level Fee Fiduciary,” the BIC Exemption requires in addition to the conditions listed above, that the investment adviser also:

- Adopt policies and procedures designed to ensure that its associated persons adhere to the Impartial Conduct Standards;

- Disclose important information relating to fees, compensation and material conflicts of interest;

- Retain records demonstrating compliance with the exemption;

- Not include in any contract exculpatory provisions for a violation of the contract’s terms, waiver or qualification of the investor’s right to participate in a class action, or agreement to arbitrate or mediate an individual claim in a distant or unreasonable venue; and

- If the investor is an IRA or non-ERISA Plan, enter into a written contract with the investor, stating that the investment adviser and its associated persons are fiduciaries and warranting that they will comply with the Impartial Conduct Standards, including the Best Interest standard. The contract must not contain provisions that disclaim or limit the liability of

the investment adviser or its associated person, or waive or qualify the right to bring or participate in a class action.

Compliance Date. Because the final regulation does not become applicable until April 10, 2017, reliance on the BIC Exemption before then is not required. During a transition period from that date through the end of 2017, only some of the BIC Exemption conditions must be met. The DOL has indicated that it will provide additional guidance on the BIC Exemption before its applicability date.

If you have any questions or comments, please contact one of the attorneys in the Investment Funds & Advisers Group at Shartsis Friese LLP: [John Broadhurst](#), [Geoff Haynes](#), [Chris Rupright](#), [Carolyn Reiser](#), [Neil Koren](#), [Jim Frolik](#), [Christina Hamilton](#), [Joan Grant](#), [Lyn Roberts](#), [Anthony Caldwell](#), [David Suozzi](#) or [Kathryn Miller](#).

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