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DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

[Application Number D–11713]

ZRIN 1210–ZA25

Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs

AGENCY: Employee Benefits Security Administration (EBSA), U.S. Department of Labor.

ACTION: Adoption of Class Exemption.

SUMMARY: This document contains an exemption from certain prohibited transactions provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (the Code). The provisions at issue generally prohibit fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs) from purchasing and selling investments when the fiduciaries are acting on behalf of their own accounts (principal transactions). The exemption permits principal transactions and riskless principal transactions in certain investments between a plan, plan participant or beneficiary account, or an IRA, and a fiduciary that provides investment advice to the plan or IRA, under conditions to safeguard the interests of these investors. The exemption affects participants and beneficiaries of plans, IRA owners, and fiduciaries with respect to such plans and IRAs.

DATES:

Issuance date: This exemption is issued June 7, 2016.

Applicability date: This exemption is applicable to transactions occurring on or after April 10, 2017. See Section F of this preamble, *Applicability Date and Transition Rules* in this preamble, for further information.

FOR FURTHER INFORMATION CONTACT: Brian Shiker, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor (202) 693–8824 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Executive Summary

Purpose of Regulatory Action

The Department grants this exemption in connection with its publication today, elsewhere in this issue of the **Federal Register**, of a final regulation defining who is a ''fiduciary'' of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries (Regulation). The Regulation also applies to the definition of a ''fiduciary'' of a plan (including an IRA) under the Code. The Regulation amends a prior regulation, dating to 1975, specifying when a person is a ''fiduciary'' under ERISA and the Code by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. The Regulation takes into account the advent of 401(k) plans and IRAs, the dramatic increase in rollovers, and other developments that have transformed the retirement plan landscape and the associated investment market over the four decades since the existing regulation was issued. In light of the extensive changes in retirement investment practices and relationships, the Regulation updates existing rules to distinguish more appropriately between the sorts of advice relationships that should be treated as fiduciary in nature and those that should not.

This exemption allows investment advice fiduciaries to engage in purchases and sales of certain investments out of their inventory (*i.e.,* engage in principal transactions) with plans, participant or beneficiary accounts, and IRAs, under conditions designed to safeguard the interests of these investors. In the absence of an exemption, these transactions would be prohibited under ERISA and the Code. In this regard, ERISA and the Code generally prohibit fiduciaries with respect to plans and IRAs from purchasing or selling any property to plans, participant or beneficiary accounts, or IRAs. Fiduciaries also may not engage in self-dealing or, under ERISA, act in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan or the interests of its participants and beneficiaries. When a fiduciary purchases or sells an investment in a principal transaction or riskless principal transaction, it violates these prohibitions.

ERISA section 408(a) specifically authorizes the Secretary of Labor to grant administrative exemptions from ERISA's prohibited transaction provisions.[1] Regulations at 29 CFR 2570.30 to 2570.52 describe the procedures for applying for an administrative exemption. In granting this exemption, the Department has determined that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners.

Summary of the Major Provisions

The exemption allows an individual investment advice fiduciary (an Adviser) [2] and the firm that employs or otherwise contracts with the Adviser (a Financial Institution) to engage in principal transactions and riskless principal transactions involving certain investments, with plans, participant and beneficiary accounts, and IRAs. The exemption limits the type of investments that may be purchased or sold and contains conditions which the

[1] Code section 4975(c)(2) authorizes the Secretary of the Treasury to grant exemptions from the parallel prohibited transaction provisions of the Code. Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)) (Reorganization Plan) generally transferred the authority of the Secretary of the Treasury to grant administrative exemptions under Code section 4975 to the Secretary of Labor. To rationalize the administration and interpretation of dual provisions under ERISA and the Code, the Reorganization Plan divided the interpretive and rulemaking authority for these provisions between the Secretaries of Labor and of the Treasury, so that, in general, the agency with responsibility for a given provision of Title I of ERISA would also have responsibility for the corresponding provision in the Code. Among the sections transferred to the Department were the prohibited transaction provisions and the definition of a fiduciary in both Title I of ERISA and in the Code. ERISA's prohibited transaction rules, 29 U.S.C. 1106–1108, apply to ERISA-covered plans, and the Code's corresponding prohibited transaction rules, 26 U.S.C. 4975(c), apply both to ERISA-covered pension plans that are tax-qualified pension plans, as well as other tax-advantaged arrangements, such as IRAs, that are not subject to the fiduciary responsibility and prohibited transaction rules in ERISA. Specifically, section 102(a) of the Reorganization Plan provides the Department of Labor with ''all authority'' for ''regulations, rulings, opinions, and exemptions under section 4975 [of the Code]'' subject to certain exceptions not relevant here. Reorganization Plan section 102. In President Carter's message to Congress regarding the Reorganization Plan, he made explicitly clear that as a result of the plan, ''Labor will have statutory authority for fiduciary obligations. . . . Labor will be responsible for overseeing fiduciary conduct under these provisions.'' Reorganization Plan, Message of the President. This exemption provides relief from the indicated prohibited transaction provisions of both ERISA and the Code.

[2] By using the term ''Adviser,'' the Department does not intend to limit the exemption to investment advisers registered under the Investment Advisers Act of 1940 or under state law. As explained herein, an Adviser must be an investment advice fiduciary of a plan or IRA who is an employee, independent contractor, agent, or registered representative of a registered investment adviser, bank, or registered broker-dealer.

Adviser and Financial Institution must satisfy in order to rely on the exemption. To safeguard the interests of plans, participants and beneficiaries, and IRA owners, the exemption requires Financial Institutions to give the appropriate fiduciary of the plan or IRA owner a written statement in which the Financial Institution acknowledges its fiduciary status and that of its Advisers. The Financial Institution and Adviser must adhere to enforceable standards of fiduciary conduct and fair dealing when providing investment advice regarding the transaction to Retirement Investors. In the case of IRAs and non-ERISA plans, the exemption requires that these standards be set forth in an enforceable contract with the Retirement Investor. Under the exemption's terms, Financial Institutions are not required to enter into a contract with ERISA plan investors, but they are obligated to acknowledge fiduciary status in writing, and adhere to these same standards of fiduciary conduct, which the investors can effectively enforce pursuant to section 502(a)(2) and (3) of ERISA. Under this standards-based approach, the Adviser and Financial Institution must give prudent advice that is in the customer's Best Interest, avoid misleading statements, and seek to obtain the best execution reasonably available under the circumstances with respect to the transaction. Additionally, Financial Institutions must adopt policies and procedures reasonably designed to mitigate any harmful impact of conflicts of interest, and must disclose their conflicts of interest to Retirement Investors.

The exemption is calibrated to align the Adviser's interests with those of the plan or IRA customer, while leaving the Adviser and the Financial Institution the flexibility and discretion necessary to determine how best to satisfy the exemption's standards in light of the unique attributes of their business. Financial Institutions relying on the exemption must obtain the Retirement Investor's consent to participate in principal transactions and riskless principal transactions, and the Financial Institutions are subject to recordkeeping requirements.

Executive Order 12866 and 13563 Statement

Under Executive Orders 12866 and 13563, the Department must determine whether a regulatory action is ''significant'' and therefore subject to the requirements of the Executive Order and subject to review by the Office of Management and Budget (OMB). Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing and streamlining rules, and of promoting flexibility. It also requires federal agencies to develop a plan under which the agencies will periodically review their existing significant regulations to make the agencies' regulatory programs more effective or less burdensome in achieving their regulatory objectives.

Under Executive Order 12866, ''significant'' regulatory actions are subject to the requirements of the Executive Order and review by the OMB. Section 3(f) of Executive Order 12866, defines a ''significant regulatory action'' as an action that is likely to result in a rule (1) having an annual effect on the economy of $100 million or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as ''economically significant'' regulatory actions); (2) creating serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order. Pursuant to the terms of the Executive Order, OMB has determined that this action is ''significant'' within the meaning of Section 3(f)(1) of the Executive Order. Accordingly, the Department has undertaken an assessment of the costs and benefits of the proposal, and OMB has reviewed this regulatory action. The Department's complete Regulatory Impact Analysis is available at *www.dol.gov/ebsa.*

I. Background

The Department proposed this class exemption on its own motion, pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637 (October 27, 2011)).

A. Regulation Defining a Fiduciary

As explained more fully in the preamble to the Regulation, ERISA is a comprehensive statute designed to protect the interests of plan participants and beneficiaries, the integrity of employee benefit plans, and the security of retirement, health, and other critical benefits. The broad public interest in ERISA-covered plans is reflected in its imposition of stringent fiduciary responsibilities on parties engaging in important plan activities, as well as in the tax-favored status of plan assets and investments. One of the chief ways in which ERISA protects employee benefit plans is by requiring that plan fiduciaries comply with fundamental obligations rooted in the law of trusts. In particular, plan fiduciaries must manage plan assets prudently and with undivided loyalty to the plans and their participants and beneficiaries.[3] In addition, they must refrain from engaging in ''prohibited transactions,'' which ERISA does not permit because of the dangers posed by the fiduciaries' conflicts of interest with respect to the transactions.[4] When fiduciaries violate ERISA's fiduciary duties or the prohibited transaction rules, they may be held personally liable for the breach.[5] In addition, violations of the prohibited transaction rules are subject to excise taxes under the Code.

The Code also has rules regarding fiduciary conduct with respect to tax-favored accounts that are not generally covered by ERISA, such as IRAs. In particular, fiduciaries of these arrangements, including IRAs, are subject to the prohibited transaction rules and, when they violate the rules, to the imposition of an excise tax enforced by the Internal Revenue Service. Unlike participants in plans covered by Title I of ERISA, IRA owners do not have a statutory right to bring suit against fiduciaries for violations of the prohibited transaction rules.

Under this statutory framework, the determination of who is a ''fiduciary'' is of central importance. Many of ERISA's and the Code's protections, duties, and liabilities hinge on fiduciary status. In relevant part, ERISA section 3(21)(A) and Code section 4975(e)(3) provide that a person is a fiduciary with respect to a plan or IRA to the extent he or she (i) exercises any discretionary authority or discretionary control with respect to management of such plan or IRA, or exercises any authority or control with respect to management or disposition of

[3] ERISA section 404(a).

[4] ERISA section 406. ERISA also prohibits certain transactions between a plan and a party in interest.

[5] ERISA section 409; *see also* ERISA section 405.

its assets; (ii) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan or IRA, or has any authority or responsibility to do so; or, (iii) has any discretionary authority or discretionary responsibility in the administration of such plan or IRA.

The statutory definition deliberately casts a wide net in assigning fiduciary responsibility with respect to plan and IRA assets. Thus, ''any authority or control'' over plan or IRA assets is sufficient to confer fiduciary status, and any persons who render ''investment advice for a fee or other compensation, direct or indirect'' are fiduciaries, regardless of whether they have direct control over the plan's or IRA's assets and regardless of their status as an investment adviser or broker under the federal securities laws. The statutory definition and associated responsibilities were enacted to ensure that plans, plan participants and IRA owners can depend on persons who provide investment advice for a fee to provide recommendations that are untainted by conflicts of interest. In the absence of fiduciary status, the providers of investment advice are neither subject to ERISA's fundamental fiduciary standards, nor accountable under ERISA or the Code for imprudent, disloyal, or biased advice.

In 1975, the Department issued a regulation, at 29 CFR 2510.3–21(c)(1975) defining the circumstances under which a person is treated as providing ''investment advice'' to an employee benefit plan within the meaning of section 3(21)(A)(ii) of ERISA (the 1975 regulation).[6] The 1975 regulation narrowed the scope of the statutory definition of fiduciary investment advice by creating a five-part test for fiduciary advice. Under the 1975 regulation, for advice to constitute ''investment advice,'' an adviser must—(1) render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property (2) on a regular basis (3) pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary that (4) the advice will serve as a primary basis for investment decisions with respect to plan assets, and that (5) the advice will be individualized based on the particular needs of the plan. The 1975 regulation provided that an adviser is a fiduciary with respect to any particular instance of advice only if he or she meets each and every element of the five-part test with respect to the particular advice recipient or plan at issue.

The market for retirement advice has changed dramatically since the Department first promulgated the 1975 regulation. Individuals, rather than large employers and professional money managers, have become increasingly responsible for managing retirement assets as IRAs and participant-directed plans, such as 401(k) plans, have supplanted defined benefit pensions. At the same time, the variety and complexity of financial products have increased, widening the information gap between advisers and their clients. Plan fiduciaries, plan participants and IRA investors must often rely on experts for advice, but are unable to assess the quality of the expert's advice or effectively guard against the adviser's conflicts of interest. This challenge is especially true of retail investors, who typically do not have financial expertise and can ill-afford lower returns to their retirement savings caused by conflicts. The IRA accounts of these investors often account for all or the lion's share of their assets, and can represent all of savings earned for a lifetime of work. Losses and reduced returns can be devastating to the investors who depend upon such savings for support in their old age. As baby boomers retire, they are increasingly moving money from ERISA-covered plans, where their employer has both the incentive and the fiduciary duty to facilitate sound investment choices, to IRAs where both good and bad investment choices are myriad and advice that is conflicted is commonplace. These rollovers are expected to approach $2.4 trillion cumulatively from 2016 through 2020.[7] These trends were not apparent when the Department promulgated the 1975 regulation. At that time, 401(k) plans did not yet exist and IRAs had only just been authorized.

As the marketplace for financial services has developed in the years since 1975, the five-part test has now come to undermine, rather than promote, the statutes' text and purposes. The narrowness of the 1975 regulation has allowed advisers, brokers, consultants and valuation firms to play a central role in shaping plan and IRA investments, without ensuring the accountability that Congress intended for persons having such influence and responsibility. Even when plan sponsors, participants, beneficiaries, and IRA owners clearly relied on paid advisers for impartial guidance, the 1975 regulation has allowed many advisers to avoid fiduciary status and disregard basic fiduciary obligations of care and prohibitions on disloyal and conflicted transactions. As a consequence, these advisers have been able to steer customers to investments based on their own self-interest (*e.g.,* products that generate higher fees for the adviser even if there are identical lower-fee products available), give imprudent advice, and engage in transactions that would otherwise be prohibited by ERISA and the Code without fear of accountability under either ERISA or the Code.

In the Department's amendments to the 1975 regulation defining fiduciary advice within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) (the Regulation), which are also published in this issue of the **Federal Register**, the Department is replacing the existing regulation with one that more appropriately distinguishes between the sorts of advice relationships that should be treated as fiduciary in nature and those that should not, in light of the legal framework and financial marketplace in which IRAs and plans currently operate.[8]

The Regulation describes the types of advice that constitute ''investment advice'' with respect to plan or IRA assets for purposes of the definition of a fiduciary at ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B). The Regulation covers ERISA-covered plans, IRAs, and other plans not covered by Title I, such as Keogh plans, and health savings accounts described in Code section 223(d).

As amended, the Regulation provides that a person renders investment advice with respect to assets of a plan or IRA if, among other things, the person provides, directly to a plan, a plan fiduciary, plan participant or beneficiary, IRA or IRA owner, the following types of advice, for a fee or other compensation, whether direct or indirect:

(i) A recommendation as to the advisability of acquiring, holding, disposing of, or exchanging, securities or other investment property, or a

[6] The Department of Treasury issued a virtually identical regulation, at 26 CFR 54.4975–9(c), which interprets Code section 4975(e)(3).

[7] Cerulli Associates, ''Retirement Markets 2015.''

[8] The Department initially proposed an amendment to its regulation defining a fiduciary within the meaning of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) on October 22, 2010, at 75 FR 65263. It subsequently announced its intention to withdraw the proposal and propose a new rule, consistent with the President's Executive Orders 12866 and 13563, in order to give the public a full opportunity to evaluate and comment on the new proposal and updated economic analysis. The first proposed amendment to the rule was withdrawn on April 20, 2015, *see* 80 FR 21927.

recommendation as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred or distributed from the plan or IRA; and

(ii) A recommendation as to the management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, selection of other persons to provide investment advice or investment management services, types of investment account arrangements (brokerage versus advisory), or recommendations with respect to rollovers, transfers or distributions from a plan or IRA, including whether, in what amount, in what form, and to what destination such a rollover, transfer or distribution should be made.

In addition, in order to be treated as a fiduciary, such person, either directly or indirectly (*e.g.,* through or together with any Affiliate), must: Represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code with respect to the advice described; represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code; render the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the particular investment needs of the advice recipient; or direct the advice to a specific advice recipient or recipients regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the plan or IRA.

The Regulation also provides that as a threshold matter in order to be fiduciary advice, the communication must be a ''recommendation'' as defined therein. The Regulation, as a matter of clarification, provides that a variety of other communications do not constitute ''recommendations,'' including non-fiduciary investment education; general communications; and specified communications by platform providers. These communications which do not rise to the level of ''recommendations'' under the Regulation are discussed more fully in the preamble to the final Regulation.

The Regulation also specifies certain circumstances where the Department has determined that a person will not be treated as an investment advice fiduciary even though the person's activities technically may satisfy the definition of investment advice. For example, the Regulation contains a provision excluding recommendations to independent fiduciaries with financial expertise that are acting on behalf of plans or IRAs in arm's length transactions, if certain conditions are met. The independent fiduciary must be a bank, insurance carrier qualified to do business in more than one state, investment adviser registered under the Investment Advisers Act of 1940 or by a state, broker-dealer registered under the Securities Exchange Act of 1934 (Exchange Act), or any other independent fiduciary that holds, or has under management or control, assets of at least $50 million, and: (1) The person making the recommendation must know or reasonably believe that the independent fiduciary of the plan or IRA is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition); (2) the person must fairly inform the independent fiduciary that the person is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction and must fairly inform the independent fiduciary of the existence and nature of the person's financial interests in the transaction; (3) the person must know or reasonably believe that the independent fiduciary of the plan or IRA is a fiduciary under ERISA or the Code, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition); and (4) the person cannot receive a fee or other compensation directly from the plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner for the provision of investment advice (as opposed to other services) in connection with the transaction.

Similarly, the Regulation provides that the provision of any advice to an employee benefit plan (as described in ERISA section 3(3)) by a person who is a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, or a swap clearing firm in connection with a swap or security-based swap, as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a) and section 3(a) of the Exchange Act (15 U.S.C. 78c(a)) is not investment advice if certain conditions are met. Finally, the Regulation describes certain communications by employees of a plan sponsor, plan, or plan fiduciary that would not cause the employee to be an investment advice fiduciary if certain conditions are met.

B. Prohibited Transactions

The Department anticipates that the Regulation will cover many investment professionals who did not previously consider themselves to be fiduciaries under ERISA or the Code. Under the Regulation, these entities will be subject to the prohibited transaction restrictions in ERISA and the Code that apply specifically to fiduciaries. ERISA section 406(b)(1) and Code section 4975(c)(1)(E) prohibit a fiduciary from dealing with the income or assets of a plan or IRA in his own interest or his own account. ERISA section 406(b)(2), which does not apply to IRAs, provides that a fiduciary shall not ''in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries.'' ERISA section 406(b)(3) and Code section 4975(c)(1)(F) prohibit a fiduciary from receiving any consideration for his own personal account from any party dealing with the plan or IRA in connection with a transaction involving assets of the plan or IRA.

Parallel regulations issued by the Departments of Labor and the Treasury explain that these provisions impose on fiduciaries of plans and IRAs a duty not to act on conflicts of interest that may affect the fiduciary's best judgment on behalf of the plan or IRA.[9] The prohibitions extend to a fiduciary causing a plan or IRA to pay an additional fee to such fiduciary, or to a person in which such fiduciary has an interest that may affect the exercise of the fiduciary's best judgment as a fiduciary. Likewise, a fiduciary is prohibited from receiving compensation from third parties in connection with a transaction involving the plan or IRA.[10]

The purchase or sale of an investment in a principal transaction or riskless principal transaction between a plan or IRA and a fiduciary, resulting from the fiduciary's provision of investment advice, implicates the prohibited

[9] Subsequent to the issuance of these regulations, Reorganization Plan No. 4 of 1978, 5 U.S.C. App. (2010), divided rulemaking and interpretive authority between the Secretaries of Labor and the Treasury. The Secretary of Labor was given interpretive and rulemaking authority regarding the definition of fiduciary under both Title I of ERISA and the Internal Revenue Code. *Id.* section 102(a) (''all authority of the Secretary of the Treasury to issue [regulations, rulings opinions, and exemptions under section 4975 of the Code] is hereby transferred to the Secretary of Labor'').

[10] 29 CFR 2550.408b–2(e); 26 CFR 54.4975–6(a)(5).

transaction rules set forth in ERISA section 406(b) and Code section 4975(c)(1)(E).[11] Nevertheless, the Department recognizes that certain investment advice fiduciaries view the ability to execute principal transactions or riskless principal transaction as integral to the economically efficient distribution of fixed income securities. Therefore, in connection with the Regulation, the Department reviewed the existing legal framework to determine whether additional exemptions were needed for investment advice fiduciaries to engage in these transactions. In this regard, as further discussed below, fiduciaries who engage in such transactions under certain circumstances can avoid the ERISA and Code restrictions. Moreover, there are existing statutory and administrative exemptions, also discussed below, that already provide prohibited transaction relief for fiduciaries engaging in principal transactions and riskless principal transactions with plans and IRAs. Nevertheless, the Department determined that additional relief in this area is necessary and therefore, after reviewing the comments on the proposal, determined to grant this exemption for investment advice fiduciaries to engage in certain principal transactions and riskless principal transactions with plans and IRAs.

1. Blind Transactions

Certain principal transactions and riskless principal transactions between a plan or IRA and an investment advice fiduciary may not need exemptive relief because they are blind transactions executed on an exchange. The ERISA Conference Report states that a transaction will, generally, not be a prohibited transaction if the transaction is an ordinary ''blind'' purchase or sale of securities through an exchange where neither the buyer nor the seller (nor the agent of either) knows the identity of the other party involved.[12]

2. Principal Transactions Permitted Under an Exemption

As the prohibited transaction provisions demonstrate, ERISA and the Code strongly disfavor conflicts of interest. In appropriate cases, however, the statutes provide exemptions from their broad prohibitions on conflicts of interest. In addition, the Secretary of Labor has discretionary authority to grant administrative exemptions under ERISA and the Code on an individual or class basis, but only if the Secretary first finds that the exemptions are (1) administratively feasible, (2) in the interests of plans and their participants and beneficiaries and IRA owners, and (3) protective of the rights of the participants and beneficiaries of such plans and IRA owners. Accordingly, fiduciary advisers may always give advice without need of an exemption if they avoid the sorts of conflicts of interest that result in prohibited transactions. However, when they choose to give advice in which they have a conflict of interest, they must rely upon an exemption.

a. Statutory Exemptions

ERISA section 408(b)(14) provides a statutory exemption for transactions entered into in connection with the provision of fiduciary investment advice to a participant or beneficiary of an individual account plan or an IRA owner. The exemption provides relief for, among other things, the acquisition, holding, or sale of a security or other property as an investment under the plan pursuant to the investment advice. As set forth in ERISA section 408(g), the exemption is available if the advice is provided under an ''eligible investment advice arrangement'' which either (1) ''provides that any fees (including any commission or other compensation) received by the fiduciary adviser for investment advice or with respect to the sale, holding or acquisition of any security or other property for purposes of investment of plan assets do not vary depending on the basis of any investment option selected'' or (2) ''uses a computer model under an investment advice program meeting the requirements of [ERISA section 408(g)(3)].'' The ERISA section 408(g) exemptions include special conditions calibrated to insulate the fiduciary adviser from conflicts of interest. Code section 4975(d)(17) provides the same relief from the taxes imposed by Code section 4975(a) and (b).

ERISA section 408(b)(16) provides relief for transactions involving the purchase or sale of securities between a plan and a party in interest, including an investment advice fiduciary, if the transactions are executed through an electronic communication network, alternative trading system, or similar execution system or trading venue. Among other conditions, subparagraph (B) of the statutory exemption requires that either: (i) ''the transaction is effected pursuant to rules designed to match purchases and sales at the best price available through the execution system in accordance with applicable rules of the Securities and Exchange Commission or other relevant governmental authority,'' or (ii) ''neither the execution system nor the parties to the transaction take into account the identity of the parties in the execution of trades[.]'' The transactions covered by ERISA section 408(b)(16) include principal transactions between a plan and an investment advice fiduciary. Code section 4975(d)(19) provides the same relief from the taxes imposed by Code section 4975(a) and (b).

b. Administrative Exemptions

An administrative exemption for certain principal transactions will continue to be available through PTE 75–1.[13] Specifically, PTE 75–1, Part IV, provides an exemption that is available to investment advice fiduciaries who are ''market-makers.'' Relief is available from ERISA section 406 for the purchase or sale of securities by a plan or IRA, from or to a market-maker with respect to such securities who is also an investment advice fiduciary with respect to the plan or IRA, or an affiliate of such fiduciary. However, PTE 75–1, Part IV, is amended today in a Notice, published elsewhere in this issue of the **Federal Register**, to require fiduciaries relying on the exemption to comply with the Impartial Conduct Standards that are also incorporated in this exemption.

Further, Part II(1) of PTE 75–1 provides relief from ERISA section 406(a) and Code section 4975(c)(1)(A) through (D) for the purchase or sale of a security in a principal transaction between a plan or IRA and a broker-dealer registered under the Exchange Act or a bank supervised by the United States or a state. However, the exemption permits plans and IRAs to engage in principal transactions with broker-dealers and banks only if the broker-dealers and banks do not have or exercise any discretionary authority or control (except as a directed trustee) with respect to the investment of plan or IRA assets involved in the transaction, and *do not render investment advice (within the meaning of 29 CFR 2510.3–21(c)) with respect to the investment of those assets.* PTE 75–1, Part II(1) will continue to be available to parties in interest that are not fiduciaries and that satisfy its conditions. In this regard, the Regulation provides that parties will not be investment advice fiduciaries if they engage in arm's length transactions with

[11] The purchase or sale of an investment in a principal transaction or a riskless principal transaction between a plan or IRA and a fiduciary also is prohibited by ERISA section 406(a)(1)(A) and (D) and Code section 4975(c)(1)(A) and (D).

[12] *See* H.R. Rep. 93–1280, 93rd Cong., 2d Sess. 307 (1974); *see also* ERISA Advisory Opinion 2004–05A (May 24, 2004).

[13] 40 FR 50845 (Oct. 31, 1975), as amended, 71 FR 5883 (Feb. 3, 2006).

certain independent fiduciaries of a plan or IRA with financial expertise, including banks, insurance carriers, registered investment advisers, broker-dealers and persons holding, or possessing under management or control, total assets of at least $50 million, and who are capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies, and certain other conditions are satisfied. These non-fiduciary counterparties can continue to rely on PTE 75–1, Part II, for relief regarding principal transactions.

In connection with the proposed Regulation, the Department recognized the need for additional relief. Accordingly, the Department proposed this exemption for principal transactions in certain debt securities between a plan, participant or beneficiary account, or IRA, and an investment advice fiduciary. The proposed exemption was intended to facilitate continued access by plan and IRA investors to certain types of investments commonly sold in principal transactions.

The Department also proposed the Best Interest Contract Exemption, which is adopted elsewhere in this issue of the **Federal Register**. The Best Interest Contract Exemption provides broad relief for investment advice fiduciaries and their Affiliates and related entities to receive compensation as a result of investment advice to retail Retirement Investors (plan participants and beneficiaries, IRA owners, and certain plan fiduciaries, including small plan sponsors) under conditions specifically designed to address the conflicts of interest associated with the wide variety of payments advisers receive in connection with retail transactions involving plans and IRAs.

At the same time that the Department has granted these new exemptions, it has also amended existing exemptions to ensure uniform application of the Impartial Conduct Standards, which are fundamental obligations of fair dealing and fiduciary conduct, and include obligations to act in the customer's Best Interest, avoid misleading statements, and receive no more than reasonable compensation.[14] Taken together, the new exemptions and amendments to existing exemptions ensure that Retirement Investors are consistently protected by Impartial Conduct Standards, regardless of the particular exemption upon which the adviser relies.

The amendments also revoke certain existing exemptions, which provided little or no protections to IRA and non-ERISA plan participants, in favor of a more uniform application of the Best Interest Contract Exemption in the market for retail investments. With limited exceptions, it is the Department's intent that investment advice fiduciaries in the retail investment market rely on statutory exemptions, the Best Interest Contract Exemption, or this exemption to the extent that they receive conflicted forms of compensation that would otherwise be prohibited. The new and amended exemptions reflect the Department's view that Retirement Investors should be protected by a more consistent application of fundamental fiduciary standards across a wide range of investment products and advice relationships, and that retail investors, in particular, should be protected by the stringent protections set forth in the Best Interest Contract Exemption and this exemption. When fiduciaries have conflicts of interest, they will uniformly be expected to adhere to fiduciary norms and to make recommendations that are in their customer's Best Interest.

These new and amended exemptions follow a lengthy public notice and comment process, which gave interested persons an extensive opportunity to comment on this proposed exemption, proposed Regulation and other related exemption proposals. The proposals initially provided for 75-day comment periods, ending on July 6, 2015, but the Department extended the comment periods to July 21, 2015. The Department then held four days of public hearings on the new regulatory package, including the proposed exemptions, in Washington, DC from August 10 to 13, 2015, at which over 75 speakers testified. The transcript of the hearing was made available on September 8, 2015, and the Department provided additional opportunity for interested persons to comment on the proposals or hearing transcript until September 24, 2015. A total of over 3000 comment letters were received on the new proposals. There were also over 300,000 submissions made as part of 30 separate petitions submitted on the proposal. These comments and petitions came from consumer groups, plan sponsors, financial services companies, academics, elected government officials, trade and industry associations, and others, both in support and in opposition to the rule.[15] The Department has reviewed all comments, and after careful consideration of the comments, has decided to grant this exemption.

II. Exemption for Principal Transactions in Certain Assets

As finalized, this exemption for certain principal transactions and riskless principal transactions retains the core protections of the proposed exemption, but with revisions designed to facilitate implementation and compliance with the exemption's terms. In broadest outline, the exemption permits Advisers and the Financial Institutions that employ or otherwise retain them to enter into principal transactions and riskless principal transactions with plans and IRAs regarding certain investments, provided that they give advice regarding the transactions that is in their customers' Best Interest and the Financial Institution implements basic protections against the dangers posed by conflicts of interest. In particular, to rely on the exemption, Financial Institutions must:

- Acknowledge fiduciary status with respect to any investment advice regarding principal transactions or riskless principal transactions;
- Adhere to Impartial Conduct Standards requiring them to
  - Give advice that is in the Retirement Investor's Best Interest (*i.e.,* prudent advice that is based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to financial or other interests of the Adviser, Financial Institution or any Affiliates or other parties);
  - Seek to obtain the best execution reasonably available under the circumstances with respect to the transaction; and
  - Make no misleading statements about investment transactions, compensation, and conflicts of interest;
- Implement policies and procedures reasonably and prudently designed to prevent violations of the Impartial Conduct Standards;
- Refrain from giving or using incentives for Advisers to act contrary to the customer's Best Interest; and
- Make additional disclosures.

Advisers relying on the exemption must comply with the Impartial Conduct Standards when making investment recommendations regarding principal transactions and riskless principal transactions.

[14] The amended exemptions, published elsewhere in this **Federal Register**, include Prohibited Transaction Exemption (PTE) 75–1; PTE 77–4; PTE 80–83; PTE 83–1: PTE 84–24; and PTE 86–128.

[15] As used throughout this preamble, the term ''comment'' refers to information provided through these various sources, including written comments, petitions and witnesses at the public hearing.

The exemption takes a principles-based approach that permits Financial Institutions and Advisers to enter into transactions that would otherwise be prohibited. The exemption holds Financial Institutions and their Advisers responsible for adhering to fundamental standards of fiduciary conduct and fair dealing, while leaving them the flexibility and discretion necessary to determine how best to satisfy these basic standards in light of the unique attributes of their particular businesses. The exemption's principles-based conditions, which are rooted in the law of trust and agency, have the breadth and flexibility necessary to apply to a large range of investment and compensation practices, while ensuring that Advisers put the interests of Retirement Investors first. When Advisers choose to give advice regarding principal transactions and riskless principal transactions to Retirement Investors, they must protect their customers from the dangers posed by conflicts of interest.

In order to ensure compliance with the exemption's broad protective standards and purposes, the exemption gives special attention to the enforceability of the exemption's terms by Retirement Investors. When Financial Institutions and Advisers breach their obligations under the exemption and cause losses to Retirement Investors, it is generally critical that the investors have a remedy to redress the injury. The existence of enforceable rights and remedies gives Financial Institutions and Advisers a powerful incentive to comply with the exemption's standards, implement policies and procedures that are more than window-dressing, and carefully police conflicts of interest to ensure that the conflicts of interest do not taint the advice.

Thus, in the case of IRAs and non-ERISA plans, the exemption requires the Financial Institution to commit to the Impartial Conduct Standards in an enforceable contract with Retirement Investor customers. The exemption does not similarly require the Financial Institution to execute a separate contract with ERISA investors (plan participants, beneficiaries, and fiduciaries), but the Financial Institution must acknowledge its fiduciary status and that of its Advisers, and ERISA investors can directly enforce their rights to proper fiduciary conduct under ERISA section 502(a)(2) and (3). In addition, the exemption safeguards Retirement Investors' enforcement rights by providing that Financial Institutions and Advisers may not rely on the exemption if they include contractual provisions disclaiming liability for compensatory remedies or waiving or qualifying Retirement Investors' right to pursue a class action or other representative action in court. However, the exemption does permit Financial Institutions to include provisions waiving the right to punitive damages or rescission as contract remedies to the extent permitted by other applicable laws. In the Department's view, the availability of make-whole relief for such claims is sufficient to protect Retirement Investors and incentivize compliance with the exemption's conditions.

While the final exemption retains the proposed exemption's core protections, the Department has revised the exemption to ease implementation in response to commenters' concerns about the exemption's workability. Thus, for example, the final exemption eliminates the contract requirement altogether in the ERISA context and simplifies the mechanics of contract-formation for IRAs and plans not covered by Title I of ERISA. For new customers, the final exemption provides that the required contract terms may simply be incorporated in the Financial Institution's account opening documents and similar commonly-used agreements. The exemption additionally permits reliance on a negative consent process for existing contract holders. The Department recognizes that Retirement Investors may talk to numerous Advisors in numerous settings over the course of their relationship with a Financial Institution. Accordingly, the exemption also simplifies execution of the contract by simply requiring the Financial Institution to execute the contract, rather than each of the individual Advisers from whom the Retirement Investor receives advice. For similar reasons, the exemption does not require execution of the contract at the start of Retirement Investors' conversations with Advisers, as long as it is entered into prior to or at the same time as the recommended transaction.

As a means of facilitating use of the exemption, the Department also reduced compliance burdens by eliminating some of the conditions that were not critical to the exemption's protective purposes, and expanding the scope of the exemption's coverage (*e.g.,* by covering interests in unit investment trusts (UITs) and certificates of deposit (CDs)). The Department eliminated the requirement of adherence to other state and federal laws relating to advice as unduly expansive and duplicative of other laws; dropped a two-quote requirement; and eliminated a mark-up and mark-down disclosure requirement. In addition, the Department streamlined the disclosure conditions by simplifying the obligations. The Department also provided a mechanism for correcting good faith violations of the disclosure conditions, so that Financial Institutions would not lose the benefit of the exemption as a result of such good faith errors and would have an incentive to promptly correct them.

While making these changes to facilitate the implementation of the exemption, the Department emphasizes that the exemption is limited because of the severity of the conflicts of interest associated with principal transactions. When acting as a principal in a transaction involving a plan, participant or beneficiary account, or IRA, a fiduciary can have difficulty reconciling its duty to avoid conflicts of interest with its concern for its own financial interests as the Retirement Investor's counterparty. Of primary concern are issues involving liquidity, pricing, transparency, and the fiduciary's possible incentive to ''dump'' unwanted assets. The scope of this exemption balances the Department's significant concerns regarding principal transactions with the need to preserve market choice for plans, participants and beneficiary accounts, and IRAs.

The comments on this exemption, the Best Interest Contract Exemption, the Regulation, and related exemptions have helped the Department improve this exemption, while preserving and enhancing its protections. As described above, the Department has revised the exemption to facilitate implementation and compliance with the exemption, without diluting its core protections, which are critical to reducing the harm caused by conflicts of interest in the marketplace for advice. The tax-preferred investments covered by the exemption are critical to the financial security and physical health of investors. After consideration of the comments, the Department remains convinced of the importance of the exemption's core protections.

ERISA and the Code are rightly skeptical of the dangers posed by conflicts of interest, and generally prohibit conflicted advice. Before granting exemptive relief, the Department has a statutory obligation to ensure that the exemption is in the interests of plan and IRA investors and protective of their rights. Adherence to the fundamental fiduciary norms and basic protective conditions of this exemption helps ensure that investment recommendations are not driven by Adviser conflicts, but by the Best Interest of the Retirement Investor. The conditions of this exemption are carefully calibrated to permit principal transaction and riskless principal transactions in certain investments, while protecting Retirement Investors' interest in receiving sound advice on vitally important investments. Based upon these protective conditions, the Department finds that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners.

The preamble sections that follow provide a much more detailed discussion of the exemption's terms, comments on the exemption, and the Department's responses to those comments. After a discussion of the exemption's scope and limitations, the preamble discusses the conditions of the exemptions.

A. Scope of Relief in the Exemption

The exemption provides relief for ''Advisers'' and ''Financial Institutions'' to enter into ''principal transactions'' and ''riskless principal transactions'' in ''principal traded assets'' with plans and IRAs. For purposes of the exemption, a principal transaction is a transaction in which an Adviser or Financial Institution is purchasing from or selling to the plan, participant or beneficiary account, or IRA on behalf of the account of the Financial Institution or the account of any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Financial Institution. The term principal transaction does not include a riskless principal transaction as defined in the exemption. A riskless principal transaction is defined as a transaction in which a Financial Institution, after having received an order from a Retirement Investor to buy or sell a principal traded asset, purchases or sells the asset for the Financial Institution's own account to offset the contemporaneous transaction with the Retirement Investor.

The exemption uses the term ''Retirement Investor'' to describe the types of persons who can be investment advice recipients under the exemption, and the term ''Affiliate'' to describe people and entities with a connection to the Adviser or Financial Institution. These terms are defined in Section VI of this exemption. The following sections discuss the scope and conditions of the exemption as well as key definitional terms.

1. Principal Traded Assets

The exemption provides relief for principal transactions and riskless principal transactions involving certain investments, referred to as ''principal traded assets,'' between a plan, participant or beneficiary account, or IRA, and an Adviser, Financial Institution or an entity in a control relationship with the Financial Institution, when the transaction is a result of an Adviser's or Financial Institution's provision of investment advice. Relief is provided from ERISA sections 406(a)(1)(A) and (D), and 406(b)(1) and (2), and the taxes imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A), (D) and (E). Relief has not been provided in this exemption from ERISA section 406(b)(3) and Code section 4975(c)(1)(F), which prohibit a fiduciary from receiving any consideration for its own personal account from any party dealing with the plan or IRA in connection with a transaction involving the assets of the plan or IRA.

The principal traded assets that are permitted to be *purchased* by plans, participant and beneficiary accounts, and IRAs, under the exemption include CDs, interests in UITs, and securities within the exemption's definition of ''debt security.'' Debt securities are generally defined as corporate debt securities offered pursuant to a registration statement under the Securities Act of 1933; treasury securities; agency securities; and asset-backed securities that are guaranteed by an agency or government sponsored enterprise (GSE).

In addition, the final exemption includes a feature under which the definition of principal traded asset can be expanded without amending the class exemption. Under the definition of principal traded asset, investments can be added to the class exemption in the future based on an individual exemption granted by the Department. Accordingly, a principal traded asset for purposes of the class exemption also includes an investment that is permitted to be purchased under an individual exemption granted by the Department after the issuance date of this exemption, that provides relief for investment advice fiduciaries to engage in the purchase of the investment in a principal transaction or riskless principal transaction with a plan or IRA under the same conditions as this exemption. To the extent parties wish to expand the definition of principal traded asset in the future, they can submit a request for an individual exemption to the Department setting forth the specific attributes of the principal traded asset, the sales and compensation practices, and how conflicts of interest will be mitigated with respect to principal transactions and riskless principal transactions in that principal traded asset. If the exemption is granted, the class exemption will expand to include that investment within the definition of principal traded asset.

The exemption's definition of principal traded assets is more expansive with respect to the *sale* of principal traded assets by plans and IRAs. The definition extends to ''securities or other investment property,'' which corresponds to the broad range of assets that can be recommended by fiduciary advisers under the Regulation. This permits trades that may be necessary, according to commenters, when a Retirement Investor seeks to sell an investment and cannot obtain a reasonable price from a third party. In addition, in response to commenters, the Department expanded the scope of the Best Interest Contract Exemption to cover riskless principal transactions involving all investment products.

As proposed, the exemption limited the types of assets that could be traded (both bought and sold) on a principal basis to corporate debt securities offered pursuant to a registration statement under the Securities Act of 1933, treasury securities, and agency securities. The Department received many comments regarding this limitation and the general intent of the exemption. Supporting comments emphasized that the exemption's limited scope and conditions were appropriate for the mitigation of conflicts of interest and the protection of plans and IRAs. One commenter particularly supported the exemption's approach of granting relief only to those securities least likely to be subject to principal trading abuses. The commenter supported, in particular, the exclusion of municipal securities.

Others urged the Department to broaden the scope of the exemption. Many of these commenters argued that principal transactions are necessary for the maintenance of inventory, liquidity, access to investments, and best execution. They contended that the failure to provide broader relief would drive up the cost to investors, and hinder normal transactions that are generally classified as facilitation trades or riskless principal transactions. Commenters took the position that the Department should not substitute its judgment for the judgment of investors and advisers. In particular, commenters urged the Department to: (a) Provide relief for riskless principal transactions, (b) add specific additional securities to the scope of the exemption, and (c) provide broad principal transaction relief for all securities and other property.

a. Riskless Principal Transactions

A number of comments noted that the proposal did not specifically address riskless principal transactions. In a riskless principal transaction, according to a commenter, a Financial Institution, after receiving an order to purchase or sell a security from a customer, purchases or sells the investment for its own account to offset the contemporaneous transaction with the customer. Commenters argued that riskless principal transactions are the functional equivalent of agency transactions. A commenter asserted that for this reason, riskless principal transactions would not involve the incentive to dump unwanted investments on Retirement Investors, which was one of the Department's concerns. Another commenter indicated that without wider availability of riskless principal transactions, many investments would not be available at all to plans and IRAs because it is typical for broker-dealers to engage in transactions with third parties on a riskless principal basis rather than a pure agency basis. One commenter stated that this is because counterparties may not want to assume settlement risk with an investor.

After consideration of these comments, the Department concurs with commenters that broader relief in this area is appropriate. The Department intended that the proposal cover riskless principal transactions within the general meaning of principal transactions, but the transactions would have been limited to the debt securities covered under the proposed exemption. The Department agrees with commenters that, to the extent a Financial Institution engages in a transaction based on an existing customer order, the riskless principal transaction can be viewed as functionally similar to an agency transaction, and the Department accepts the position of commenters that some investments may not be functionally available without this relief. For this reason, the Department expanded the scope of the companion Best Interest Contract Exemption to permit riskless principal transactions in all investments, and provide relief for compensation received in connection with such transactions, subject to the conditions of that exemption.

The Department also clarified that this exemption is available for riskless principal transactions involving principal traded assets. The definition of a principal transaction now explicitly excludes riskless principal transactions, and the exemption's scope specifically encompasses both principal transactions and separately-defined riskless principal transactions. In this manner, the exemption now clearly draws a distinction between principal transactions and riskless principal transactions and provides relief for both with respect to principal traded assets.

This approach results in some overlap between coverage of riskless principal transactions in the Best Interest Contract Exemption and this exemption. With respect to a recommended purchase of an investment that occurs in a riskless principal transaction, this exemption is available for principal traded assets. The Best Interest Contract Exemption, however, provides broader relief for all recommended purchases. In addition, *sales* from a plan or IRA in riskless principal transactions can occur under either exemption.

This approach is intended to provide flexibility to Financial Institutions relying on the exemptions. The Department believes that some Financial Institutions have business models that involve only riskless principal transactions. These Financial Institutions may not, as a general matter, hold investments in inventory to sell in principal transactions, but they may execute certain transactions as riskless principal transactions. Financial Institutions that do not engage in principal transactions, as defined in the exemptions, do not have to rely on this exemption at all, and can organize their practices to comply with the Best Interest Contract Exemption alone.

On the other hand, Financial Institutions that engage in both principal transactions and riskless principal transactions may want to organize their practices to comply with this exemption. They may not be certain at the outset whether a particular purchase by a plan or IRA will be executed as a principal transaction or a riskless principal transaction. Those Financial Institutions can rely on this exemption for principal traded assets that may be sold to plans and IRAs without concern for whether the transaction is, in fact a riskless principal transaction or principal transaction.

b. Adding to the Definition of Principal Traded Assets

Some commenters requested that this exemption extend to principal transactions in specific additional types of securities or investments, including municipal securities, currency, agency debt securities, CDs (including brokered CDs), asset backed securities, unit investment trusts (UITs), equities (including new issue and initial public offerings), new issue of debt securities, preferred securities, foreign corporate securities, foreign sovereign debt, debt of a charitable organization, derivatives, bank note offerings and wrap or other contracts that are not insurance products.

In response, the Department added to this final exemption CDs, UITs, and asset backed securities guaranteed by an agency or GSE. Both CDs and UITs were included as investments permitted to be sold under the proposed Best Interest Contract Exemption, and commenters informed us that these investments are typically sold in principal transactions. Without relief for CDs and UITs in this exemption, commenters asserted that Retirement Investors might lose access to such investments. Commenters indicated that these investments were common investments in ERISA plans, IRAs and non-ERISA plans. The Department therefore included them in this final exemption. As with the exemptive relief originally proposed regarding principal transactions in debt securities, the Department believes that the conflicts of interest created by principal transactions in CDs and UITs are effectively addressed by the conditions of this exemption so as to protect the interests of Retirement Investors while maintaining Retirement Investors' access to these investments.

Agency and GSE guaranteed asset backed securities were always intended to be included in the definition of debt security. The proposal provided that agency debt securities were defined by reference to the Financial Industry Regulatory Authority (FINRA) rule 6710(l).[16] Commenters informed us that the Department's definition omitted agency and GSE mortgage backed securities. Based on the Department's original intent to provide relief for these investments, and the view that the conditions are protective in these contexts, the Department included them in the final exemption.

Reflecting this expansion of relief to CDs, UITs and agency and GSE guaranteed asset backed securities, the final exemption uses the term ''principal traded asset,'' rather than ''debt security'' to describe the

[16] FINRA is registered with the Securities and Exchange Commission (SEC) as a national securities association and is a self-regulatory organization, as those terms are defined in the Exchange Act, which operates under SEC oversight.

investments that can be purchased or sold.

As explained in greater detail below, the Department did not expand the purchase provisions of the exemption, as some commenters suggested, to include other investments such as municipal securities, currency, asset backed securities, equities (including new issue and initial public offerings), new issue of debt securities, preferred securities, foreign corporate securities, foreign sovereign debt, debt of a charitable organization, derivatives, bank note offerings and wrap or other contracts that are not insurance products. The Department determined that the conditions of this exemption may not be appropriately tailored to these types of investments. The Department invites interested parties to request an individual exemption for other investments that they would like to see included in this class exemption. This will provide the Department with the opportunity to gain additional information about those investments, their sales practices and associated conflicts of interest.

c. Principal Transaction Relief for All Securities and Other Property

Other commenters sought to more generally expand the scope of the exemption. Some commenters felt that unrestricted relief should be provided with respect to all principal transactions with few, if any, conditions. Some of these commenters took issue with the Department's decision to place any limitations at all on investments that can be purchased or sold in a principal transaction. The commenters expressed the view that the Department was substituting its judgment for those of individual investors and their advisers.

In support of their approach, a few commenters urged the Department to more closely hew to the approach taken under the securities laws, citing Temporary Rule 206(3)–3T issued by the Securities and Exchange Commission (SEC) under the Investment Advisers Act of 1940.[17] According to the commenters, Temporary Rule 206(3)–3T applies to institutions that are dually registered as investment advisers and broker-dealers and to transactions in non-discretionary accounts at such institutions, and it permits principal transactions involving all securities unless the investment adviser or Affiliate is the issuer of, or, at the time of the sale, an underwriter of, a security that is not an investment grade debt security. The rule generally requires written prospective consent by the customer to principal transactions; oral or written pre-transaction disclosure and customer consent; written confirmation to the customer; and written annual disclosure to the customer of transactions entered into in reliance on the rule.

Commenters also focused on principal transactions involving sales by plans and IRAs. Commenters indicated that broader relief was necessary to provide liquidity for Retirement Investors. They said that Financial Institutions serve an essential function in purchasing securities from their clients who need such liquidity.

The Department did not accept the commenters' call for relief for all principal transactions. The Department's approach in the proposal of this exemption was intentionally narrow, based on the potentially acute conflicts of interest associated with principal transactions that are recommended by fiduciaries. The Department believes that broad relief for all principal transactions, without tailored conditions, is inconsistent with longstanding principles that fiduciaries must act with loyalty to Retirement Investors. Because the fiduciary is on both sides of a principal transaction, the fiduciary duty of loyalty is sorely tested. In addition, the securities typically traded in principal transactions often lack objective market prices and Retirement Investors may have difficulty evaluating the fairness of a particular transaction. Principal traded investments also can be associated with low liquidity, low transparency and the possible incentive to dump unwanted investments.

Therefore, although the Department's approach harmonizes in many ways, as discussed below, with the disclosures required by the SEC's Temporary Rule 206(3)–3T, the Department did not adopt an exemption that is as broad in scope. The Department also notes in this respect that the SEC has not yet finalized its approach to rule 206(3)–3T, and the SEC has indicated the delay is related to the SEC's consideration of regulatory standards of care for broker-dealers and investment advisers under section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). In the most recent release proposing to extend the Temporary Rule, the SEC stated:

> As part of our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers, we intend to carefully consider principal trading by advisers, including whether rule 206(3)–3T should be substantively modified, supplanted, or permitted to sunset.[18]

Given the SEC's ongoing consideration of these issues, the Department does not believe there is a significant advantage to mirroring the scope of the Temporary Rule.

Although the Department retained the limited definition of principal traded asset, as discussed above, for recommendations that a plan or IRA *purchase* an investment, the Department did provide broader relief for recommended *sales* from a plan or IRA to a Financial Institution. The Department is persuaded by commenters that a broader exemption is necessary to provide liquidity to plans and IRAs.

The Department also notes that the final Regulation provides additional ways in which parties can engage in principal transactions and riskless principal transactions and avoid prohibited transactions. The Regulation provides that a person is not a fiduciary when the person engages in an arm's length transaction with an independent plan fiduciary with financial expertise, as defined in the Regulation. Financial professionals that engage in such transactions are not considered fiduciaries, and may rely on other exemptions such as PTE 75–1, Part II, or ERISA section 408(b)(17) and Code section 4975(d)(20), for a broader range of principal transactions and riskless principal transactions. Therefore, the concerns of commenters such as the Stable Value Investment Association, about principal transactions involving a stable value fund managed by a professional investment manager, should be addressed in that fashion.

Finally, this exemption does not affect the ability of a self-directed investor to obtain the services of a financial professional to effect or execute a transaction involving any type of investment, in the absence of investment advice. In that sense, the Department is not limiting investment opportunities for individual investors or substituting the Department's judgment for theirs. Instead, the exemption is aimed squarely at conflicted investment advice by fiduciaries and is intended to minimize the harms of such conflicts of interest.

In this regard, one commenter requested a clarification as to whether an exemption is necessary for the provision of principal transaction services where the services do not involve the provision of individual recommendations to a plan or IRA. In

[17] 17 CFR 275.206(3)–3T.

[18] See SEC's Release No. IA–3893, August 12, 2014.

response, the Department notes that relief from ERISA section 406(b) would only be necessary to the extent the service provider was acting as a fiduciary. To the extent the service provider does not make recommendations, it does not act as a fiduciary investment adviser. If the service provider is not a fiduciary, ERISA section 406(b) relief is not necessary, and the other exemptions referenced above, apply.

2. Exclusions

The exclusions set forth in Section I(c) of the proposal remain a part of the final exemption. First, under Section I(c)(1), Advisers who have or exercise discretionary authority or discretionary control with respect to management of the assets of a plan, participant or beneficiary account, or IRA or who exercise any discretionary authority or control respecting management or the disposition of the assets, or have any discretionary authority or discretionary responsibility in the administration of the plan, participant or beneficiary account, or IRA, may not take advantage of relief under the exemption to engage in principal transactions and riskless principal transactions with such investors.

A comment related to this provision asked that the limitation on investment managers be modified so that Financial Institutions that sponsor separately managed accounts that use independent, individual investment managers should be permitted to engage in principal transactions on behalf of their managed plans and IRAs with the sponsor. The Department did not adopt this suggestion. Instead, the Department notes that the Regulation was revised to provide that a person does not act as a fiduciary when engaged in an arm's length transaction with a plan fiduciary with financial expertise under the circumstances set forth in the Regulation. In such circumstances, the financial professionals may, therefore, rely on existing exemptions for non-fiduciary principal transactions and riskless principal transactions.

Second, under Section I(c)(2), the exemption is not available for a principal transaction involving a plan covered by Title I of ERISA if the Adviser or Financial Institution, or any Affiliate is the employer of employees covered by the plan. In accordance with this condition, the exemption is not available for a principal transaction entered into as part of a rollover from such a plan to an IRA, where the principal transaction is being executed by the plan, not the IRA. This restriction on employers does not apply in the case of an IRA or other similar plan that is not covered by Title I of ERISA. Accordingly, an Adviser or Financial Institution may provide advice to the beneficial owner of an IRA who is employed by the Adviser, its Financial Institution or an Affiliate, and receive compensation as a result, provided the IRA is not covered by Title I of ERISA.

No comments were received specific to the principal transactions exemption on proposed Section I(c)(2). Comments were received, however, on the same language, proposed in Section I(c)(1), of the Best Interest Contract Exemption. Specifically, industry commenters requested elimination of this exclusion in the Best Interest Contract Exemption. In particular, they said that Financial Institutions in the business of providing investment advice should not be compelled to hire a competitor to provide services to the Financial Institution's own plan. They warned that the exclusion could effectively prevent these Financial Institutions from providing any investment advice to their employees. Some commenters additionally stated that for compliance reasons, employees of a Financial Institution are often required to maintain their financial assets with that Financial Institution. As a result, they argued employees of Financial Institutions could be denied access to investment advice on their retirement savings.

As with the Best Interest Contract Exemption, the Department has not scaled back the exclusion. As noted above, the Department did not receive comments requesting that Financial Institutions be able to engage in principal transactions with their in-house plans. More generally, however, the Department continues to be concerned that the danger of abuse is compounded when the advice recipient receives recommendations from the employer, upon whom he or she depends for a job, to make investments in which the employer has a financial interest. To protect employees from abuse, employers generally should not be in a position to use their employees' retirement benefits as potential revenue or profit sources, without stringent safeguards. See, *e.g.,* ERISA section 403(c)(1) (generally providing that ''the assets of a plan shall never inure to the benefit of any employer''). Additionally, the exclusion of employers in Section I(c) does not apply in the case of an IRA or other similar plan that is not covered by Title I of ERISA. The decision to open an IRA account or obtain IRA services from the employer is much more likely to be entirely voluntary on the employees' part than would be true of their interactions with the retirement plan sponsored and designed by their employer for its employee benefit program. Accordingly, an Adviser or Financial Institution may provide advice to the beneficial owner of an IRA who is employed by the Adviser, its Financial Institution or an Affiliate regarding a principal transaction or riskless principal transaction, and engage in a principal transaction or riskless principal transaction as a result, provided the IRA is not covered by Title I of ERISA, and the conditions of this exemption are satisfied.

Section I(c)(2) further provides that the exemption is unavailable if the Adviser or Financial Institution is a named fiduciary or plan administrator, as defined in ERISA section 3(16)(A) with respect to an ERISA plan, or an Affiliate thereof, that was selected to provide advice to the plan by a fiduciary who is not independent of them. This provision is intended to disallow the selection of Advisers and Financial Institutions by named fiduciaries or plan administrators that have a significant financial stake in the selection and was adopted in the final exemption unchanged from the proposal.[19]

B. Conditions of the Exemption

Section I, discussed above, establishes the scope of relief provided by this Principal Transactions Exemption. Sections II–V set forth the conditions of the exemption. All applicable conditions must be satisfied in order to avoid application of the specified prohibited transaction provisions of ERISA and the Code. The Department finds that, subject to these conditions, the exemption is administratively feasible, in the interests of plans and of their participants and beneficiaries, and IRA owners and protective of the rights of the participants and beneficiaries of such plans and IRA owners. Under ERISA section 408(a), and Code section 4975(c)(2), the Secretary may not grant an exemption without making such findings. The conditions of the exemption, comments on those conditions, and the Department's responses, are described below.

1. Enforceable Right to Best Interest Advice (Section II)

Section II of the exemption sets forth the requirements that establish the Retirement Investor's enforceable right

[19] The definition of ''independent'' was adjusted in response to comments, as discussed below, to permit circumstances in which the person selecting the Adviser and Financial Institution could receive no more than 2% of its compensation from the Financial Institution.

to adherence to the Impartial Conduct Standards and related conditions. For advice to certain Retirement Investors—specifically, advice regarding transactions with IRAs, and plans that are not covered by Title I of ERISA (non-ERISA plans), such as Keogh plans—Section II(a) requires the Financial Institution and Retirement Investor to enter into a written contract that includes the provisions described in Section II(b)–(d) of the exemption and that also does not include any of the ineligible provisions described in Section II(f) of the exemption, and provide the disclosures set forth in Section II(e). As discussed further below, pursuant to Section II(g) of the exemption, advice to Retirement Investors regarding ERISA plans does not have to be subject to a written contract but Advisers and Financial Institutions must comply with the substantive standards established in Section II(b)–(e) to avoid liability for a non-exempt prohibited transaction.

The contract with Retirement Investors regarding IRAs and non-ERISA plans must include the Financial Institution's acknowledgment of its fiduciary status and that of its Advisers, as required by Section II(b); the Financial Institution's agreement that it and its Advisers will adhere to the Impartial Conduct Standards, including a Best Interest standard, as required by Section II(c); the Financial Institution's warranty that it has adopted and will comply with certain policies and procedures, including anti-conflict policies and procedures reasonably and prudently designed to ensure that Advisers adhere to the Impartial Conduct Standards, as required by Section II(d). The Financial Institution's disclosure of information about Material Conflicts of Interest associated with principal transactions and riskless principal transactions, as required by Section II(e), may be provided in the contract or in a separate single written disclosure. Section II(f) generally provides that the exemption is unavailable if the contract includes exculpatory provisions or provisions waiving the rights and remedies of the plan, IRA or Retirement Investor, including their right to participate in a class action in court. The contract may, however, provide for binding arbitration of individual claims, and may waive contractual rights to punitive damages or rescission.

The contract between the IRA or non-ERISA plan, and the Financial Institution, forms the basis of the IRA's or non-ERISA plan's enforcement rights. The Department intends that all the contractual obligations imposed on the Financial Institution (the Impartial Conduct Standards and warranties) will be actionable by the IRAs and non-ERISA plans. Because these standards are contractually imposed, an IRA or non-ERISA plan has a contract claim if, for example, its Adviser recommends an investment product that is not in the Best Interest of the IRA or other non-ERISA plan.

In the Department's view, these contractual rights serve a critical function for IRA owners and participants and beneficiaries of non-ERISA plans. Unlike participants and beneficiaries in plans covered by Title I of ERISA, IRA owners and participants and beneficiaries in non-ERISA plans do not have an independent statutory right to bring suit against fiduciaries for violation of the prohibited transaction rules. Nor can the Secretary of Labor bring suit to enforce the prohibited transactions rules on their behalf.[20] Thus, for investors in IRAs and non-ERISA plans, the contractual requirement creates a mechanism for investors to enforce their rights and ensures that they will have a remedy for misconduct. In this way, the exemption creates a powerful incentive for Financial Institutions and Advisers alike to oversee and adhere to basic fiduciary standards when engaging in principal transactions and riskless principal transactions, without requiring the imposition of unduly rigid and prescriptive rules and conditions.

Under Section II(g), however, the written contract requirement does not apply to advice to Retirement Investors regarding transactions with plans that are covered by Title I of ERISA (ERISA plans) in light of the existing statutory framework which provides a pre-existing enforcement mechanism for these investors and the Department. Instead, Advisers and Financial Institutions must satisfy the provisions in Section II(b)–(e) as conditions of the exemption when transacting with such Retirement Investors. Under the terms of the exemptions, the Financial Institution must provide a written acknowledgment of its and its Advisers' fiduciary status prior to or at the same time as the execution of the transaction, although it does not have to be part of a contract, as required by Section II(b); the Financial Institution and its Advisers must comply with the Impartial Conduct Standards, as required by Section II(c); the Financial Institutions must establish and comply with certain policies and procedures, as required by Section II(d); and they must provide the disclosures required by Section II(e).

If these conditions are not satisfied with respect to an ERISA plan engaging in a principal transaction or a riskless principal transaction, the Adviser and Financial Institution would be unable to rely on the exemption for relief from ERISA's prohibited transactions restrictions. An Adviser's failure to comply with the exemption would result in a non-exempt prohibited transaction under ERISA section 406 and would likely constitute a fiduciary breach under ERISA section 404. As a result, a plan, plan participant or beneficiary would be able to sue under ERISA section 502(a)(2) or (3) to recover any loss in value to the plan (including the loss in value to an individual account), or to obtain disgorgement of any wrongful profits or unjust enrichment. In addition, the Secretary of Labor can enforce ERISA's prohibited transaction and fiduciary duty provisions with respect to these ERISA plans, and an excise tax under the Code, as described above, applies.

In this regard, under Section II(g)(5) of the exemption, the Financial Institution and Adviser may not rely on the exemption if, in any contract, instrument, or communication they disclaim any responsibility or liability for any responsibility, obligation, or duty under Title I of ERISA to the extent the disclaimer would be prohibited by ERISA section 410, waive or qualify the right of the Retirement Investor to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution, or require arbitration or mediation of individual claims in locations that are distant or that otherwise unreasonably limit the ability of the Retirement Investors to assert the claims safeguarded by this exemption. The exemption's enforceability, and the potential for liability, is critical to ensuring adherence to the exemption's stringent standards and protections, notwithstanding the competing pull of the conflicts of interest associated with principal transactions and riskless principal transactions.

The Department expects claims of Retirement Investors regarding investments in ERISA plans to be brought under ERISA's enforcement provisions, discussed above. In general, ERISA section 410 invalidates

[20] An excise tax does apply in the case of a violation of the prohibited transaction provisions of the Code, generally equal to 15% of the amount involved. The excise tax is generally self-enforced; requiring parties not only to realize that they've engaged in a prohibited transaction but also to report it and pay the tax. Parties who have participated in a prohibited transaction for which an exemption is not available must pay the excise tax and file Form 5330 with the Internal Revenue Service.

instruments purporting to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under ERISA. Accordingly, provisions purporting to waive fiduciary obligations under ERISA serve only to mislead Retirement Investors about the scope of their rights. Additionally, the legislative intent of ERISA was, in part, to provide for ''ready access to federal courts.'' Accordingly, any recommended transaction covered by a contract or other instrument that waives or qualifies the right of the Retirement Investor to bring or participate in a class action or other representative action in court, will not be eligible for relief under this exemption.

A number of comments were received on the contract requirement as it was proposed. The comments, and the Department's responses, are discussed below. The Department notes that some of the commenters simply cross-referenced their comments, in the entirety, with respect to the same provisions in the proposed Best Interest Contract Exemption. Additionally, some commenters focused their comments solely on the Best Interest Contract Exemption. The Department determined it was important that the contract provisions in the Best Interest Contract Exemption be compatible with the contract provisions in this exemption, so that the two exemptions can easily be used together. For this reason, the Department considered all comments made on either exemption on a consolidated basis, and made corresponding changes in the two exemptions. For ease of use, the Department has included in this preamble the same general discussion of comments as in the Best Interest Contract Exemption, despite the fact that some comments discussed below were not made directly with respect to this exemption.

In this regard, one commenter inquired as to whether the contract required in this exemption could be combined with the contract required by the Best Interest Contract Exemption, or whether two contracts would be needed. It was the Department's intent in crafting this exemption that it could be used in connection with the Best Interest Contract Exemption, and it is the Department's view that there need only be one contract. If parties wish to give themselves flexibility to engage in principal transactions and riskless principal transactions with Retirement Investors, they can include the contract provisions that are specific to principal transactions and riskless principal transactions and obtain the Retirement Investor's consent to participate in such transactions.

a. Contract Requirement Applicable to IRAs and Non-ERISA Plans

A number of commenters took the position that the consumer protections afforded by the contract requirement are an essential feature of the exemption, particularly in the IRA market. Commenters indicated that enforceability is critical in the IRA market because of IRA owners' lack of a statutory right to enforce prohibited transactions provisions. Commenters said that, in order to achieve the goal of providing meaningful new protections to Retirement Investors, the exemption must provide a mechanism by which Advisers and Financial Institutions can be held legally accountable for the retirement recommendations they make.

Many other commenters, however, raised significant objections to the contract requirement. Commenters pointed to certain conditions of the exemption that they found ambiguous or subjective and indicated that these conditions could form the basis of class action lawsuits by disappointed investors. Some commenters said the contract requirement and associated litigation exposure will cause investment advice providers to cease serving Retirement Investors or provide only fee-based accounts that do not vary on the basis of the advice provided, resulting in the loss of services to retirement investors with smaller account balances. These commenters stated that investment advice fiduciaries would not risk the anticipated legal liability for Retirement Investors, or at least with respect to small accounts. Commenters also indicated that the SEC's Temporary Rule 206(3)–3T already addresses the issues regarding principal transactions that the Department is attempting to address.

In the final exemption, the Department retained the contract requirement with respect to IRAs and non-ERISA plans. The contractual commitment provides an administrable means of ensuring fiduciary conduct, eliminating ambiguity about the fiduciary nature of the relationship, and enforcing the exemption's conditions, thereby assuring compliance. The existence of enforceable rights and remedies gives Financial Institutions and Advisers a powerful incentive to comply with the exemption's standards, implement effective anti-conflict policies and procedures, and carefully police conflicts of interest. The enforceable contract gives clarity to the fiduciary nature of the undertaking, and ensures that Advisers and Financial Institutions do not subordinate the interests of the Retirement Investor to their own competing financial interests. The contract effectively aligns the interests of Retirement Investor, Advisers, and the Financial Institution, and gives the Retirement Investor the means to redress injury when violations occur.

Without a contract, the possible imposition of an excise tax provides an additional, but inadequate incentive to ensure compliance with the exemption's standards-based approach. This is particularly true because imposition of the excise tax critically depends on fiduciaries' self-reporting of violations, rather than independent investigations and litigation by the IRS. In contrast, contract enforcement does not rely on conflicted fiduciaries' assessment of their own adherence to fiduciary norms or require the creation and expansion of a government enforcement apparatus. The contract provides an administrable way of ensuring adherence to fiduciary standards, broadly applicable to an enormous range of investments and advice relationships.

The enforceability of the exemption's provisions enables the Department to grant exemptive relief based upon broad protective standards rather than rely exclusively upon highly proscriptive conditions. In the context of this exemption, the risk of litigation and enforcement serves many of the same functions that it has for hundreds of years under the law of trust and agency. It gives fiduciaries a powerful incentive to adhere to broad, flexible, and protective standards applicable to principal transactions and riskless principal transactions by imposing liability and providing a remedy when fiduciaries fail to comply with those standards.

In addition, a number of features of this final exemption, discussed more fully below, should temper commenters' concerns about the risk of excessive litigation. In particular, the exemption permits Advisers and Financial Institutions to require mandatory arbitration of individual claims, so that claims that do not involve systemic abuse or entire classes of participants can be resolved outside of court. Similarly, the exemption permits waivers of the right to obtain punitive damages or rescission based on violation of the contract. In the Department's view, make-whole compensatory relief is sufficient to incentivize compliance and redress injury caused by fiduciary misconduct. The Department has also clarified a number of the exemption's conditions and simplified the disclosure and compliance obligations to facilitate adherence to the exemption's terms.

The core principles of the exemption are well-established under trust law, ERISA and the Code, and have a long history of interpretations in court. Moreover, the Impartial Conduct Standards are measured based on the circumstances existing at the time of the recommendation, not based on the ultimate performance of the investment with the benefit of hindsight. It is well settled as a legal matter that fiduciary advisers are not guarantors of the success of investments under ERISA or the Code, and this exemption does nothing to change that fact. Finally, the Department added provisions enabling Advisers and Financial Institutions to correct good faith errors in disclosure, without facing loss of the exemption.

The Department did not rely solely on the approach in the SEC's Temporary Rule 206(3)–3T, or another primarily disclosure-based approach, as suggested by some commenters. In the Department's view, disclosure of conflicts is a necessary, but not sufficient, basis for relief in the context of fiduciary self-dealing involving tax-favored accounts.

One commenter asked the Department to address the interaction of the contract cause of action and state securities laws. In this connection, the Department confirms that it is not the Department's intent to preempt or supersede state securities law and enforcement, and the state securities laws remain subject to the ERISA section 514(b)(2)(A) savings clause.

b. No Contract Requirement Applicable to ERISA Plans

Under Section II(g) of the exemption, there is no contract requirement for transactions involving ERISA plans, but Financial Institutions and their Advisers must satisfy the conditions of Section II(b)–(e), including the conditions requiring written fiduciary acknowledgment, adherence to Impartial Conduct Standards, policies and procedures, and disclosures.

The Department eliminated the proposed contract requirement with respect to ERISA plans in this final exemption in response to public comment on this issue. A number of commenters indicated that the contract requirement was unnecessary for ERISA plans due to the statutory framework that already provides enforcement rights to such plans, their participants and beneficiaries, and the Secretary of Labor. Some commenters additionally questioned the extent to which the contract provided additional rights or remedies, and whether state-law contract claims would be pre-empted under ERISA's pre-emption provisions.

In the Department's view, the requirement that a Financial Institution provide written acknowledgement of fiduciary status for itself and its Advisers provides protections in the ERISA plan context that are comparable to the contract requirement for IRAs and non-ERISA plans. As a result of the written acknowledgment of fiduciary status, the fiduciary nature of the relationship will be clear to the parties both at the time of the investment transaction, and in the event of subsequent disputes over the conduct of the Advisers or Financial Institutions. There will be far less cause for the parties to litigate disputes over fiduciary status, as opposed to the substance of the fiduciaries' recommendations and conduct.

2. Contract Operational Issues—Section II(a)

Section II(a) specifies the mechanics of entering into the contract and provides that the contract must be enforceable against the Financial Institution. In addition, the section indicates that the contract may be a master contract covering multiple recommendations, and that it may cover advice that was rendered prior to the execution of the contract as long as the contract is entered into prior to or at the same time as the execution of the recommended transaction.

Section II(a)(1) further describes the methods for obtaining customer assent to the contract. For "new contracts," the Retirement Investor's assent must be demonstrated through a written or electronic signature. The exemption provides flexibility by permitting the contract terms to be set forth in a standalone document or in an investment advisory agreement, investment program agreement, account opening agreement, insurance or annuity contract or application, or similar document, or amendment thereto.

For Retirement Investors with "existing contracts," the exemption permits assent to be evidenced either by affirmative consent, as described above, or by a negative consent procedure. Under the negative consent procedure, the Financial Institution delivers a proposed contract amendment along with the disclosure required in Section II(e) to the Retirement Investor prior to January 1, 2018, and if the Retirement Investor does not terminate the amended contract within 30 days, the amended contract is effective. If the Retirement Investor does terminate the contract within that 30-day period, this exemption will provide relief for 14 days after the date on which the termination is received by the Financial Institution.[21] An existing contract is defined in the exemption as "an investment advisory agreement, investment program agreement, account opening agreement, insurance contract, annuity contract, or similar agreement or contract that was executed before January 1, 2018 and remains in effect." If the Financial Institution elects to use the negative consent procedure, it may deliver the proposed amendment by mail or electronically, but it may not impose any new contractual obligations, restrictions, or liabilities on the Retirement Investor by negative consent.

Finally, Section II(a)(2) of the exemption requires the Financial Institution to maintain an electronic copy of the Retirement Investor's contract on its Web site that is accessible by the Retirement Investor. This condition ensures that the Retirement Investor has ready access to the terms of the contract, and reinforces the exemption's goals of clearly establishing the fiduciary status of the Adviser and Financial Institution and ensuring their adherence to the exemption's conditions.

Comments on specific contract operational issues are discussed below.

a. Contract Timing

As proposed, Section II(a) required that, "[p]rior to recommending that the plan, participant or beneficiary account, or IRA purchase, sell or hold the Asset, the Adviser and Financial Institution enter into a written contract with the Retirement Investor that incorporates the terms required by Section II(b)–(e)." A large number of commenters responded to various aspects of this proposed requirement.

Many commenters objected to the timing of the contract requirement. They said that requiring execution of a contract "prior to" any recommendations would be contrary to existing industry practices. The commenters indicated that preliminary discussions may evolve into recommendations before a Retirement Investor has decided to work with a particular Adviser and Financial Institution. Requiring a contract upfront

[21] Alternatively, for purposes of this exemption, Advisers and Financial Institutions can provide the contractual terms required by the exemption and permit the Retirement Investor to specifically decline to authorize principal transactions and riskless principal transactions within 30 days but continue the existing contract. Of course, to the extent prohibited transaction relief is needed for transactions under the existing contract, the Adviser and Financial Institution would need to comply with another exemption.

could chill such preliminary discussions, unduly complicate the relationship between the Adviser and the Retirement Investor, and interfere with an investor's ability to shop around. Many commenters suggested that it would be better to time the requirement so that the contract would have to be entered into prior to the execution of the actual principal transaction, or even later, rather than before any advice was rendered. While some other commenters supported the proposed timing, noting the benefit of allowing Retirement Investors the chance to carefully review the contract prior to engaging in transactions, several commenters that strongly supported the contract requirement agreed that the timing could be adjusted without loss of protection to the Retirement Investor.

In the Department's view, the precise timing of the contract is not critical to the exemption, provided that the parties enter into a contract covering the advice. The Department did not intend to chill developing advice relationships or limit investors' ability to shop around. Therefore, the Department adjusted the exemption on this point by deleting the proposed requirement that the contract be entered into prior to the advice recommendation. Instead, the exemption generally provides that the advice must be subject to an enforceable written contract entered into prior to or at the same time as the execution of the recommended transaction. However, in order for the exemption to be available to recommendations made prior to the contract's formation, the contract's terms must cover the prior recommendations.

A few commenters suggested that the Department require the contract to be a separate document, not combined with any other document. However, other commenters requested that the Department allow Financial Institutions to incorporate the contract terms into other account documents. While the Department believes the contract is critical to IRA and non-ERISA plan investors, the Department recognizes the need for flexibility in its implementation. Therefore, the exemption contemplates that the contract may be incorporated into other documents to the extent desired by the Financial Institution. Additionally, as requested by commenters, the Department confirms that the contract requirement may be satisfied through a master contract covering multiple recommendations and does not require execution prior to each additional recommendation.

b. Contract Parties

A number of commenters questioned the necessity of the proposed requirement that Advisers be parties to the contract. These commenters indicated that the proposed requirement posed significant logistical challenges. For example, commenters stated that Advisers often work in teams and it would be difficult to obtain signatures from all such Advisers. Similarly, if call center representatives made recommendations that include principal transactions and riskless principal transactions, it could be hard to cover them under a contract. Over the course of a Retirement Investor's relationship with a Financial Institution, he or she could receive advice from a number of persons. Requiring that each such person execute a contract could prove difficult and unwieldy.

Based upon these objections, the Department deleted the requirement that individual Advisers be parties to the contract. The Financial Institution must be a party to the contract and take responsibility for satisfying the exemption's conditions, including the obligation to have policies and procedures reasonably and prudently designed to ensure that individual Advisers adhere to the Impartial Conduct Standards, and the obligation to insulate the Adviser from incentives to violate the Best Interest standard. Such Advisers include call center representatives who provide investment advice within the meaning of the Regulation.

Some commenters suggested that the Department provide additional flexibility and allow the individual Adviser to be obligated under the contract instead of the Financial Institution. The Department has not adopted that suggestion. To ensure operation of the exemption as intended, the Financial Institution should be a party to the contract. The supervisory responsibility and liability of the Financial Institution is important to the exemption's protections. In particular, the exemption contemplates that the Financial Institution will adopt and monitor stringent anti-conflict policies and procedures; avoid financial incentives that undermine the Impartial Conduct standards; and take appropriate measures to ensure that it and its representatives adhere to the exemption's conditions. The contract provides both a mechanism for imposing these obligations on the Financial Institution and creates a powerful incentive for the Financial Institution to take the obligations seriously in the management and supervision of investment recommendations.

c. Contract Signatures

Section II(a) of the exemption provides that the contract must be enforceable against the Financial Institution. As long as that is the case, the Financial Institution is not required to sign the contract. Section II(a) of the exemption further describes the methods through which customer assent may be achieved, and reflects commenters' requests for greater specificity on this point.

With respect to new contracts, a few commenters asked the Department to confirm that electronic execution by the Retirement Investor is sufficient. Another commenter asked about telephone assent. In the final exemption, the Department specifically permits electronic execution as a form of customer assent. The Department has not permitted telephone assent, however, because of the potential issues of proof regarding the existence and terms of a contract executed in that manner. It is the Department's goal that Retirement Investors obtain clear evidence of the contract terms and their applicability to the Retirement Investor's own account or contract. The exemption will best serve its purpose if the contractual commitments are clear to all the parties, and if ancillary disputes about the fiduciary nature of the advice relationship are avoided. For this same reason, the exemption requires that a copy of the applicable contract be maintained on a Web site accessible to the Retirement Investor.

Commenters also asked for the ability to use a negative consent procedure with respect to existing customers to avoid the expense and difficulty associated with obtaining a large number of client signatures. The Department adjusted the exemption on this point to permit amendment of existing contracts by negative consent, as discussed above. As this approach will still result in the Retirement Investor receiving clear evidence of the contract terms and their applicability to the Retirement Investor's own account or contract, the Department concurred with commenters on its use.

Treating the Retirement Investor's silence as consent after 30 days provides the Retirement Investor a reasonable opportunity to review the new terms and to reject them. The Financial Institution may not use the negative consent procedure, however, to impose new obligations, restrictions or liabilities on the Retirement Investor in connection with this exemption. Any attempt by the Financial Institution to impose additional obligations, restrictions or liabilities on the Retirement Investor must receive affirmative consent from the Retirement Investor, and cannot violate Section II(f).

A number of commenters also asked that the exemption authorize Financial Institutions to satisfy the contract requirement for all Retirement Investors—including new customers after the January 1, 2018—through unilateral contracts or implied or negative consent. Some commenters suggested that the Department should not require a contract at all, but only a ''customer bill of rights'' or similar disclosure, without any additional signature requirement. Some commenters suggested that the requirement of obtaining signatures could delay execution of time sensitive investment strategies.

Although the final exemption accommodates a wide variety of concerns regarding contract operational issues, the Department did not adopt the alternative approaches suggested by some commenters, such as merely requiring delivery of a customer bill of rights, broader reliance on a unilateral contract approach, or increased reliance on negative consent. The Department intends that Retirement Investors that are new customers of the Financial Institution should enter into an enforceable contract under Section II(a)(1)(i). Consistent with the Department's goal that Retirement Investors obtain clear evidence of the contract terms and their applicability to the Retirement Investor's own account or contract, the exemption limits the negative consent option to existing customers as a form of transitional relief, so that Financial Institutions can avoid the burdens associated with obtaining signatures from a large number of already-existing customers.

Apart from this transitional relief, the Department does not believe it is appropriate to dispense with the clarity, enforceability and legal protections associated with an affirmative contract. Contracts are commonplace in a wide range of commercial transactions occurring in person, on the web, and elsewhere. The Department has facilitated the process by providing that Financial Institutions can incorporate the contract terms into commonplace account opening or similar documents that they already use; by permitting electronic signatures; and by revising the timing rules, so that the contract's execution can follow the provision of advice, as long as it precedes or occurs at the same time as the execution of the recommended transaction.

3. Fiduciary Acknowledgment—Section II(b)

Section II(b) of the exemption requires the Financial Institution to affirmatively state in writing that the Financial Institution and the Adviser(s) act as fiduciaries under ERISA or the Code, or both, with respect to any investment advice regarding principal transactions and riskless principal transactions provided by the Financial Institution or the Adviser subject to the contract or, in the case of an ERISA plan, with respect to any investment advice regarding the principal transactions and riskless principal transactions between the Financial Institution and the Plan or participant or beneficiary account.

With respect to IRAs and non-ERISA plans, if this acknowledgment of fiduciary status does not appear in a contract with a Retirement Investor, the exemption is not satisfied with respect to transactions involving that Retirement Investor. With respect to ERISA plans, this acknowledgment must be provided to the Retirement Investor prior to or at the same time as the execution of the recommended transaction, but not as part of a contract. This fiduciary acknowledgment is critical to ensuring clarity and certainty with respect to fiduciary status of both the Adviser and Financial Institution under ERISA and the Code with respect to that advice.

The fiduciary acknowledgment provision received significant support from some commenters. Commenters described it as a necessary protection and noted that it would clarify the obligations of the Adviser. One commenter said that facilitating proof of fiduciary status should enhance investors' ability to obtain a remedy for Adviser misconduct in arbitration by eliminating ancillary litigation over fiduciary status. Rather than litigate over fiduciary status, the fiduciary acknowledgment would help ensure that the proceedings focused on the Advisers' compliance with fundamental fiduciary norms.

Some commenters opposed the fiduciary acknowledgment requirement in the proposal, as applicable to Financial Institutions, on the basis that it could force Financial Institutions to take on fiduciary responsibilities, even if they would not otherwise be functional fiduciaries under ERISA or the Code. The commenters pointed out that under the proposed Regulation, the acknowledgment of fiduciary status would have been a factor in imposing fiduciary status on a party. Therefore, Financial Institutions could become fiduciaries by virtue of the fiduciary acknowledgment. To address these concerns, a few commenters suggested language under which a Financial Institution would only be considered a fiduciary to the extent that it is ''an affiliate of the Adviser within the meaning of 29 CFR 2510.3–21(f)(7) that, with the Adviser, functions as a fiduciary.''

The Department has not adjusted the exemption as these commenters requested. The exemption requires as a condition of relief that a sponsoring Financial Institution accept fiduciary responsibility for the recommendations of its Adviser(s). The Financial Institution's role in supervising individual Advisers and overseeing their adherence to the Impartial Conduct Standards is a key safeguard of the exemption. The exemption's success critically depends on the Financial Institution's careful implementation of anti-conflict policies and procedures, avoidance of Adviser incentives to violate the Impartial Conduct Standards and broad oversight of Advisers. Accordingly, Financial Institutions that wish to engage in principal transactions and riskless principal transactions that would otherwise be prohibited under ERISA and the Code must agree to take on these responsibilities as a condition of relief under the exemption. To the extent Financial Institutions do not wish to take on this role with their associated responsibilities and liabilities, they may structure their operations to avoid prohibited transactions and the resultant need of the exemption.

Other commenters expressed the view that the fiduciary acknowledgement would potentially require broker-dealers to satisfy the requirements of the Investment Advisers Act of 1940. As described by commenters, the Act does not require broker-dealers to register as investment advisers if they provide advice that is solely incidental to their brokerage services. Commenters expressed concern that acknowledging fiduciary status and providing advice in satisfaction of the Impartial Conduct Standards could call into question whether the advice provided was solely incidental.

The Department does not, however, require the Adviser or Financial Institution to acknowledge fiduciary status under the securities laws, but rather under ERISA or the Code or both. Neither does the Department require Advisers to agree to provide investment advice on an ongoing, rather than transactional, basis. An Adviser's status as an ERISA fiduciary is not dispositive of its obligations under the securities laws, and compliance with the exemption does not trigger an automatic loss of the broker-dealer exception under the separate requirements of those laws. A broker-dealer who provides investment advice under the Regulation is an ERISA fiduciary; acknowledgment of ERISA fiduciary status would not, by itself, cause the Adviser to lose the broker-dealer exception. Under the Regulation and this exemption, the primary import of fiduciary status is that the broker has to act in the customer's Best Interest when making recommendations; seek to obtain the best execution reasonably available under the circumstances with respect to the transaction; and refrain from making misleading statements. Certainly, nothing in the securities laws precludes brokers from adhering to these basic standards, or forbids them from working for Financial Institutions that implement appropriate policies and procedures to ensure that these standards are met.

The Department changed the fiduciary acknowledgment provision in response to several comments requesting revisions to clarify the required extent of the fiduciary acknowledgment. Accordingly, the Department has clarified that the acknowledgment can be limited to investment recommendations subject to the contract or, in the case of an ERISA plan, any investment recommendations regarding the plan or beneficiary or participant account. As discussed in more detail below, the exemption (including the required fiduciary acknowledgment) does not in and of itself, impose an ongoing duty to monitor on the Adviser and Financial Institution. However, there may be some investments which cannot be prudently recommended for purchase to individual Retirement Investors, in the first place, without a mechanism in place for the ongoing monitoring of the investment.

4. Impartial Conduct Standards—Section II(c)

Section II(c) of the exemption requires that the Adviser and Financial Institution comply with fundamental Impartial Conduct Standards. Generally stated, the Impartial Conduct Standards require that Advisers and Financial Institutions provide investment advice regarding the principal transaction or riskless principal transaction that is in the Retirement Investor's Best Interest, seek to obtain the best execution reasonably available under the circumstances with respect to the transaction, and not make misleading statements to the Retirement Investor about the recommended transaction and Material Conflicts of Interest. As defined in the exemption, a Financial Institution and Adviser act in the Best Interest of a Retirement Investor when they provide investment advice that reflects ''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 Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution, any Affiliate or other party.''

The Impartial Conduct Standards represent fundamental obligations of fair dealing and fiduciary conduct. The concepts of prudence, undivided loyalty and reasonable compensation are all deeply rooted in ERISA and the common law of agency and trusts.[22] These longstanding concepts of law and equity were developed in significant part to deal with the issues that arise when agents and persons in a position of trust have conflicting loyalties, and accordingly, are well-suited to the problems posed by conflicted investment advice. The phrase ''without regard to'' is a concise expression of ERISA's duty of loyalty, as expressed in section 404(a)(1)(A) of ERISA and applied in the context of advice. It is consistent with the formulation stated in the common law, and it is consistent with the language used by Congress in Section 913(g)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act),[23] and cited in the Staff of the U.S. Securities and Exchange Commission ''Study on Investment Advisers and Broker-Dealers as Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act'' (Jan. 2011) (SEC staff Dodd-Frank Study).[24]

Under ERISA section 408(a) and Code section 4975(c)(2), the Department cannot grant an exemption unless it first finds that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners. An exemption permitting transactions that violate the Impartial Conduct Standards would fail these standards.

The Impartial Conduct Standards are conditions of the exemption for the provision of advice with respect to all Retirement Investors. For advice to Retirement Investors in IRAs and non-ERISA plans, the Impartial Conduct Standards must also be included as contractual commitments on the part of the Financial Institution and its Advisers. As noted above, there is no contract requirement for advice with respect Retirement Investors in ERISA plans.

Comments on each of the Impartial Conduct Standards are discussed below. Additionally, in response to commenters' assertion that the exemption is not administratively feasible due to uncertainty regarding some terms and requests for additional clarity, the Department has clarified some key terms in the text and provides additional interpretive guidance in the preamble discussion that follows. Finally, the Department discusses comments on the treatment of the Impartial Conduct Standards as both exemption conditions for all Retirement Investors as well as contractual representations with respect to IRAs and other non-ERISA Plans.

a. Best Interest Standard

Under Section II(c)(1), the Financial Institution must state that it and its Advisers will comply with a Best Interest standard when providing investment advice to the Retirement Investor with respect to principal transactions and riskless principal transactions, and, in fact, adhere to the standard. Advice in the Retirement Investor's Best Interest means advice that, at the time of the recommendation:

> reflects 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 Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, or other party.

The Best Interest standard set forth in the exemption is based on longstanding

[22] *See generally* ERISA sections 404(a), 408(b)(2); Restatement (Third) of Trusts section 78 (2007), and Restatement (Third) of Agency section 8.01.

[23] Section 913(g) of the Dodd-Frank Act governs ''Standard of Conduct'' and subsection (1) provides that ''The Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.''

[24] SEC Staff Study on Investment Advisers and Broker-Dealers, January 2011, available at *https://www.sec.gov/news/studies/2011/913studyfinal.pdf,* pp. 109–110.

concepts derived from ERISA and the law of trusts. It is meant to express the concept, set forth in ERISA section 404, that a fiduciary is required to act ''solely in the interest of the participants . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man 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.'' Similarly, both ERISA section 404(a)(1)(A) and the trust-law duty of loyalty require fiduciaries to put the interests of trust beneficiaries first, without regard to the fiduciaries' own self-interest. Under this standard, for example, an Adviser, in choosing between two investments, could not select an investment because it is better for the Adviser's or Financial Institution's bottom line, even though it is a worse choice for the Retirement Investor.

A wide range of commenters indicated support for a broad Best Interest standard. Some comments indicated that the Best Interest standard is consistent with the way Advisers provide investment advice to clients today. However, a number of these commenters expressed misgivings as to the definition used in the proposed exemption, in particular, the ''without regard to'' formulation. The commenters indicated uncertainty as to the meaning of the phrase, including whether it effectively precluded an Adviser from receiving compensation if a particular investment would generate higher Adviser compensation.

Other commenters asked the Department to use a different definition of Best Interest, or simply use the exact language from ERISA's section 404 duty of loyalty. Others suggested definitional approaches that would require that the Adviser and Financial Institution ''not subordinate'' their customers' interests to their own interests, or that the Adviser and Financial Institution ''put their customers' interests ahead of their own interests,'' or similar constructs.

FINRA suggested that the federal securities laws should form the foundation of the Best Interest standard. Specifically, FINRA urged that the Best Interest definition in the exemption incorporate the suitability standard applicable to investment advisers and broker dealers under federal securities laws. According to FINRA, this would facilitate customer enforcement of the Best Interest standard by providing adjudicators with a well-established basis on which to find a violation.

Other commenters found the Best Interest standard to be an appropriate statement of the obligations of a fiduciary investment advice provider and believed it would provide concrete protections against conflicted recommendations. These commenters asked the Department to maintain the Best Interest definition as proposed. One commenter wrote that the term ''best interest'' is commonly used in connection with a fiduciary's duty of loyalty and cautioned the Department against creating an exemption that failed to include the duty of loyalty. Others urged the Department to avoid definitional changes that would reduce current protections to Retirement Investors. Some commenters also noted that the ''without regard to'' language is consistent with the recommended standard in the SEC staff Dodd-Frank Study, and suggested that it has added benefit of potentially harmonizing with a future securities law standard for broker-dealers.

In the context of principal transactions, one commenter suggested that the Department make clear that both the advice and the execution of the transaction must be in the Retirement Investor's Best Interest. The Department agrees that the execution of the transaction is an important concern, and has incorporated in Section II(c)(2) of the exemption, a provision requiring Financial Institutions that are FINRA members to agree that they and their Advisers and Financial Institution will comply with the terms of FINRA rule 5310 (Best Execution and Interpositioning).

The final exemption retains the Best Interest definition as proposed, with minor adjustments. The first prong of the standard was revised to more closely track the statutory language of ERISA section 404(a), and, is consistent with the Department's intent to hold investment advice fiduciaries to a prudent investment professional standard. Accordingly, the definition of Best Interest now requires advice that ''reflects 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 Retirement Investor . . .'' The exemption adopts the second prong of the proposed definition, ''without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate or other party,'' without change. The Department continues to believe that the ''without regard to'' language sets forth the appropriate, protective standard under which a fiduciary investment adviser should act. The standard ensures that the advice will not be tainted by self-interest. Under this language, an Adviser and Financial Institution must make a recommendation with respect to the principal transaction or riskless principal transaction without considering their own financial or other interests, or those of their Affiliates, or others. They may not recommend such a transaction on the basis that it pays them more, or otherwise benefits them more than a transaction conducted on an agency basis. Many of the alternative approaches suggested by commenters pose their own ambiguities and interpretive challenges, and lower standards run the risk of undermining this regulatory initiative's goal of reducing the impact of conflicts of interest on Retirement Investors.

The Department has not specifically incorporated the suitability obligation as an element of the Best Interest standard, as suggested by FINRA but many aspects of suitability are also elements of the Best Interest standard. An investment recommendation that is not suitable under the securities laws would not meet the Best Interest standard. Under FINRA's rule 2111(a) on suitability, broker-dealers ''must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer.'' The text of rule 2111(a), however, does not do any of the following: Reference a best interest standard, clearly require brokers to put their client's interests ahead of their own, expressly prohibit the selection of the least suitable (but more remunerative) of available investments, or require them to take the kind of measures to avoid or mitigate conflicts of interests that are required as conditions of this exemption.

The Department recognizes that FINRA issued guidance on rule 2111 in which it explains that ''in interpreting the suitability rule, numerous cases explicitly state that a broker's recommendations must be consistent with his customers' best interests,'' and provided examples of conduct that would be prohibited under this standard, including conduct that this exemption would not allow.[25] The guidance goes on to state that ''[t]he suitability requirement that a broker make only those recommendations that are consistent with the customer's best interests prohibits a broker from placing his or her interests ahead of the customer's interests.'' The Department, however is reluctant to adopt as an

[25] FINRA Regulatory Notice 12–25, p. 3 (2012).

express standard such guidance, which has not been formalized as a clear rule and that, in any case, may be subject to change. Additionally, FINRA's suitability rule may be subject to interpretations which could conflict with interpretations by the Department, and the cases cited in the FINRA guidance, as read by the Department, involved egregious fact patterns that one would have thought violated the suitability standard even without reference to the customer's best interest.

Moreover, suitability under SEC practice differs somewhat from the FINRA approach. According to the SEC staff Dodd-Frank Study, the SEC requirements are based on the anti-fraud provisions of the Securities Act Section 17(a), the Exchange Act Section 10(b) and Rule 10b–5 thereunder.[26] As a general matter, SEC Rule 10b–5 prohibits any person, directly or indirectly, from: (a) Employing any device, scheme, or artifice to defraud; (b) making untrue statements of material fact or omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances, not misleading; or (c) engaging in any act or practice or course of business which operates or that would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security. FINRA does not require scienter, but the weight of authority holds that violations of the Self-Regulatory Organization rules, standing alone, do not give right to a private cause of action. Courts, however, allow private claims for violations of SEC Rule 10b–5 for fraud claims, including, among others, unsuitable recommendations. The private plaintiff must establish that the broker's unsuitable recommendation involved a misrepresentation (or material omission) made with scienter. Accordingly, after review of the issue, the Department has decided not to accept the comment. The Department has concluded that its articulation of a clear loyalty standard within the exemption, rather than by reference to the FINRA guidance, will provide clarity and certainty to investors, and better protect their interests.

The Best Interest standard, as set forth in the exemption, is intended to effectively incorporate the objective standards of care and undivided loyalty that have been applied under ERISA for more than forty years. Under these objective standards, the Adviser must adhere to a professional standard of care in making investment recommendations regarding principal transactions and riskless principal transactions that are in the Retirement Investor's Best Interest. The Adviser may not base his or her recommendations on the Adviser's own financial interest in the transaction. Nor may the Adviser recommend a principal transaction or riskless principal transaction, unless it meets the objective prudent person standard of care. Additionally, the duties of loyalty and prudence embodied in ERISA are objective obligations that do not require proof of fraud or misrepresentation, and full disclosure is not a defense to making an imprudent recommendation or favoring one's own interests at the Retirement Investor's expense.

A few commenters also questioned the requirement in the Best Interest standard that recommendations be made without regard to the interests of the Adviser, Financial Institution, any Affiliate, or other party. The commenters indicated they did not know the purpose of the reference to ''other party'' and asked that it be deleted. The Department intends the reference to make clear that an Adviser and Financial Institution operating within the Impartial Conduct Standards should not take into account the interests of any party other than the Retirement Investor—whether the other party is related to the Adviser or Financial Institution or not—in making a recommendation regarding a principal transaction or riskless principal transaction. For example, an entity that may be unrelated to the Adviser or Financial Institution but could still constitute an ''other party,'' for these purposes, is the manufacturer of the investment product being recommended.

Other commenters asked for confirmation that the Best Interest standard is applied based on the facts and circumstances as they existed at the time of the recommendation, and not based on hindsight. Consistent with the well-established legal principles that exist under ERISA today, the Department confirms that the Best Interest standard is not a hindsight standard, but rather is based on the facts as they existed at the time of the recommendation. Thus, the courts have evaluated the prudence of a fiduciary's actions under ERISA by focusing on the process the fiduciary used to reach its determination or recommendation—whether the fiduciary, ''at the time they engaged in the challenged transactions, employed the proper procedures to investigate the merits of the investment and to structure the investment.'' [27] The standard does not measure compliance by reference to how investments subsequently performed or turn Advisers and Financial Institutions into guarantors of investment performance, even though they gave advice that was prudent and loyal at the time of transaction.[28]

This is not to suggest that the ERISA section 404 prudence standard, or Best Interest standard, are solely procedural standards. Thus, the prudence standard, as incorporated in the Best Interest standard, is an objective standard of care that requires investment advice fiduciaries to investigate and evaluate investments, make recommendations, and exercise sound judgment in the same way that knowledgeable and impartial professionals would. ''[T]his is not a search for subjective good faith—a pure heart and an empty head are not enough.'' [29] Whether or not the fiduciary is actually familiar with the sound investment principles necessary to make particular recommendations, the fiduciary must adhere to an objective professional standard. Additionally, fiduciaries are held to a particularly stringent standard of prudence when they have a conflict of interest.[30] For this reason, the Department declines to provide a safe harbor based on ''procedural prudence'' as requested by a commenter.

The Department additionally confirms its intent that the phrase ''without regard to'' be given the same meaning as the language in ERISA section 404 that requires a fiduciary to act ''solely in the interest of'' participants and

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[26] SEC staff Dodd-Frank Study at 61.

[27] *Donovan* v. *Mazzola,* 716 F.2d 1226, 1232 (9th Cir. 1983).

[28] One commenter requested an adjustment to the ''prudence'' component of the Best Interest standard, under which the standard would be that of a ''prudent person serving clients with similar retirement needs and offering a similar array of products.'' In this way, the commenter sought to accommodate varying perspectives and opinions on particular investment products and business practices. The Department disagrees with the comment, which could be read as qualifying the stringency of the prudence obligation based on the Financial Institution's or Adviser's independent decisions on which products to offer, rather than on the needs of the particular Retirement Investor. Therefore, the Department did not adopt this suggestion.

[29] *Donovan* v. *Cunningham,* 716 F.2d 1455, 1467 (5th Cir. 1983), *cert. denied,* 467 U.S. 1251 (1984); *see also DiFelice* v. *U.S. Airways, Inc.,* 497 F.3d 410, 418 (4th Cir. 2007) (''Good faith does not provide a defense to a claim of a breach of these fiduciary duties; 'a pure heart and an empty head are not enough.''').

[30] *Donovan* v. *Bierwirth,* 680 F.2d 263, 271 (2d Cir. 1982) (''the[] decisions [of the fiduciary] must be made with an eye single to the interests of the participants and beneficiaries''); *see also Bussian* v. *RJR Nabisco, Inc.,* 223 F.3d 286, 298 (5th Cir. 2000); *Leigh* v. *Engle,* 727 F.2d 113, 126 (7th Cir. 1984).

beneficiaries, as such standard has been interpreted by the Department and the courts. Therefore, the standard would not, as some commenters suggested, foreclose the Adviser and Financial Institution from being paid. The Department confirms that the standard does not preclude the Financial Institution from receiving reasonable compensation or from recouping the cost of obtaining and carrying the security, assuming the investment remains prudent when all its costs are considered.

In response to commenter concerns, the Department also confirms that the Best Interest standard does not impose an unattainable obligation on Advisers and Financial Institutions to somehow identify the single ''best'' investment for the Retirement Investor out of all the investments in the national or international marketplace, assuming such advice or management were even possible. Instead, as discussed above, the Best Interest standard set out in the exemption, incorporates two fundamental and well-established fiduciary obligations: the duties of prudence and loyalty. Thus, the fiduciary's obligation under the Best Interest standard is to give advice or acquire or dispose of investments in a manner that adheres to professional standards of prudence, and to put the Retirement Investor's financial interests in the driver's seat, rather than the competing interests of the Adviser or other parties.

Finally, in response to questions regarding the extent to which this Best Interest standard or other provisions of the exemption impose an ongoing monitoring obligation on Advisers or Financial Institutions, the Department has added specific language in Section II(e) regarding monitoring. The text does not impose a monitoring requirement, but instead requires clarity. As suggested by FINRA, Section II(e) requires Advisers and Financial Institutions to disclose whether or not they will monitor the Retirement Investor's investments and alert the Retirement Investor to any recommended changes to those investments and, if so, the frequency with which the monitoring will occur and the reasons for which the Retirement Investor will be alerted. This is consistent with the Department's interpretation of an investment advice fiduciary's monitoring responsibility as articulated in the preamble to the Regulation.

The terms of the contract or disclosure along with other representations, agreements, or understandings between the Adviser, Financial Institution and Retirement Investor, will govern whether the nature of the relationship between the parties is ongoing or not. The preamble to the proposed Best Interest Contract Exemption stated that adherence to a Best Interest standard did not mandate an ongoing or long-term relationship, but instead left the determination of whether to enter into such a relationship to the parties.[31] This exemption builds upon this and requires that the contract clearly state the nature of the relationship and whether there is any duty to monitor on the part of the Adviser or Financial Institution. Whether the Adviser and Financial Institution, in fact, have an obligation to monitor the investment and provide long-term advice depends on the parties' reasonable understandings, arrangements, and agreements.

b. Best Execution

Section II(c)(2) of the exemption requires that the Adviser and Financial Institution seek to obtain the best execution reasonably available under the circumstances with respect to the principal transaction or riskless principal transaction with the plan, participant or beneficiary account or IRA.

Section II(c)(2)(i) further provides that Financial Institutions that are FINRA members may satisfy Section II(c)(2) by complying with the terms of FINRA rules 2121 (Fair Prices and Commissions) and 5310 (Best Execution and Interpositioning), or any successor rules in effect at the time of the transaction,[32] as interpreted by FINRA, with respect to the principal transaction or riskless principal transaction.

This provision is revised from the proposal, which provided that the purchase or sales price could not be unreasonable under the circumstances. Commenters on the proposal indicated that they were uncertain as to what an unreasonable price would be and requested additional clarification of the rule.

Further, some commenters indicated that FINRA rule 2121 (Fair Prices and Commissions) should be incorporated in the alternative. According to FINRA, rule 2121 ''prohibits a broker-dealer from entering into a transaction with a customer 'at any price' that is not reasonably related to the current market price of the security.'' FINRA additionally recommended that the Department incorporate FINRA rule 5310 (Best Execution and Interpositioning) instead of its proposed two-quote requirement (discussed below). According to FINRA:

> [Rule 5310] uses a ''facts and circumstances'' analysis by requiring that a firm dedicate reasonable diligence to ascertain the best market for the security and to buy or sell in such market so that the price to the customer is as favorable as possible under the prevailing market conditions. A key determinant in assessing whether a firm has met this reasonable diligence standard is the character of the market for the security itself, which includes an analysis of price, volatility and relative liquidity.
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> [The] Rule . . . also addresses instances in which there is limited quotation or pricing information available. The rule requires a broker-dealer to have written policies and procedures that address how the firm will determine the best inter-dealer market for such a security in the absence of pricing information or multiple quotations and to document its compliance with those policies and procedures.

After consideration of the comments received, the Department revised the proposed condition to focus on best execution, rather than an unreasonable price. The Department determined that a requirement that Advisers and Financial Institutions seek to obtain the best execution reasonably available under the circumstances with respect to the transaction, particularly as articulated by FINRA in rule 5310, would provide protections that are comparable to the Department's proposed condition but that are more familiar to the parties relying on the exemption.

The Department specifically incorporated FINRA rules 2121 and 5310 for FINRA members, as a method of satisfying this requirement, as suggested by some commenters. For Advisers and Financial Institutions that are not FINRA members, the best execution obligation under the exemption is satisfied if the Adviser and Financial Institution satisfies the best execution obligation as interpreted by their functional regulator. However, to the extent non-FINRA members wish for additional certainty as to their compliance obligations under this exemption, they may comply with the provisions of FINRA rules 2121 and 5310 to satisfy Section II(c)(2).

Under Section II(c)(2)(ii), if the Department expands the scope of this exemption to include additional principal traded assets by individual exemption,[33] the Department may

[31] 80 FR 21969 (Apr. 20, 2015).

[32] Accordingly, to the extent FINRA rules 2121 (Fair Prices and Commissions) or 5310 (Best Execution and Interpositioning) are amended, the Adviser and Financial Institution must comply with the requirements that are in effect at the time the transaction occurs.

[33] *See* Section VI(j)(1)(iv).

identify specific alternative best execution and fair pricing requirements imposed by another regulator or self-regulatory organization that must be complied with. This would potentially permit, for example, Financial Institutions to cite specific requirements of the Municipal Securities Rulemaking Board, if municipal securities become covered under the exemption.

c. Misleading Statements

The final Impartial Conduct Standard, set forth in Section II(c)(3), requires that statements by the Financial Institution and its Advisers to the Retirement Investor about the recommended transaction, fees and compensation, Material Conflicts of Interest, and any other matters relevant to a Retirement Investor's investment decision to engage in a principal transaction or a riskless principal transaction, may not be materially misleading at the time they are made. In response to commenters, the Department adjusted the text to clarify that the standard is measured at the time of the representations, *i.e.,* the statements must not be misleading ''at the time they are made.'' Similarly, the Department added a materiality standard in response to comments.

The Department did not accept certain other comments, however. One commenter requested that the Department add a qualifier providing that the standard is violated only if the statement was ''reasonably relied'' on by the Retirement Investor. The Department rejected the comment. The Department's aim is to ensure that Financial Institutions and Advisors uniformly adhere to the Impartial Conduct Standards, including the obligation to avoid materially misleading statements, when they give advice. Whether a Retirement Investor relied on a particular statement may be relevant to the question of damages in subsequent arbitration or court proceedings, but it is not and should not be relevant to the question of whether the fiduciary violated the exemption's standards in the first place. Moreover, inclusion of a reasonable reliance standard runs the risk of inviting boilerplate disclaimers of reliance in contracts and disclosure documents precisely so the Adviser can assert that any reliance is unreasonable.

One commenter asked the Department to require only that the Adviser ''reasonably believe'' the statements are not misleading. The Department is concerned that this standard too could undermine the protections of this condition, by requiring Retirement Investors or the Department to prove the Adviser's actual belief rather than focusing on whether the statement is objectively misleading. However, to address commenters' concerns about the risks of engaging in a prohibited transaction, as noted above, the Department has clarified that the standard is measured at the time of the representations and has added a materiality standard.

The Department believes that Retirement Investors are best served by statements and representations that are free from material misstatements. Financial Institutions and Advisers best avoid liability—and best promote the interests of Retirement Investors—by ensuring that accurate communications are a consistent standard in all their interactions with their customers.

A commenter suggested that the Department adopt FINRA's ''Frequently Asked Questions regarding Rule 2210'' in this connection.[34] FINRA's rule 2210, Communications with the Public, sets forth a number of procedural rules and standards that are designed to, among other things, prevent broker-dealer communications from being misleading. The Department agrees that adherence to FINRA's standards can promote materially accurate communications, and certainly believes that Financial Institutions and Advisers should pay careful attention to such guidance documents. After review of the rule and FAQs, however, the Department declines to simply adopt FINRA's guidance, which addresses written communications, since the condition of the exemption is broader in this respect. In the Department's view, the meaning of the standard is clear, and is already part of a plan fiduciary's obligations under ERISA. If, however, issues arise in implementation of the exemption, the Department will consider requests for additional guidance.

d. Contractual Representation Versus Exemption Condition

Commenters expressed a variety of views on whether violations of the Impartial Conduct Standards with respect to advice regarding principal transactions to Retirement Investors regarding IRAs and non-ERISA plans should result in loss of the exemption, violation of the contract, or both.[35] Some commenters objected to the incorporation of the Impartial Conduct Standards as contract terms, generally, on the basis that the requirement would contribute to litigation risk. Some commenters preferred that the Impartial Conduct Standards only be required as a condition of the exemption, and not give rise to contract claims.

Other commenters advocated for the opposite result, asserting that the Impartial Conduct Standards should be required for contractual promises only, and not treated as exemption conditions. These commenters asserted that the Impartial Conduct Standards are too vague and would result in uncertainty as to whether an excise tax under the Code, which is self-assessed, is owed. There were also suggestions to limit the contractual representation to the Best Interest standard alone. One commenter asserted that the favorable price requirement and the obligation not to make misleading statements fall within a Best Interest standard, and do not need to be stated separately. There were also suggestions that the Impartial Conduct Standards not apply to ERISA plans because fiduciaries to these plans already are required to adhere to similar statutory fiduciary obligations. In these commenters' views, requiring these standards in an exemption is redundant and inappropriately increases the consequences of any fiduciary breach by imposing an excise tax.

In response to comments, the Department has revised the language of the Impartial Conduct Standards and provided interpretive guidance to alleviate the commenters' concerns about uncertainty and litigation risk. However, the Department has concluded that, failure to adhere to the Impartial Conduct Standards should be both a violation of the contract (where required) and the exemption. Accordingly, the Department has not eliminated any of the conduct standards or, for IRAs and non-ERISA plans, restricted them just to conditions of the exemption for Retirement Investors investing in IRAs or non-ERISA plans. In the Department's view, all the Impartial Conduct Standards form the baseline standards that should be applicable to fiduciaries relying on the exemption; therefore, the Department has not accepted comments suggesting that the contract representation be limited to the Best Interest standard. Making all the Impartial Conduct Standards required contractual promises for dealings with IRAs and other non-ERISA plans creates the potential for contractual liability, incentivizes Financial Institutions to comply, and gives injured Retirement Investors a remedy if those Financial Institutions do not comply. This enforceability is critical to the safeguards afforded by the exemption.

[34] *Currently available at http://www.finra.org/industry/finra-rule-2210-questions-and-answers.*

[35] Commenters also asserted that the Department did not have the authority to condition the exemption on the Impartial Conduct Standards. Comments on the Department's jurisdiction are discussed in a separate Section D. of this preamble.

As previously discussed, the Impartial Conduct Standards will not unduly increase litigation risk. The standards are not unduly vague or unknown, but rather track longstanding concepts in law and equity. Also, the Department has simplified execution of the contract, streamlined disclosure, and made certain language changes to address legitimate concerns.

Similarly, the Department has not accepted the comment that the Impartial Conduct Standards should apply only to IRAs and non-ERISA plans. One of the Department's goals is to ensure equal footing for all Retirement Investors. The SEC staff Dodd-Frank Study found that investors were frequently confused by the differing standards of care applicable to broker-dealers and registered investment advisers. The Department hopes to minimize such confusion in the market for retirement advice by holding Advisers and Financial Institutions to similar standards, regardless of whether they are giving the advice to an ERISA plan, IRA, or a non-ERISA plan.

Moreover, inclusion of the standards in the exemption's conditions adds an important additional safeguard for ERISA and IRA investors alike because the party engaging in a prohibited transaction has the burden of showing compliance with an applicable exemption, when violations are alleged.[36] In the Department's view, this burden-shifting is appropriate because of the dangers posed by conflicts of interest, as reflected in the Department's Regulatory Impact Analysis and because of the difficulties Retirement Investors have in effectively policing such violations.[37] One important way for Financial Institutions to ensure that they can meet this burden is by implementing strong anti-conflict policies and procedures, and by refraining from creating incentives to violate the Impartial Conduct Standards. Thus, treating the Impartial Conduct Standards as exemption conditions creates an important incentive for Financial Institutions to carefully monitor and oversee their Advisers' conduct for adherence with fiduciary norms.

Moreover, as noted repeatedly, the language for the Impartial Conduct Standards borrows heavily from ERISA and the law of trusts, providing sufficient clarity to alleviate the commenters' concerns. Ensuring that fiduciary investment advisers adhere to the Impartial Conduct Standards and that all Retirement Investors have an effective legal mechanism to enforce the standards are central goals of this regulatory project.

[36] *See, e.g., Fish* v. *GreatBanc Trust Company,* 749 F.3d 671 (7th Cir. 2014).

[37] *See* Regulatory Impact Analysis.

5. Sales Incentives and Anti-Conflict Policies and Procedures

Under Section II(d)(1)–(3) of the exemption, the Financial Institution is required to adopt certain anti-conflict policies and procedures and to insulate Advisers from incentives to violate the Best Interest standard. In order for relief to be available under the exemption, a Financial Institution that meets the definition set forth in the exemption must provide oversight of Advisers' recommendations, as described in this section. The Financial Institution must prepare a written document describing the Financial Institution's policies and procedures, and make copies of the document readily available to Retirement Investors, free of charge, upon request as well as on the Financial Institution's Web site.[38] The written description must accurately describe or summarize key components of the policies and procedures relating to conflict-mitigation and incentive practices in a manner that permits Retirement Investors to make an informed judgment about the stringency of the Financial Institution's protections against conflicts of interest. The Department opted against requiring disclosure of the full policies and procedures to Retirement Investors to avoid giving them a potentially overwhelming amount of information that could run contrary to its purpose (*e.g.,* by alerting Advisers to the particular surveillance mechanisms employed by Financial Institutions). However, the exemption requires that the full policies and procedures must be made available to the Department upon request.

These obligations have several important components. First, the Financial Institution must adopt and comply with written policies and procedures reasonably and prudently designed to ensure that its individual Advisers adhere to the Impartial Conduct Standards set forth in Section II(c). Second, the Financial Institution in formulating its policies and procedures, must specifically identify and document its Material Conflicts of Interest associated with principal transactions and riskless principal transactions; adopt measures reasonably and prudently designed to prevent Material Conflicts of Interest from causing violations of the Impartial Conduct Standards set forth in Section II(c); and designate a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards. For purposes of the exemption, a Material Conflict of Interest exists when an Adviser or Financial Institution 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 a Retirement Investor.

[38] *See* Section IV(e).

Finally, the Financial Institution's policies and procedures must require that, neither the Financial Institution nor (to the best of its knowledge) any Affiliate uses or relies on quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended or would reasonably be expected to cause individual Advisers to make recommendations regarding principal transactions and riskless principal transactions that are not in the Best Interest of the Retirement Investor.

In this respect, however, the exemption makes clear that that requirement does not prevent the Financial Institution or its Affiliates from providing Advisers with differential compensation (whether in type or amount, and including, but not limited to, commissions) based on investment decisions by Plans, participant or beneficiary accounts, or IRAs, to the extent that the policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of Advisers with the interests of the Retirement Investors they serve as fiduciaries.

The anti-conflict policies and procedures will safeguard the interests of Retirement Investors by causing Financial Institutions to consider the conflicts of interest affecting their provision of advice to Retirement Investors regarding principal transactions and riskless principal transactions and to take action to mitigate the impact of such conflicts. In particular, under the final exemption, Financial Institutions must not use compensation and other employment incentives to the extent they are intended to or would reasonably be expected to cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. Financial Institutions must also establish a supervisory structure reasonably and prudently designed to ensure the Advisers will adhere to the

Impartial Conduct Standards. Mitigating conflicts of interest associated with principal transactions and riskless principal transactions by requiring greater alignment of the interests of the Adviser and Financial Institution, and the Retirement Investor, is necessary for the Department to make the findings under ERISA section 408(a) and Code section 4975(c)(2) that the exemption is in the interests of, and protective of, Retirement Investors. This warranty gives the Financial Institution a powerful incentive to ensure advice is provided in accordance with fiduciary norms, rather than risk litigation, including class litigation and liability.

Like the proposal, the exemption does not specify the precise content of the anti-conflict policies and procedures. This flexibility is intended to allow Financial Institutions to develop policies and procedures that are effective for their particular business models, while prudently ensuring compliance with their and their Advisers' fiduciary obligations and the Impartial Conduct Standards. The policies and procedures requirement, if taken seriously, can also reduce Financial Institutions' litigation risk by minimizing incentives for Advisers to provide advice that is not in Retirement Investors' Best Interest.

As adopted in the final exemption, the policies and procedures requirement is a condition of the exemption for all Retirement Investors—in ERISA plans, IRAs and non-ERISA plans. Failure to comply could result in liability under ERISA for engaging in a prohibited transaction and the imposition of an excise tax under the Code, payable to the Treasury. Additionally, with respect to Retirement Investors in IRAs and non-ERISA plans, the requirements take the form of a contractual warranty. The Financial Institution must warrant that it has adopted and will comply with the anti-conflict policies and procedures (including the obligation to avoid misaligned incentives). Failure to comply with the warranty could result in contractual liability.

Comments on the proposed policies and procedures requirement are discussed below. As stated above, for ease of use, the Department has included in this preamble the same general discussion of comments as in the Best Interest Contract Exemption, to the extent applicable to principal transactions and riskless principal transactions, despite the fact that some comments discussed below were not made directly with respect to this exemption.

a. Policies and Procedures Requirement Generally

Under the policies and procedures requirement, described in greater detail above, Financial Institutions must adopt and comply with anti-conflict policies and procedures. In addition, neither the Financial Institution nor (to the best of its knowledge) any Affiliates may use or rely on quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended or would reasonably be expected to cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor.

Some commenters were extremely supportive of the policies and procedures requirement as proposed. They expressed the view that the policies and procedures requirement, and in particular the restrictions on compensation and other employment incentives, was one of the most critical investor protections in the proposal because it would cause Financial Institutions to make specific and necessary changes to their compensation arrangements that would result in significant protections to Retirement Investors.

Some commenters believed that the Department did not go far enough. These commenters indicated that flat compensation arrangements should be required, or at least that the rules applicable to differential compensation should be more specific and stringent.

A few commenters also indicated that, in addition to focusing on the Adviser, the Financial Institution's policies and procedures need to consider the impact of compensation practices on branch managers. A commenter indicated that branch managers have responsibilities under FINRA's supervisory rules to ensure suitability and possibly approve individual transactions. The commenter asserted that branch managers financially benefit from Advisers' recommendations and have a variety of methods of influencing Adviser behavior.

Many others objected to the policies and procedures warranty and requested that it be eliminated in the final exemption. Some commenters believed that compliance would require drastic changes to current compensation arrangements or could possibly result in the complete prohibition of commissions and other transaction-based compensation. Other commenters suggested that the requirement should be eliminated as it would be unnecessary in light of the exemption's Best Interest standard, and because it would unnecessarily increase litigation risk to Financial Institutions. Alternatively, there were requests to clarify specific provisions and provide safe harbors in the policies and procedures requirement.

In the final exemption, the Department has retained the general approach of the proposal. The Department concurs with commenters who view the policies and procedures requirement as an important safeguard for Retirement Investors and as a necessary condition for the Department to make the findings under ERISA section 408(a) and Code section 4975(c)(2) that the exemption is in the interests of, and protective of, Retirement Investors. This provision will require Financial Institutions to take concrete and specific steps to ensure that its individual Advisers adhere to the Impartial Conduct Standards, and in particular, forego compensation practices and employment incentives (quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives) that are intended or would reasonably be expected to cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. Strong policies and procedures reduce the temptation (conscious or unconscious) to violate the Best Interest standard in the first place by ensuring that the Advisers' incentives are appropriately aligned with the interests of the customers they serve, and by ensuring appropriate monitoring and supervision of individual Advisers' conduct. While the Department views the Best Interest standard as critical to the protections of the exemption, the policies and procedures requirement is equally critical as a means of supporting Best Interest advice and protecting Retirement Investors from having to enforce the Best Interest standard after the advice has already been rendered and the damage done.

The Department has not made the requirements more stringent, as suggested by some commenters, so as to require completely level compensation. The Department designed the exemption to preserve mark-ups and mark-downs and other payments as applicable to the transaction in connection with principal transactions and riskless principal transactions, thereby preserving existing business models.

The Department also adopted the suggestion of one commenter that the exemption require the Financial

Institution to designate a specific person to address Material Conflicts of Interest and monitor Advisers' adherence to the Impartial Conduct Standards.[39] In the proposal, the Department had already suggested that Financial Institutions consider this approach; however, the commenter suggested that it should be a specific requirement and indicated that most Financial Institutions already have a designated compliance officer. The Department concurs with the commenter and has included that requirement in the final exemption, based on the view that formalizing the process for identifying and monitoring these issues will result in increased protections to Retirement Investors.

b. Specific Language of Policies and Procedures Requirement

There were also questions and comments on certain language in the proposed policies and procedures requirement. As proposed, the components of the policies and procedures requirement in Section II(d) read as follows:

- The Financial Institution has adopted written policies and procedures reasonably designed to mitigate the impact of Material Conflicts of Interest and to ensure that its individual Advisers adhere to the Impartial Conduct Standards set forth in Section II(c);
- In formulating its policies and procedures, the Financial Institution has specifically identified Material Conflicts of Interest and adopted measures to prevent the Material Conflicts of Interest from causing violations of the Impartial Conduct Standards set forth in Section II(c); and
- Neither the Financial Institution nor (to the best of its knowledge) any Affiliate uses quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives to the extent they would tend to encourage individual Advisers to make recommendations regarding principal transactions that are not in the Best Interest of the Retirement Investor.

A few commenters asked the Department to explain the difference between the first and second prongs of the policies and procedures requirement, as proposed. In response, the first prong of the requirement was intended to establish a general standard, while the second (and third) prongs provided specific rules regarding the policies and procedures requirement. This approach was also adopted in the final exemption. In addition, the language of Section II(d)(3) specifically provides that the third prong of the requirement, requiring Financial Institutions to insulate Advisers from incentives to violate the Best Interest standard, is part of the policies and procedures requirement.

There were also comments on (i) the definition and use of the term ''Material Conflicts of Interest;'' (ii) the language requiring the policies and procedures to be ''reasonably designed'' to mitigate the impact of such conflicts of interest, and (iii) the meaning of incentives that ''tend to encourage'' individual Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. These comments are discussed below.

i. Materiality

A number of commenters focused on the definition of Material Conflict of Interest used in the proposal. Under the definition as proposed, a Material Conflict of Interest exists when an Adviser or Financial Institution ''has a financial interest that could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor.'' Some commenters took the position that the proposal did not adequately explain the term ''material'' or incorporate a materiality standard into the definition. A commenter wrote that the proposed definition was so broad that it would be difficult for Financial Institutions to comply with the various aspects of the exemption related to Material Conflicts of Interest, such as provisions requiring disclosure of Material Conflicts of Interest.

Another commenter indicated that the Department should not use the term ''material'' in defining conflicts of interest. The commenter believed that it could result in a standard that was too subjective from the perspective of the Adviser and Financial Institution, and could undermine the protectiveness of the exemption.

After consideration of the comments, the Department adjusted the definition of Material Conflict of Interest. In the final exemption, a Material Conflict of Interest exists when an Adviser or Financial Institution has a ''financial interest that that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor.'' This language responds to concerns about the breadth and potential subjectivity of the standard. The Department did not, as some commenters suggested, include the word ''material'' in the definition of Material Conflict of Interest, to avoid the potential circularity of that approach.

ii. Reasonably Designed

One commenter asked that the Department more broadly use the modifier ''reasonably designed'' in describing the standard the policies and procedures must meet so as to avoid a construction that required standards that ensured perfect compliance, a potentially unattainable standard. The Department has accepted the comment and adjusted the language in Sections II(d)(1) and (2) to generally use the phrase ''reasonably and prudently designed.'' Other commenters asked for guidance on the proposed phrasing ''reasonably designed to mitigate'' the impact of Material Conflicts of Interest. The Department provides additional guidance in this respect in the preamble of the Best Interest Contract Exemption published elsewhere in this issue of the **Federal Register**, which gives examples of some possible approaches to policies and procedures.

iii. Tend To Encourage

A number of commenters asked for clarification or revision of the proposed exemption's prohibition of incentives that ''tend to encourage'' violation of the Best Interest standard, generally to require a tight link between the incentives and the Advisers' recommendations. Commenters argued that the ''tend to encourage'' language established a standard that could be impossible to meet in the context of differential compensation. Accordingly, they requested that the Department use language such as ''intended to encourage,'' ''does encourage,'' ''causes,'' or similar formulation.

In response to these commenters the Department has adjusted the condition's language as follows:

> [N]either the Financial Institution nor (to the best of the Financial Institution's knowledge) any Affiliate uses or relies on quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are *intended* or would *reasonably be expected to* cause individual Advisers to make recommendations regarding Principal Transactions and Riskless Principal Transactions that are not in the Best Interest of the Retirement Investor (emphasis added).

This language more accurately captures the Department's intent, which was to require that procedures reasonably address Advisers' incentives,

[39] One important consideration in addressing conflicts of interest is the Financial Institution's attentiveness to the qualifications and disciplinary history of the persons it employs to provide such advice. *See* Egan, Mark, Gregor Matvos and Amit Seru, *The Market for Financial Adviser Misconduct,* at 3 (February 26, 2016) (''Past offenders are five times more likely to engage in misconduct than the average adviser, even compared with other advisers in the same firm at the same point in time. The large presence of repeat offenders suggests that consumers could avoid a substantial amount of misconduct by avoiding advisers with misconduct records.'').

not guarantee perfection. The Department disagrees, however, with the suggestion that Financial Institutions should be permitted to tolerate or create incentives that would ''reasonably be expected to cause such violations'' unless the Retirement Investor can actually prove the Financial Institution's intent to cause violations of the standard or the Adviser's improper motivation in making the recommendation. The aim of the policies and procedures requirement is to require the Financial Institution to take prophylactic measures to ensure that Retirement Advisers adhere to the Impartial Conduct Standards, a goal completely at odds with the creation of incentives to violate the Best Interest standard. In exchange for the receipt of compensation that would otherwise be prohibited by ERISA and the Code, the Financial Institution's responsibility under the exemption is to protect Retirement Investors from conflicts of interest, not to promote or continue to offer incentives to violate the Best Interest standard. Moreover, absent extensive discovery or the ability to prove the motivations of individual Advisers, Retirement Investors would generally be in a poor position to prove such ill intent.

However, the final exemption provides that the policies and procedures requirement does not:

> [P]revent the Financial Institution or its Affiliates from providing Advisers with differential compensation *(whether in type or amount, and including, but not limited to, commissions)* based on investment decisions by Plans, participant or beneficiary accounts, or IRAs, *to the extent that the policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of Advisers with the interests of the Retirement Investors they serve as fiduciaries* (emphasis added).

This language is designed to make clear that differential compensation is permitted, but only if the Financial Institution's policies and procedures, as a whole, are reasonably designed to avoid a misalignment of interests between Advisers and Retirement Investors.

For further guidance, the preamble to the Best Interest Contract Exemption, published in this same issue of the **Federal Register**, provides examples of the types of policies and procedures that may satisfy the warranty.

c. Contractual Warranty Versus Exemption Condition

In the proposal, both the Adviser and Financial Institution had to give a warranty to the Retirement Investor about the adoption and implementation of anti-conflict policies and procedures. A few commenters indicated that the Adviser should not be required to give the warranty, and questioned whether the Adviser would always be in a position to speak to the Financial Institution's incentive and compensation arrangements. The Department agrees that the Financial Institution has the primary responsibility for design and implementation of the policies and procedures requirement and, accordingly, has limited the warranty requirement to the Financial Institution.

Some commenters believed that even if the Department included a policies and procedure requirement in the exemption, it should not require a warranty on implementation and compliance with the requirement. According to some of these commenters the warranty was unnecessary in light of the Best Interest standard, and would unduly contribute to litigation risk. A few commenters also suggested that a Financial Institution's failure to comply with the contractual warranty could give rise to a cause of action to Retirement Investors who had suffered no injuries from failure to implement or comply with appropriate policies and procedures. A few other commenters expressed concern that the provision of a warranty could result in tort liability, rather than just contractual liability.

Other commenters argued that the Department should require Financial Institutions not only to make an enforceable warranty as a condition of the exemption, but also require actual compliance with the warranty as a condition of the exemption. One such commenter argued that it would be difficult for Retirement Investors to prove that policies and procedures were not ''reasonably designed'' to achieve the required purpose.

As noted above, the final exemption adopts the required policies and procedures as a condition of the exemption. The policies and procedures requirement is a critical part of the exemption's protections. The risk of liability associated with a non-exempt prohibited transaction gives Financial Institutions a strong incentive to design protective policies and procedures in a way that is consistent with the purposes and requirements of this exemption. Of course, the Department does not expect that successful contract claims will be brought by Retirement Investors without a showing of damages.

In addition, the final exemption requires the Financial Institution to make a warranty regarding the policies and procedures in contracts with Retirement Investors regarding IRAs and other non-ERISA plans. The warranty, and potential liability associated with that warranty, gives Financial Institutions both the obligation and the incentive to tamp down harmful conflicts of interest and protect Retirement Investors from misaligned incentives that encourage Advisers to violate the Best Interest standard and other fiduciary obligations and ensures that there is a means to redress the failure to do so. While the warranty exposes Financial Institutions and Advisers to litigation risk, these risks are circumscribed by the availability of binding arbitration for individual claims and the legal restrictions that courts generally use to police class actions.

The Department does not share a commenter's view that it would be too difficult for Retirement Investors to prove that the policies and procedures were not ''reasonably designed'' to achieve the required purpose. The final exemption requires the Financial Institution to disclose Material Conflicts of Interest associated with the principal transactions and riskless principal transactions to Retirement Investors and to describe its policies and procedures for safeguarding against those conflicts of interest. These disclosures should assist Retirement Investors in assessing the care with which Financial Institutions have designed their procedures, even if they are insufficient to fully convey how vigorously the Financial Institution implements the protections. In some cases, a systemic violation, or the possibility of such a violation, may be apparent on the face of the policies. In other cases, normal discovery in litigation may provide the information necessary. Certainly, if a Financial Institution were to provide significant prizes or bonuses for Advisers to push principal transactions and riskless principal transactions that were not in the Best Interest of Retirement Investors, Retirement Investors would often be in a position to pursue the claim. Most important, however, the enforceable obligation to adopt and comply with the policies and procedures as set forth herein, and to make relevant disclosures of the policies and procedures and of Material Conflicts of Interest, should create a powerful incentive for Financial Institutions to carefully police conflicts of interest, reducing the need for litigation in the first place.

In response to commenters that expressed concern about the specific use of the term ''warranty,'' the Department intends the term to have its standard meaning as a ''promise that something in furtherance of the contract is guaranteed by one of the contracting parties.'' [40] The Department merely requires that the contract with IRA and non-ERISA plan investors include an express enforceable promise of compliance with the policies and procedures condition. As previously discussed, the potential liability for violation of the warranty is cabined by the availability of non-binding arbitration in individual claims, and the ability to waive claims for punitive damages and rescission to the extent permitted by applicable law.

Additionally, although the policies and procedure requirement applies equally to ERISA plans, the final exemption does not require Financial Institutions to make a warranty with respect to ERISA plans, just as it does not require the execution of a contract with respect to ERISA plans. For these plans, a separate warranty is unnecessary because Title I of ERISA already provides an enforcement mechanism for failure to comply with the policies and procedures requirement. Under ERISA section 502(a), plan participants, fiduciaries, and the Secretary of Labor have ready means to enforce any failure to meet the conditions of the exemption, including a failure to comply with the policies and procedure requirement. A Financial Institution's failure to comply with the exemption's policies and procedure requirements would result in a non-exempt prohibited transaction under ERISA section 406 and would likely constitute a fiduciary breach under ERISA section 404. As a result, a plan participant or beneficiary, plan fiduciary, and the Secretary would be able to sue under ERISA section 502(a)(2), (3), or (5) to recover any loss in value to the plan (including the loss in value to an individual account), or to obtain disgorgement of any wrongful profits or unjust enrichment. Accordingly, the warranty is unnecessary in the context of ERISA plans.

d. Compliance With Laws Proposed Warranty

The proposed exemption also contained a requirement that the Adviser and Financial Institution would have had to warrant that they and their Affiliates would comply with all applicable federal and state laws regarding the rendering of the investment advice, the purchase, sale or holding of the Asset and the payment of compensation related to the purchase, sale and holding. While the Department did receive some support for this condition in comments, several commenters opposed this warranty proposal as being overly broad, and urged that it be deleted. The commenters argued that the warranty could create contract claims based on a wide variety of state and federal laws, without regard to the limitations imposed on individual actions under those laws. In addition, commenters suggested that many of the violations associated with these laws could be quite minor or unrelated to the Department's concerns about conflicts of interest. In response to these comments, the Department has eliminated this warranty from the final exemption.

6. Credit Standards and Liquidity

Section II(d)(4) provides that the Financial Institution's written policies and procedures regarding principal transactions and riskless principal transactions must address how the credit risk and liquidity assessments required by Section III(a)(3) of the exemption will be made. This requirement serves as an implementation tool for the exemption condition that a debt security that is purchased by a plan, participant or beneficiary account, or IRA, possess at the time of purchase no greater than moderate credit risk and sufficiently liquidity that it can be sold at or near its carrying value within a reasonably short period of time.

As discussed later in this preamble, when addressing the credit and liquidity conditions set forth in Section III(a) of the exemption, many commenters identified perceived compliance difficulties. Of those comments, one comment was applicable to Section II of the exemption. The commenter suggested that the Financial Institution be required to develop policies and procedures to assist Advisers by specifying how these assessments are to be made. This suggestion addressed some concerns expressed by commenters regarding the credit and liquidity conditions, and the Department concurs with the comment. The Department believes that Financial Institutions will be able to comply with the requirement, in part, by developing, if they do not already exist, policies and procedures to ensure that the credit worthiness and liquidity of debt securities are properly evaluated.

7. Contractual Disclosures

Section II(e) of the exemption obligates the Financial Institution to make specified contract disclosures to Retirement Investors in order to ensure that they have basic information about the scope of Adviser conflicts and that they appropriately authorize principal transactions and riskless principal transactions. For advice to Retirement Investors in IRAs and non-ERISA plans, the disclosures must be provided prior to or at the same time as the recommended transaction either as part of the contract or in a separate written disclosure provided to the Retirement Investor. For advice to Retirement Investors regarding investments in ERISA plans, the disclosures must be provided prior to or at the same time as the execution of the recommended transaction. The disclosure may be provided in person, electronically, or by mail. In the disclosures, the Financial Institution must clearly and prominently in a single written disclosure:

(1) Set forth in writing (i) the circumstances under which the Adviser and Financial Institution may engage in Principal Transactions and Riskless Principal Transactions with the Plan, participant or beneficiary account, or IRA, (ii) a description of the types of compensation that may be received by the Adviser and Financial Institution in connection with Principal Transactions and Riskless Principal Transactions, including any types of compensation that may be received from third parties, and (iii) identify and disclose the Material Conflicts of Interest associated with Principal Transactions and Riskless Principal Transactions;

(2) Except for existing contracts, document the Retirement Investor's affirmative written consent, on a prospective basis, to Principal Transactions and Riskless Principal Transactions between the Adviser or Financial Institution and the Plan, participant or beneficiary account, or IRA;

(3) Inform the Retirement Investor (i) that the consent set forth in Section II(e)(2) is terminable at will upon written notice by the Retirement Investor at any time, without penalty to the Plan or IRA, (ii) of the right to obtain, free of charge, copies of the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d), as well as information about the Principal Traded Asset, including its purchase or sales price, and other salient attributes, including, as applicable: The credit quality of the issuer; the effective yield; the call provisions; and the duration, provided that if the Retirement Investor's request is made prior to the transaction, the information must be provided prior to the transaction, and if the request is made after the transaction, the information must be provided within 30 business days after the request, (iii) that model contract disclosures or other model notice of the contractual terms which are reviewed for accuracy no less than quarterly and updated within 30 days as necessary are maintained on the Financial Institution's Web site, and (iv) that the Financial Institution's written description of its policies and procedures adopted in

[40] Black's Law Dictionary 10th ed. (2014).

accordance with Section II(d) is available free of charge on the Financial Institution's Web site; and

(4) Describe whether or not the Adviser and Financial Institution will monitor the Retirement Investor's investments that are acquired through a Principal Transaction or Riskless Principal Transaction and alert the Retirement Investor to any recommended change to those investments and, if so, the frequency with which the monitoring will occur and the reasons for which the Retirement Investor will be alerted.

By ''clearly and prominently in a single written disclosure,'' the Department means that the Financial Institution may provide a document prepared for this purpose containing only the required information, or include the information in a specific section of the contract in which the disclosure information is provided, rather than requiring the Retirement Investor to locate the relevant information in several places throughout a larger disclosure or series of disclosures.

In addition, Section II(e)(5) of the exemption provides a mechanism for correcting disclosure errors, without losing the exemption. It provides that the Financial Institution will not fail to satisfy Section II(e), or violate a contractual provision based thereon, solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, or if the Web site is temporarily inaccessible, provided that (i) in the case of an error or omission on the web, the Financial Institution discloses the correct information as soon as practicable, but not later than 7 days after the date on which it discovers or reasonably should have discovered the error or omission, and (ii) in the case of other disclosures, the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. Section II(e)(5) further provides that to the extent compliance with the contract disclosure requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

Several commenters supported the proposed disclosures. Commenters recognized that well-designed disclosure can serve multiple purposes, including facilitating informed investment decisions. However, even if investors do not carefully review the disclosures they receive, commenters perceived a benefit to investors from the greater transparency of public disclosure. For example, Financial Institutions may change practices that run contrary to Retirement Investors' interests rather than disclose them publicly. One commenter suggested the disclosures should be strengthened and required for all retirement savings products, even beyond the scope of the Regulation and this exemption.

As proposed, the provision required disclosure of complete information about all the fees and other payments currently associated with the Retirement Investor's investments. Commenters objected to this as overly broad, given the exemption's limitation to principal transactions. The Department accepted this comment, and limited the disclosure to the information about the principal traded asset, including its purchase or sales price and other salient attributes, while still ensuring timely access by the Retirement Investor. By salient attributes, the Department means the credit quality of the issuer, the effective yield, the call provisions, and the duration, among other similar attributes, and the Department recognizes that the salient attributes will differ depending on the principal traded asset. In accepting this comment, the Department did not elect to modify the disclosure requirement further with qualifiers such as ''reasonably'' or ''in the Financial Institution's possession.'' The Department believes that no additional limitation need be placed on the rights of the Retirement Investor to request information because, if a Financial Institution is advising a Retirement Investor to enter into a principal transaction or a riskless principal transaction, it should have all of the salient information available when providing that advice. The Department also made a clarification, requested by a commenter, that the Retirement Investor's consent must be withdrawn in writing. The Department concurs that this will provide additional certainty to the parties.

FINRA's suggestion that the parties agree on the extent of monitoring of the Retirement Investor's investments was adopted, in Section II(e)(4). In making this determination, Financial Institutions should carefully consider whether certain investments can be prudently recommended to the individual Retirement Investor, in the first place, without a mechanism in place for the ongoing monitoring of the investment. Finally, a number of commenters requested relief for good faith, inadvertent failure to comply with the exemption. A specific provision applicable to the Section II(e) disclosures is included in Section II(e)(5).

8. Ineligible Provisions

Under Section II(f) of the final exemption, relief is not available if a Financial Institution's contract with Retirement Investors regarding investments in IRAs and non-ERISA plans contains the following:

(1) Exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms;

(2) Except as provided in paragraph (f)(4), a provision under which the Plan, IRA or Retirement Investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution, or in an individual or class claim agrees to an amount representing liquidated damages for breach of the contract; provided that the parties may knowingly agree to waive the Retirement Investor's right to obtain punitive damages or rescission of recommended transactions to the extent such a waiver is permissible under applicable state or federal law; or

(3) Agreements to arbitrate or mediate individual claims in venues that are distant or that otherwise unreasonably limit the ability of the Retirement Investors to assert the claims safeguarded by this exemption.

Section II(f)(4) provides that, in the event the provision on pre-dispute arbitration agreements for class or representative claims in paragraph (f)(2) is ruled invalid by a court of competent jurisdiction, this provision shall not be a condition of the exemption with respect to contracts subject to the court's jurisdiction unless and until the court's decision is reversed, but all other terms of the exemption shall remain in effect.

The purpose of Section II(f) is to ensure that Retirement Investors receive the full benefit of the exemption's protections, by preventing them from being contracted away. If an Adviser makes a recommendation regarding a principal transaction or a riskless principal transaction, for compensation, within the meaning of the Regulation, he or she may not disclaim the duties or liabilities that flow from that recommendation. For similar reasons, the exemption is not available if the contract includes provisions that purport to waive a Retirement Investor's right to bring or participate in class actions. However, contract provisions in which Retirement Investors agree to arbitrate any individual disputes are allowed to the extent permitted by applicable state law. Moreover, Section II(f) does not prevent Retirement Investors from voluntarily agreeing to arbitrate class or representative claims after the dispute has arisen.

The Department's approach in this respect is consistent with FINRA's rules permitting mandatory pre-dispute arbitration for individual claims, but not for class action claims.[41] This rule was adopted in 1992, in response to a directive, articulated by former SEC Chairman David Ruder, that investors have access to courts in appropriate cases.[42] Section 12000 of the FINRA manual establishes a Code of Arbitration Procedure for Customer Disputes which sets forth rules on, *inter alia,* filing claims, amending pleadings, prehearing conferences, discovery, and sanctions for improper behavior.

A number of commenters addressed the proposed approach to arbitration and the other ineligible provisions of Section II(f). A discussion of the comments and the Department's responses follow.

a. Exculpatory Provisions

The Department included Section II(f)(1) in the final exemption without changes from the proposal. Commenters did, however, raise a few questions on the provision. In particular, commenters asked whether the contract could disclaim liability for acts or omissions of third parties, and whether there could be venue selection clauses. In addition, commenters asked whether the contract could require exhaustion of arbitration or mediation before filing in court.

[41] FINRA rule 12204(a) provides that class actions may not be arbitrated under the FINRA Code of Arbitration Procedures. FINRA rule 2268(d)(3) provides that no predispute arbitration agreement may limit the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement. The FINRA Board of Governors has ruled that a broker's predispute arbitration agreement with a customer may not include a waiver of the right to file or participate in a class action in court. *Department of Enforcement* v. *Charles Schwab & Co.* (Complaint 2011029760201) (Apr. 24, 2014).

[42] NASD Notice 92–65 SEC Approval of Amendments Concerning the Exclusion of Class-Action Matters from Arbitration Proceedings and Requiring that Predispute Arbitration Agreements Include a Notice That Class-Action Matters May Not Be Arbitrated, *available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=1660.*

Section II(f)(1) does not prevent a Financial Institution's contract with IRA and non-ERISA plan investors from disclaiming liability for acts or omissions of third parties to the extent permissible under applicable law. In addition, for individual claims, reasonable arbitration and mediation requirements are not prohibited. In response to questions about venue selection, the final exemption includes a new Section II(f)(3), which provides that investors may not be required to arbitrate or mediate their individual claims in venues that are distant or that otherwise unreasonably limit their ability to assert the claims safeguarded by this exemption.

The Department has not revised Section II(f) to address every provision that may or may not be included in the contract. While some commenters submitted specific requests regarding specific contract language, and others suggested the Department provide model contracts for Financial Institutions to use, the Department has declined to make these changes in the exemption. The Department notes that Section II(f)(1) prohibits all exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms, and Section II(g)(5) prohibits Financial Institutions and Advisers from purporting to disclaim any responsibility or liability for any responsibility, obligation, or duty under Title I of ERISA to the extent the disclaimer would be prohibited by Section 410 of ERISA. Therefore, in response to comments regarding choice of law provisions, modifying ERISA's statute of limitations, and imposing obligations on the Retirement Investor, the Financial Institutions must determine whether their specific provisions are exculpatory and would disclaim or limit their liability under ERISA, or that of their Advisers. If so, they are not permitted. The Department will provide additional guidance in response to questions and enforcement proceedings

b. Arbitration

Section II(f)(2) of the final exemption adopts the approach, as proposed, that individual claims may be the subject of contractual pre-dispute binding arbitration. Class or other representative claims, however, must be allowed to proceed in court. The final exemption also provides that contract provisions may not limit recoveries to an amount representing liquidated damages for breach of the contract. However, the final exemption expressly permits Retirement Investors to knowingly waive their rights to obtain punitive damages or rescission of recommended transactions to the extent such waivers are permitted under applicable law. Commenters were divided on the approach taken in the proposal, as discussed below.

Some commenters objected to limiting Retirement Investors' right to sue in court on individual claims and specifically focused on the FINRA arbitration process. These commenters described FINRA's process as an unequal playing field, with insufficient protections for individual investors. They asserted that arbitrators are not required to follow federal or state laws, and so would not be required to enforce the terms of the contract. In addition, commenters complained that the decision of an arbitrator generally is not subject to appeal and cannot be overturned by any court. According to these commenters, even when the arbitrators find in favor of the consumer, the consumers often receive significantly smaller recoveries than they deserve. Moreover, some asserted that binding pre-dispute arbitration may be contrary to the legislative intent of ERISA, which provides for ''ready access to federal courts.''

Some commenters opposed to arbitration indicated that preserving the right to bring or participate in class actions in court would not give Retirement Investors sufficient access to courts. According to these commenters, allowing Financial Institutions to require resolution of individual claims by arbitration would impose additional and unnecessary hurdles on investors seeking to enforce the Best Interest standard. One commenter warned that the Regulation would make it more difficult for Retirement Investors to pursue class actions because the individualized requirements for proving fiduciary status could undermine any claims about commonality. Commenters said that class action lawsuits tend to be expensive and protracted, and even where successful, investors often recover only a small portion of their losses.

Other commenters just as forcefully supported pre-dispute binding arbitration agreements. Some asserted that arbitration is generally quicker and less costly than judicial proceedings. They argued that FINRA has well-developed protections in place to protect the interests of aggrieved investors. One commenter pointed out that FINRA requires that the arbitration provisions of a contract be highlighted and disclosed to the customer, and that customers be allowed to choose an ''all-public'' panel of arbitrators.[43] FINRA rules also impose larger filing fees on the industry party than on the investor. Commenters also cited evidence that investors are as likely to prevail in arbitration proceedings as they are in court, and even argued that permitting mandatory arbitration for all disputes would be in investors' best interest.

A number of commenters argued that arbitration should be available for *all* disputes that may arise under the exemption, including class or representative claims. Some of these commenters favored arbitration of class claims due to concerns about costs and potentially greater liability associated with class actions brought in court. Some commenters took the position that the ability of the Retirement Investor to participate in class actions could deter Financial Institutions from relying on the exemption at all.

After consideration of the comments on this subject, the Department has decided to adopt the general approach taken in the proposal. Accordingly, contracts with Retirement Investors may require pre-dispute binding arbitration of individual disputes with the Adviser or Financial Institution. The contract, however, must preserve the Retirement Investor's right to bring or participate in a class action or other representative action in court in such a dispute in order for the exemption to apply.

The Department recognizes that, for many claims, arbitration can be more cost-effective than litigation in court. Moreover, the exemption's requirement that Financial Institutions acknowledge their own and their Advisers' fiduciary status should eliminate an issue that frequently arises in disputes over investment advice. In addition, permitting individual matters to be resolved through arbitration tempers the litigation risk and expense for Financial Institutions, without sacrificing Retirement Investors' ability to secure judicial relief for systemic violations that affect numerous investors through class actions.

On the other hand, the option to pursue class actions in court is an important enforcement mechanism for Retirement Investors. Class actions address systemic violations affecting many different investors. Often the monetary effect on a particular investor is too small to justify the pursuit of an individual claim, even in arbitration. Exposure to class claims creates a powerful incentive for Financial Institutions to carefully supervise individual Advisers, and ensure adherence to the Impartial Conduct Standards. This incentive is enhanced by the transparent and public nature of class proceedings and judicial opinions, as opposed to arbitration decisions, which are less visible and pose less reputational risk to Financial Institutions or Advisers found to have violated their obligations.

The ability to bar investors from bringing or participating in such claims would undermine important investor rights and incentives for Advisers to act in accordance with the Best Interest standard. As one commenter asserted, courts impose significant hurdles for bringing class actions, but where investors can surmount theses hurdles, class actions are particularly well suited for addressing systemic breaches. Although by definition communications to a specific investor generally must have a degree of specificity in order to constitute fiduciary advice, a class of investors should be able to satisfy the requirements of commonality, typicality and numerosity where there is a systemic or wide-spread problem, such as the adoption or implementation of non-compliant policies and procedures applicable to numerous Retirement Investors, the systematic use of prohibited or misaligned financial incentives, or other violations affecting numerous Retirement Investors in a similar way. Moreover, the judicial system ensures that disputes involving numerous retirement investors and systemic issues will be resolved through a well-established framework characterized by impartiality, transparency, and adherence to precedent. The results and reasoning of court decisions serve as a guide for the consistent application of that law in future cases involving other Retirement Investors and Financial Institutions.

This is consistent with the approach long adopted by FINRA and its predecessor self-regulatory organizations. FINRA Arbitration rule 12204 specifically bars class actions from FINRA's arbitration process and requires that pre-dispute arbitration agreements between brokers and customers contain a notice that class action matters may not be arbitrated. In addition, it provides that a broker may not enforce any arbitration agreement against a member of certified or putative class action, until the certification is denied, the class action is decertified, the class member is excluded from, or elects not participate in, the class. This rule was adopted by the National Association of Securities Dealers and approved by the SEC in 1992.[44] In the release announcing this decision, the SEC stated:

> [T]he NASD believes, and the Commission agrees, that the judicial system has already developed the procedures to manage class action claims. Entertaining such claims through arbitration at the NASD would be difficult, duplicative and wasteful. . . . The Commission agrees with the NASD's position that, in all cases, class actions are better handled by the courts and that investors should have access to the courts to resolve class actions efficiently.[45]

In 2014, the FINRA Board of Governors upheld this rule in reviewing an enforcement action.[46]

Additional Protections

One commenter suggested that if the Department preserved the ability of a Financial Institution to require arbitration of claims, it should consider requiring a series of additional safeguards for arbitration proceedings permitted under the exemption. The commenter suggested that the conditions could state that (i) the arbitrator must be qualified and independent; (ii) the arbitration must be held in the location of the person challenging the action; (iii) the cost of the arbitration must be borne by the Financial Institution; (iv) the Financial Institution's attorneys' fees may not be shifted to the Retirement Investor, even if the challenge is unsuccessful; (v) statutory remedies may not be limited or altered by the contract; (vi) access to adequate discovery must be permitted; (vii) there must be a written record and a written decision; (viii) confidentiality requirements and protective orders which would prohibit the use of evidence in subsequent cases must be prohibited. The commenter said that some, but not all, of these procedures are currently required by FINRA.

The Department declines to mandate additional procedural safeguards for arbitration beyond those already mandated by other applicable federal and state law or self-regulatory organizations. In the Department's view, the FINRA arbitration rules, in particular, provide significant safeguards for fair dispute resolution, notwithstanding the concerns raised by some commenters. FINRA's Code of Arbitration Procedures for Customer Disputes applies when required by written agreement between the FINRA member and the customer, or if the

[43] The term ''Public Arbitrator'' is defined in FINRA rule 12100(u). According to FINRA, non-''Public Arbitrators'' are often referred to as ''industry'' arbitrators. *See* Final Report and Recommendations of the FINRA Dispute Resolution Task Force, released December 16, 2015.

[44] SEC Release No. 34–31371 (Oct. 28, 1992), 1992 WL 324491.

[45] *Id.*

[46] FINRA Decision, *Department of Enforcement* v. *Charles Schwab & Co.* (Complaint 2011029760201), p.14 (Apr. 24, 2014).

customer requests arbitration. The rules cover any dispute between the member and the customer that arises from the member's business activities, except for disputes involving insurance business activities of a member that is an insurance company.[47] FINRA's code of procedures also provide detailed instructions for initiating and pursuing an arbitration, including rules for selection of arbitrators (FINRA rule 12400), for discovery of evidence (FINRA rule 12505), and expungement of customer dispute information (FINRA rule 12805), which are designed to allow access by investors and preserve fairness for the parties. In addition, FINRA rule 12213 specifies that FINRA will generally select the hearing location closest to the customer. To the extent that the contracts provide for binding arbitration in individual claims, the Department defers to the judgment of FINRA and other regulatory bodies, such as state insurance regulators, responsible for determining the safeguards applicable to arbitration proceedings.

Federal Arbitration Act

Some commenters asserted that the Department does not have the authority to include the exemption's provisions on class action waivers under the Federal Arbitration Act (FAA), which they said protects enforceable arbitration agreements and expresses a federal policy in favor of arbitration over litigation. Without clear statutory authority to restrict arbitration, these commenters said, the Department cannot include the provisions on class action waivers.

These comments misconstrue the effect of the FAA on the Department's authority to grant exemptions from prohibited transactions. The FAA protects the validity and enforceability of arbitration agreements. Section 2 of the FAA states: ''[a] written provision in any . . . contract . . . to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.'' [48] This Act was intended to reverse judicial hostility to arbitration and to put arbitration agreements on an equal footing with other contracts.[49]

Section II(f)(2) of the exemption is fully consistent with the FAA. The exemption does not purport to render an arbitration provision in a contract between a Financial Institution and a Retirement Investor invalid, revocable, or unenforceable. Nor, contrary to the concerns of one commenter, does Section II(f)(2) prohibit such waivers. Both Institutions and Advisers remain free to invoke and enforce arbitration provisions, including provisions that waive or qualify the right to bring a class action or any representative action in court. Instead, such a contract simply does not meet the conditions for relief from the prohibited transaction provisions of ERISA and the Code. As a result, the Financial Institution and Adviser would remain fully obligated under both ERISA and the Code to refrain from engaging in prohibited transactions. In short, Section II(f)(2) does not affect the validity, revocability, or enforceability of a class-action waiver in favor of individual arbitration. This regulatory scheme is thus a far cry from the State judicially created rules that the Supreme Court has held preempted by the FAA,[50] and the National Labor Relations Board's attempt to prohibit class-action waivers as an ''unfair labor practice.'' [51]

The Department has broad discretion to craft exemptions subject to the Department's overarching obligation to ensure that the exemptions are administratively feasible, in the interests of plan participants, beneficiaries, and IRA owners, and protective of their interests. In this instance, the Department has concluded that the enforcement rights and protections associated with class action litigation are important to safeguarding the Impartial Conduct Standards and other anti-conflict provisions of the exemption. If a Financial Institution enters into a contract requiring binding arbitration of class claims, the Department would not purport to invalidate the provision, but rather would insist that the Financial Institution fully comply with statutory provisions prohibiting conflicted fiduciary transactions in its dealings with its Retirement Investment customers. The FAA is not to the contrary. It neither limits the Department's express grant of discretionary authority over exemptions, nor entitles parties that enter into arbitration agreements to a pass from the prohibited transaction rules.

While the Department is confident that its approach in the exemption does not violate the FAA, it has carefully considered the position taken by several commenters that the Department exceeded the Department's authority in including provisions in the exemption on class and representative claims, and the possibility that a court might rule that the condition regarding arbitration of class claims in Section II(f)(2) of the exemption is invalid based on the FAA. Accordingly, in an abundance of caution, the Department has specifically provided that Section II(f)(2) can be severable if a court finds it invalid based on the FAA. Specifically, Section II(f)(4) provides that:

> In the event that the provision on pre-dispute arbitration agreements for class or representative claims in paragraph (f)(2) of this Section is ruled invalid by a court of competent jurisdiction, this provision shall not be a condition of this exemption with respect to contracts subject to the court's jurisdiction unless and until the court's decision is reversed, but all other terms of the exemption shall remain in effect.

The Department is required to find that the provisions of an exemption are administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of participants and beneficiaries and IRA owners. The Department finds that the exemption with paragraph (f)(2) satisfies these requirements. The Department believes, consistent with the position of the SEC and FINRA, that the courts are generally better equipped to handle class claims than arbitration procedures and that the prohibition on contractual provisions mandating arbitration of such claims helps the Department make the requisite statutory findings for granting an exemption.

Nevertheless, the Department has determined that, based on all the exemption's other conditions, it can still make the necessary findings to grant the exemption even without the condition prohibiting pre-dispute agreements to arbitrate class claims. In particular, if a court were to invalidate the condition, the Department would still find that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries, and protective of the rights of the participants and beneficiaries. It would be less protective, but still sufficient to grant the exemption.

The Department's adoption of the specific severability provision in Section II(f)(4) of the exemption should not be viewed as evidence of the Department's intent that no other conditions of this or the other exemptions granted today are severable if a court were to invalidate them.

[47] FINRA rule 12200.

[48] 9 U.S.C. 2.

[49] *See AT&T Mobility LLC* v. *Concepcion,* 563 U.S. 333, 342 (2011).

[50] *See American Express Co.* v. *Italian Colors Restaurant,* 133 S. Ct. 2304 (2013); *AT&T Mobility LLC* v. *Concepcion,* 563 U.S. 333 (2011).

[51] *See D.R. Horton, Inc.* v. *NLRB,* 737 F.3d 344 (5th Cir. 2013).

Instead, the Department intends that invalidated provisions of the rule and exemptions may be severed when the remainder of the rule and exemptions can function sensibly without them.[52]

c. Remedies

Some commenters asked whether the proposal's prohibition of exculpatory clauses would affect the parties' ability to limit remedies under the contract, particularly regarding liquidated damages, punitive damages, consequential damages and rescission. In response, the Department has added text to Section II(f)(2) in the final exemption clarifying that the parties, in an individual or class claim, may not agree to an amount representing liquidated damages for breach of the contract. However, the exemption, as finalized, expressly permits the parties to knowingly agree to waive the Retirement Investor's right to obtain punitive damages or rescission of recommended transactions to the extent such a waiver is permissible under applicable state or federal law.

In the Department's view, it is sufficient to the exemptions' protective purposes to permit recovery of actual losses. The availability of such a remedy should ensure that plaintiffs can be made whole for any losses caused by misconduct, and provide an important deterrent for future misconduct. Accordingly, the exemption does not permit the contract to include liquidated damages provisions, which could limit Retirement Investors' ability to obtain make-whole relief.

On the other hand, the exemption permits waiver of punitive damages to the extent permissible under governing law. Similarly, rescission can result in a remedy that is disproportionate to the injury. In cases where an advice fiduciary breached its obligations, but there was no injury to the participant, a rescission remedy can effectively make the fiduciary liable for losses caused by market changes, rather than its misconduct. These new provisions in section II(f)(2) only apply to waiver of the contract claims; they do not qualify or limit statutory enforcement rights under ERISA. Those statutory remedies generally provide for make-whole relief and to rescission in appropriate cases, but they do not provide for punitive damages.

[52] *See Davis County Solid Waste Management* v. *United States Environmental Protection Agency,* 108 F.3d 1454, 1459 (D.C. Cir. 1997) (finding that severability depends on an agency's intent and whether the provisions can operate independently of one another).

9. General Conditions Applicable to Each Transaction (Section III)

Section III of the exemption sets forth conditions that apply to the terms of each principal transaction or a riskless principal transaction entered into under the exemption. Section III(a) applies only to *purchases* by a Plan, participant or beneficiary account, or IRA, of principal traded assets that are debt securities, as defined in the exemption. Section III(b) and (c) apply to both purchase and sale transactions, involving all principal traded assets. Many comments were received with respect to the proposed conditions, and the Department has revised the proposed language to address these comments.

a. Issuer/Underwriter Restrictions

Section III(a)(1) and (2) of the exemption provides that the debt security being bought by the Plan, participant or beneficiary account, or IRA must not have been issued or, at the time of the transaction, underwritten by the Financial Institution or any Affiliate. The Department received comments generally objecting to these conditions as unduly limiting investment opportunities to Retirement Investors. Commenters argued that many debt securities will only be available for purchase by a Retirement Investor on a principal basis as part of the initial issuance or underwriting since the debt securities are not frequently resold in small lots to retail investors on either a principal or an agency basis.

The Department is sympathetic to the commenters' position, but has determined to adopt the language without modification. This reflects the Department's concerns that additional conflicts of interest are inherent in transactions where the issuer or underwriter of a security (whether debt or equity) is a fiduciary to a plan or IRA. In such instances, the Financial Institution generally has either been retained by a third party to sell securities as part of an underwriting and has made guarantees as to such sales and will likely profit from such sales more than in a traditional principal transaction or is issuing securities on its own behalf for the specific purposes of benefiting itself. Further, since generally the issued or underwritten securities are being issued or underwritten by the Financial Institution for the first time, heightened issues regarding pricing and liquidity result. Since these unique conflicts exist with respect to both issuance and underwriting transactions, they would require conditions unique to issuance and underwriter principal transactions, respectively. This exemption was not designed to address such conflicts. The Department believes that permitting such transactions without applying additional conditions would not be protective of participants and beneficiaries of plans and IRA owners. Parties seeking relief for such transactions are encouraged to seek an individual exemption from the Department.

b. Credit Standards and Liquidity

Section III(a)(3) of the exemption requires that, using information reasonably available to the Adviser at the time of the transaction, the Adviser must determine that the debt security being purchased by the Plan, participant or beneficiary account, or IRA, possesses no greater than a moderate credit risk and is sufficiently liquid that the debt security could be sold at or near its carrying value within a reasonably short period of time. Debt securities subject to a moderate credit risk should possess at least average credit-worthiness relative to other similar debt issues. Moderate credit risk would denote current low expectations of default risk, with an adequate capacity for payment of principal and interest.

This condition is intended to identify investment grade securities, and avoid the circumstance in which an investment advice fiduciary can recommend speculative debt securities and then sell them to the Plan, participant or beneficiary account, or IRA, from its own inventory. The SEC used similar provisions in setting credit standards in its regulations, including its Rule 6a–5 issued under the Investment Company Act.[53]

Some commenters on this aspect of the proposal generally objected to the condition's lack of objectivity. Some requested that the Department instead specifically condition the exemption on the security's being ''investment grade,'' rather than the proposed credit and liquidity standards. While the Department generally intends the exemption to be limited to securities that a reasonable investor would treat as investment grade securities, Section 939A of the Dodd-Frank Act provides that the Department may not ''reference or rely on'' credit ratings—including ''investment grade''—in the exemption's conditions. Accordingly, Advisers and Financial Institutions wishing to rely on the exemption must make a reasonable determination of creditworthiness,

[53] 17 CFR 270.6a–5, 77 FR 70117 (November 23, 2012).

without automatic adherence to specified credit ratings.

Another commenter suggested that the Department replace the liquidity component of the standard with the provision of two quotes or a requirement that the Financial Institution reasonably believe a principal transaction provides a better price than would be available in the absence of a principal transaction. The Department agrees that it is important that the price of the principal transaction or a riskless principal transaction is reasonable and has conditioned the exemption on the Adviser and Financial Institution's commitment to seek to obtain the best execution reasonably available under the circumstances with respect to the transaction (and for FINRA members, specifically on satisfaction of FINRA rules 2121 (Fair Prices and Commissions) and 5310 (Best Execution and Interpositioning)). However, the Department determined not to replace the liquidity component with the two quote requirement in light of commenters' views that the requirement was unlikely to be workable or effective in achieving the Department's aims.

Other commenters focused on the timing associated with the liquidity component of the condition. They expressed concern that the condition may apply throughout the time period in which the security is held by the Retirement Investor. The Department revised the operative text to make clear that the standard must be satisfied based on the information reasonably available to the Adviser at the time of the transaction and not thereafter. Nevertheless, the Department notes that the Adviser's consideration of whether the recommendation is in the Retirement Investor's Best Interest may also need to include consideration of information that is reasonably available regarding restrictions or near term expected performance of the debt security, in light of the Retirement Investor's needs and objectives. The Department additionally eliminated the credit standards with respect to sales from a plan, participant or beneficiary account, or IRA; accordingly, this condition will not stand in the way of a plan or IRA selling a security that no longer meets the credit standards to a Financial Institution in a principal transaction. The purpose of the liquidity condition was to protect Retirement Investors from the dangers associated with a conflicted Adviser saddling them with low-quality securities, not to prevent them from disposing of such securities.

Commenters also argued that although the Department cited the similar credit standards set forth in the SEC's Rule 6a–5 issued under the Investment Company Act, the Department's reliance on SEC language as a template for the credit risk language is not necessarily appropriate because the SEC uses the language for a different purpose unrelated to retail accounts. While in a different context, the SEC's adoption of similar language supports the Department's view that Financial Institutions are capable of implementing the standard. For that reason, the SEC language remains relevant. Further, the Department itself has previously proposed the use of the same language in multiple class exemptions without material objections by the financial services industry to the workability of the language.[54]

Some commenters also indicated that the Department's use of the term ''fair market value'' in the proposal, in place of the term ''carrying value,'' that is used in the SEC standard, was confusing. In response, the Department revised the final exemption to use the term ''carrying value'' rather than ''fair market value.'' In addition, the Department adopted the suggestion of a commenter that Financial Institutions be required to establish policies and procedures to determine how credit risk and liquidity assessments will be made and to develop standards for such assessments. This requirement is in Section II(d), discussed above, and is intended to provide a mechanism for Financial Institutions to operationalize this requirement. As revised, the Department believes that the credit standards condition can serve a protective role without being too vague or operationally difficult.

In addition to operational concerns, commenters addressed whether credit standards should be part of the exemption at all. Some commenters opposed both the credit and liquidity conditions on the grounds that the Department was substituting the Department's judgment for the judgment of Retirement Investors. Other commenters, however, supported the Department's approach as imposing appropriate safeguards against the added risk associated with investment advice fiduciaries recommending principal transactions and riskless principal transactions involving securities that possess substantial credit risk or are thinly traded.

The Department has decided to retain the credit standards. First, the exemption addresses only those principal transactions and riskless principal transactions that are the result of the provision of fiduciary investment advice. To the extent that a Retirement Investor is truly acting on his or her own without the advice of an investment advice fiduciary, the necessary exemptive relief already exists. As discussed above, Part II of PTE 75–1 currently provides relief from ERISA section 406(a) for principal transactions so long as the broker-dealer or bank does not render investment advice with respect to the assets involved in the principal transaction. Second, the most commonly held categories of debt securities will continue to be available to plans and IRAs.

Most importantly, with respect to investment advice that is being provided by an investment advice fiduciary, the Department believes that inherent conflicts of interest justify the credit and liquidity conditions. As discussed elsewhere in this preamble, principal transactions in particular raise significant conflicts of interest, and are often associated with substantial pricing, transparency and liquidity issues. These concerns are magnified when a debt security is of lesser quality. Further, beyond the Department's heightened concerns regarding pricing, transparency and liquidity, Financial Institutions may generate higher levels of compensation with respect to lower quality debt securities, generating additional conflicts that would otherwise be absent from principal transactions and riskless principal transactions. Finally, the Department notes that other prohibited transaction exemptions granted by the Department permitting principal transactions between plans and plan fiduciaries also contain similar credit standards.[55]

c. Agreement, Arrangement or Understanding

Section III(b) provides that a principal transaction or a riskless principal transaction may not be part of an agreement, arrangement, or understanding designed to evade compliance with ERISA or the Code, or to otherwise impact the value of the principal traded asset. Such a condition protects against the Adviser or Financial Institution manipulating the terms of the principal transaction or a riskless principal transaction, either as an isolated transaction or as a part of a

[54] *See,* 78 FR 37572 (June 21, 2013).

[55] *See* PTE 75–1, Part IV, Exemptions from Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks, 40 FR 50845 (Oct. 31, 2006), proposed amendment pending, 78 FR 37572 (Friday, June 21, 2013).

series of transactions, to benefit themselves or their Affiliates. Further, this condition would also prohibit an Adviser or Financial Institution from engaging in principal transactions with Retirement Investors for the purpose of ridding inventory of unwanted or poorly performing principal traded assets. The Department did not receive comments on this condition, and it has been adopted as proposed, with the substitution of the term ''principal traded asset'' for ''debt security.''

d. Cash

Section III(c) requires that the purchase or sale of the principal traded asset must be for no consideration other than cash. By limiting a purchase or sale to cash consideration, the Department intends that relief will not be provided for a principal transaction or a riskless principal transaction that is executed on an in-kind basis. The limitation to cash reflects the Department's concern that in-kind transactions create complexity and additional conflicts of interest because of the need to value the in-kind asset involved in the transaction. The Department did not receive comments on this condition, and it was adopted as proposed.

e. Proposed Pricing Condition

Section III(d) of the proposal addressed the pricing of the principal transaction by proposing that the purchase or sale occur at a price that (1) the Adviser and Financial Institution reasonably believe is at least as favorable to the plan, participant or beneficiary account, or IRA, as the price available in a transaction that is not a principal transaction, and (2) is at least as favorable to the plan, participant or beneficiary account, or IRA, as the contemporaneous price for the security, or a similar security if a price is not available for the same security, offered by two ready and willing counterparties that are not Affiliates of the Adviser or Financial Institution. The proposal further provided that when comparing the prices, the Adviser and Financial Institution could take into account commissions and mark-ups/mark-downs.

Many commenters raised concerns regarding the practicality of the two quote process outlined in proposed Section III(d)(2). A number of commenters did not believe that the two quote process would be workable. They said that two quotes may not be available on all securities, particularly corporate debt securities. They further expressed uncertainty about the meaning of the ''similar securities'' that could be substituted. In addition, commenters indicated that the time needed to go through the two quote process could interfere with a Financial Institution's duty of best execution under FINRA rule 5310, or in any event could slow the execution of a transaction, to the detriment of the Retirement Investor. FINRA suggested the exemption should be conditioned on FINRA rule 5310 instead of the proposed two quote requirement.

Further, the Department has come to believe that the quotes themselves may not be reliable measure of fair price because they are solicited as comparisons rather than with the intent to purchase or sell. A Financial Institution might be less than rigorous in its solicitation of the two quotes, perhaps seeking quotes that simply validate the Financial Institution's opinion of the appropriate price for the principal transaction. In light of such comments and concerns, the Department did not adopt the two quote requirement.

However, in order to address the Department's concern about the price of the transaction, as discussed in more detail above, the exemption requires that Advisers and Financial Institutions engaging in the transactions seek to obtain the best execution reasonably available under the circumstances. For FINRA members, the final exemption provides that they must comply with FINRA rules 2121 and 5310. These rules provide for best execution and fair pricing, and they will ensure that the Financial Institution does not use its relationship with a plan or IRA to benefit financially to the detriment of the plan or IRA.

One commenter expressed strong support for the intent behind the pricing conditions to protect Retirement Investors. The commenter expressed concern, however, that Financial Institutions could work around the proposed pricing conditions, resulting in the conditions failing to provide the anticipated protections to Retirement Investors. The commenter suggested that Financial Institutions be required to articulate why the principal transaction is in the Retirement Investor's Best Interest and provide current market data, available from FINRA's TRACE system, for example, to back up such articulation. Another commenter also suggested that specific pricing information could be made available on request.

The Department believes that the Department's approach in Section II(c)(2) of the final exemption Impartial Conduct Standards implements the intent of the pricing condition proposed in Section III(d)(1). The Department did not adopt the suggestion to require the provision of current market data based upon its concern that the additional costs would likely outweigh the benefits, particularly for retail investors. Because of the nature of the marketplace for principal traded assets, current market data is often difficult to analyze and apply to an individual transaction involving the same asset. Such difficulties are particularly problematic with respect to less sophisticated Retirement Investors who will not have the analytic tools at their disposal to interpret any market data that could be provided to them. Consequently, disclosure of such data would likely be of limited value to retail investors. To the extent that the information would be useful to more sophisticated Retirement Investors, such Retirement Investors typically have the information and necessary analytic tools already available.

10. Disclosure Requirement (Section IV)

a. Pre-Transaction Disclosure

Section IV(a) of the exemption requires that, prior to or at the same time as the execution of the transaction, the Adviser or Financial Institution must provide the Retirement Investor, orally or in writing, a disclosure of the capacity in which the Financial Institution may act with respect to the transaction. By ''capacity in which the Financial Institution may act,'' the Department means that the Financial Institution must notify the Retirement Investor if it may act as principal in the transaction. This requirement is intended to harmonize with the SEC's Temporary Rule 206(3)–3T, which has a similar pre-transaction requirement. Such a harmonization allows for a streamlined disclosure requirement, which places less burden on the Financial Institutions.

In the proposal, Section IV(a) would have required the Adviser or Financial Institution to provide a statement, prior to engaging in the principal transaction, that the purchase or sale would be executed as a principal transaction. A few commenters indicated that they would not always know if the transaction would be executed as a principal transaction prior to the transaction. These commenters suggested that the Department adopt the approach in the SEC's Temporary Rule 206(3)–3T, which a commenter said, requires that an investment adviser inform the client ''of the capacity in which it may act with respect to such transaction.'' A commenter said this formulation recognized that the investment adviser may not know at that time whether the transaction would be executed as a principal transaction. The Department concurs with this comment and has revised the pre-transaction disclosure to more closely match the language in the SEC's Temporary Rule.

Some commenters indicated that the Department's requirement in Section IV(a) was burdensome in that they perceived it to require the Retirement Investor's affirmative consent to the specific terms of the transaction in advance of the execution. In response, the Department notes that the proposal did not, and the final exemption does not, contemplate such consent. However, the Department notes that the exemption is limited to Advisers and Financial Institutions that act in a non-discretionary capacity.

The proposed pre-transaction disclosure also would have required disclosure of the two quotes received from unrelated counterparties and the mark-up, mark-down or other payment to be applied to the principal transaction.[56] Commenters pointed to logistical problems involved in determining a true mark-up/mark-down amount when multiple, unrelated brokers facilitate the principal transaction. They asserted that, in the absence of contextual information, the disclosure of the mark-up/mark-down may not be useful to Retirement Investors. A few commenters suggested that the Department require the disclosure of the maximum and minimum possible mark-up or mark-down, with one commenter suggesting that more specific information could be made available upon request. The preamble to the proposed exemption discussed the possibility of defining the mark-up/mark-down by reference to FINRA rule 2121 and the related guidance, and asked for comment on the approach. One commenter, however, said the Department did not provide any methodology for the mark-up/mark-down disclosure requirement and, as a result, the Department's approach would lead to confusion and inconsistent application of the pricing condition. Other commenters suggested that the Department defer to other regulatory and legislative initiatives regarding mark-up/mark-down disclosure—in particular, FINRA's proposed disclosures in FINRA Regulatory Notice 14–52.

The Department was persuaded by the commenters that required disclosure of the mark-up or mark-down might introduce significant complexity to compliance with the exemption, in particular with respect to transactions that could be covered by FINRA's pending disclosure requirement, and therefore has not adopted the mark-up/mark-down disclosure requirement in the final exemption. Commenters' suggestions to require disclosure of the minimum and maximum mark-up/mark-down were not adopted because the Department believes that this disclosure would not be specific enough to benefit Retirement Investors.

b. Confirmation

Section IV(b) of the proposal would have required a written confirmation in accordance with Rule 10b–10 under the Exchange Act, that also includes disclosure of the mark-up, mark-down or other payment to be applied to the principal transaction. A number of comments noted that Rule 10b–10 does not currently include disclosure of the mark-up or mark-down, and making the change would be costly. There were also significant comments, discussed elsewhere, as to the practicality of the mark-up or mark-down disclosure, such that the Department determined not to require the disclosure as discussed above. As a result, the requirement to include a mark-up or mark-down as part of the confirmation has been eliminated. Section IV(b) now simply requires the issuance of a confirmation of the transaction. The requirement to provide a confirmation may be met by compliance with the existing Rule 10b–10, or any successor rule in effect at the time of the transaction, or for Advisers and Financial Institutions not subject to the Exchange Act, similar requirements imposed by another regulator or self-regulatory organization.

c. Annual Disclosure

Section IV(c) sets forth a requirement under which the Adviser or Financial Institution must provide certain written information clearly and prominently in a single written disclosure to the Retirement Investor on an annual basis. The annual disclosure must include: (1) A list identifying each principal transaction and riskless principal transaction executed in the Retirement Investor's account in reliance on this exemption during the applicable period and the date and price at which the transaction occurred; and (2) a statement that (i) the consent required pursuant to Section II(e)(2) is terminable at will upon written notice, without penalty to the Plan or IRA, (ii) the right of a Retirement Investor in accordance with Section II(e)(3)(ii) to obtain, free of charge, information about the Principal Traded Asset, including its salient attributes, (iii) model contract disclosures or other model notice of the contractual terms which are reviewed for accuracy no less than quarterly updated within 30 days as necessary are maintained on the Financial Institution's Web site, and (iv) the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d) are available free of charge on the Financial Institution's Web site.

With respect to this requirement, Section IV(d) of the exemption includes a good faith compliance provision, under which the Financial Institution will not fail to satisfy Section IV solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information or if the Web site is temporarily inaccessible, provided that (i) in the case of an error or omission on the web, the Financial Institution discloses the correct information as soon as practicable, but not later than 7 days after the date on which it discovers or reasonably should have discovered the error or omission, and (ii) in the case of other disclosures, the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after that date on which it discovers or reasonably should have discovered the error or omission. In addition, to the extent compliance with the annual disclosure requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, the exemption provides that they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

The proposal included an annual disclosure requirement in Section IV(c) that would have included the following elements:

(1) A list identifying each principal transaction engaged in during the applicable period, the prevailing market price at which the Debt Security was purchased or sold, and

[56] As discussed above, the proposed two quote requirement was not adopted in the final exemption.

the applicable mark-up or mark-down or other payment for each Debt Security; and

(2) A statement that the consent required pursuant to Section II(e)(2) is terminable at will, without penalty to the Plan or IRA.

The disclosure would have been required to be made within 45 days after the end of the applicable year.

As finalized, the annual disclosure now includes a list of the principal transactions and riskless principal transactions entered into in reliance on this exemption, and the date and price at which they occurred. As discussed elsewhere in this preamble, the final exemption does not include the disclosure of the mark-up or mark-down in this final exemption. However, the disclosure in the final exemption includes a reminder of the Retirement Investor's right (in accordance with Section II(e)(3)(ii) of the exemption) to obtain, free of charge, information about the principal traded asset, including its salient attributes.

The final exemption also more closely harmonizes with the SEC's Temporary Rule 206(3)–3T, as requested by some commenters. First, the Department removed the proposed condition that the annual disclosure be provided within 45 days after the end of the applicable year, in favor of the language used in the Temporary Rule that the disclosure be provided ''no less frequently than annually.'' Second, the Department added the requirement that the annual disclosure provide the date on which the transaction occurred, and a clarification that the disclosure is only required with respect to principal transactions and riskless principal transactions entered into pursuant to this exemption. These elements also harmonize with the SEC's Temporary Rule. As with the pre-transaction disclosure, the harmonization of the annual disclosure should ease compliance for Financial Institutions.

The Department adopted the annual disclosure, despite comments indicating it was unnecessary and duplicative of other disclosures. The annual disclosure provides a summary of the principal transactions and riskless principal transactions entered into during the reporting period and serves a unique purpose in collecting the information provided in the other disclosures. The annual disclosure provides Retirement Investors with the opportunity to review and evaluate all of the principal transactions and riskless principal transactions that occurred under the terms of the exemption during that period. The information provided may give Retirement Investors perspective that they do not gain from the individual confirmations.

Finally, a few commenters objected to Section IV(d) of the proposal, which would have required disclosure of information about the debt security and its purchase or sale, upon reasonable request of the Retirement Investor. Such right of request was viewed as unbounded. The Department concurs with the commenters and has deleted Section IV(d). The Department believes the provision in Section IV(c)(2), that a notice must be provided of the Retirement Investor's right to obtain, free of charge, information about the Principal Traded Asset, including its salient attributes, serves the same function. As discussed above, one commenter requested that the information must be reasonably available and in the Financial Institution's possession. The Department believes that no additional limitation need be placed on the rights of the Retirement Investor to request information because, if a Financial Institution is advising a Retirement Investor to enter into a principal transaction or a riskless principal transaction, it should have all of the salient information available when providing that advice.

11. Recordkeeping (Section V)

Under Section V(a) and (b) of the exemption, the Financial Institution must maintain for six years records necessary for the Department and certain other entities, including plan fiduciaries, participants, beneficiaries and IRA owners, to determine whether the conditions of the exemption have been satisfied. Some commenters stated that they were unsure what information would have to be saved for six years. The Department notes that the language requires that records necessary to demonstrate compliance with the exemption's conditions must be maintained.

The final exemption includes changes to the recordkeeping provision made in accordance with comments on other exemption proposals in connection with the Regulation. First, the text was revised to make clear that the records must be ''reasonably accessible for examination,'' to remove the subjective views of the person requesting to examine or audit the records. The section also clarifies that fiduciaries, employers, employee organizations, participants and their employees and representatives only have access to information concerning their own plans. In addition, Financial Institutions are not required to disclose privileged trade secrets or privileged commercial or financial information to any of the parties other than the Department, as was also true of the proposal. Financial Institutions are also not required to disclose records if such disclosure would be precluded by 12 U.S.C. 484, relating to visitorial powers over national banks and federal savings associations.[57] As revised, the exemption requires the records be ''reasonably'' available, rather than ''unconditionally available.'' Finally, additional language was added to clarify that any failure to maintain the required records with respect to a given transaction or set of transactions does not affect the relief for other transactions.

The recordkeeping provision in the exemption is necessary to demonstrate compliance with the terms of the exemption and therefore should represent prudent business practices in any event. The Department notes that similar language is used in many other exemptions and has been the Department's standard recordkeeping requirement for exemptions for some time.

12. Definitions (Section VI)

Section VI of the exemption provides definitions of the terms used in the exemption. Most of the definitions received no comment, and they are finalized as proposed. Those terms that have been revised or received comment are below. Additional comments on definitions, such as ''Best Interest,'' ''Principal Transaction'' and ''Material Conflict of Interest,'' are discussed above in their respective sections.

a. Adviser

The exemption contemplates that an individual person, an Adviser, will provide advice to the Retirement Investor. An Adviser must be an investment advice fiduciary of a plan or IRA who is an employee, independent contractor, agent, or registered representative of a Financial Institution, and the Adviser must satisfy the applicable federal and state regulatory and licensing requirements of banking and securities laws with respect to the covered transaction.[58] Advisers may be, for example, registered representatives

[57] A commenter with respect to the Best Interest Contract Exemption raised concerns that the Department's right to review a bank's records under that exemption could conflict with federal banking laws that prohibit agencies other than the Office of the Comptroller of the Currency (OCC) from exercising ''visitorial'' powers over national banks and federal savings associations. To address the comment, Financial Institutions are not required to disclose records if the disclosure would be precluded by 12 U.S.C. 484. A corresponding change was made in this exemption.

[58] *See* Section VI(a) of the exemption.

of broker-dealers registered under the Exchange Act.

One commenter suggested that applicable federal and state regulatory and licensing language, similar to that in the Best Interest Contract Exemption proposal, be added to the definition. The Department agrees with the commenter, and the exemption contains the suggested language.

b. Financial Institutions

A Financial Institution is the entity that employs an Adviser or otherwise retains the Adviser as an independent contractor, agent or registered representative and customarily purchases or sells Principal Traded Assets for its own account in the ordinary course of its business.[59] Financial Institutions must be investment advisers registered under the Investment Advisers Act of 1940 or state law, banks, or registered broker-dealers.

The Department specifically requested comment on whether there are other types of Financial Institutions that should be included in the definition. No comments were received regarding the need for additional entities to be included. The only comments regarding the definition that were received addressed the language in the proposal that would have required that advice by a bank be delivered through the bank's trust department. Commenters indicated that the language serves no material purpose. As a result, the definition is finalized as proposed with the exception of the removal of the trust requirement.

c. Debt Securities and Principal Traded Assets

As discussed in detail above with respect to the scope of the exemption, the Department heard from many commenters that wanted to expand the scope of the assets that would be eligible to participate in principal transactions under the exemption. After a review of individual investments, the Department revised the proposal to include asset backed securities, CDs, UITs and additional investments later determined to be added through individual exemptions. Further, with respect to *sales* by a plan or IRA in a principal transaction or a riskless principal transaction, all securities or other property are provided exemptive relief. The Department operationalized these additions by revising the proposed definition of a debt security to include asset backed securities guaranteed by an agency or a government sponsored enterprise, both within the meaning of FINRA rule 6710. Further, in order to capture the remaining investments, the new defined term ''principal traded asset'' was included in Section VI. The definition of a principal traded asset encompasses both the definition of ''debt security'' and the other investments listed herein.

In addition to the comments discussed above, one commenter stated that requiring that a debt security be offered pursuant to a registration statement under the Securities Act of 1933 was difficult to comply with operationally in the secondary market. The commenter argued that the requirement could be eliminated in reliance on the Best Interest standard. The Department does not agree, and the language is finalized as proposed. Requiring that a security be registered is a straightforward mechanism by which the Department can ensure a base level of regulatory compliance and quality. An Adviser or Financial Institution should be able to verify the registration of a particular debt security by using a variety of sources.

d. Affiliate

Section VI(b) defines ''Affiliate'' of an Adviser or Financial Institution as:

(1) Any person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution. For this purpose, the term ''control'' means the power to exercise a controlling influence over the management or policies of a person other than an individual;

(2) Any officer, director, partner, employee, or relative (as defined in ERISA section 3(15)), of the Adviser or Financial Institution; or

(3) Any corporation or partnership of which the Adviser or Financial Institution is an officer, director, or partner of the Adviser or Financial Institution.

The Department received a comment requesting that this definition adopt a securities law definition. The commenter expressed the view that use of a separate definition would make compliance more difficult for broker-dealers. The Department did not accept this comment. Instead, the Department made minor adjustments so that the definition is identical to the affiliate definition incorporated in prior exemptions under ERISA and the Code, that are applicable to broker dealers,[60] as well as the definition that is used in the Regulation. Therefore, the definition should not be new to the broker-dealer community, and is consistent with other applicable laws.

e. Independent

The term Independent is used in Section I(c)(2)(ii), which precludes Financial Institutions and Advisers from relying on the exemption if they are the named fiduciary or plan administrator, as defined in ERISA section 3(16)(A), with respect to an ERISA-covered plan, unless such Financial Institutions or Advisers are selected to provide advice to the plan by a plan fiduciary that is Independent of the Financial Institutions or Advisers.

In the proposed exemption, the definition of Independent provided that the person (*e.g.,* the independent fiduciary appointing the Adviser or Financial Institution under Section I(c)(2)(ii)) could not receive any compensation or other consideration for his or her own account from the Adviser, the Financial Institution or an Affiliate. A commenter indicated that as a result, a number of parties providing services to the Financial Institution, and receiving compensation in return, could not satisfy the Independence requirement. The commenter suggested defining entities that receive less than 5% of their gross income from the fiduciary as Independent.

In response, the Department revised the definition of Independent so that it provides that the person's compensation from the Financial Institution may not be in excess of 2% of the person's annual revenues based on the prior year. This approach is consistent with the Department's general approach to fiduciary independence. For example, the prohibited transaction exemption procedures provide a presumption of independence for appraisers and fiduciaries if the revenue they receive from a party is not more than 2% of their total annual revenue.[61] The Department has revised the definition accordingly.[62]

C. Good Faith

Commenters requested that the exemption continue to apply in the event of a Financial Institution's or Adviser's good faith failure to comply with one or more of the conditions. In the commenters' views, the exemption was sufficiently complex and the implementation timeline sufficiently short to justify such a provision. For example, FINRA suggested that the Department include a provision for continued application of the exemption

[59] *See* Section VI(e) of the exemption.

[60] *See, e.g.,* PTE 75–1, Part II, 40 FR 50845 (Oct. 31, 1975), as amended at 71 FR 5883 (Feb. 3, 2006).

[61] 29 CFR 2570.31(j).

[62] The same commenter also requested clarification that an IRA owner will not be deemed to fail the Independence requirement simply because he or she is an employee of the Financial Institution. However, the Independence is not applicable to IRA owners.

despite a failure to comply with ''any term, condition or requirement of this exemption . . . if the failure to comply was insignificant and a good faith and reasonable attempt was made to comply with all applicable terms, conditions and requirements.'' Several commenters specifically supported FINRA's suggestion.

The Department has reviewed the exemption's requirements with these comments in mind and has included a good faith correction mechanism for the disclosure requirements in the exemption. These provisions take a similar approach to the provisions in the Department's regulations under ERISA sections 404 and 408(b)(2). In addition, as discussed above, the Department has eliminated a condition requiring compliance with other federal and state laws, which many commenters had argued could expose them to loss of the exemption based on small or technical violations. The Department has also facilitated compliance by streamlining the contracting process (and eliminating the contract requirement for ERISA plans), reducing the disclosure burden, and extending the time for compliance with many of the exemption's conditions. These and other changes should reduce the need for a self-correction process for excusing violations.

The Department declines to permanently adopt a broader unilateral good faith provision for Financial Institutions and their Advisers that could undermine fiduciaries' incentive to comply with the fundamental standards imposed by the exemption. The exemption's primary purpose is to combat harmful conflict of interest. If the exemption is too forgiving of abusive conduct, however, it runs the risk of permitting those same conflicts of interest to play a role in the design of policies and procedures, the use and oversight of adviser-incentives, the supervision of Adviser conduct, and the substance of investment recommendations. At the very least, it could encourage Financial Institutions and Advisers to resolve doubts on such questions in favor of their own financial interests rather than the interests of the Retirement Investor. Given the dangers posed by conflicts, the Department has deliberately structured this exemption to provide a strong counter-incentive to such conduct.

Additionally, many of the exemption's standards, such as the Best Interest standard and the pricing condition, already have a built-in reasonableness or prudence standard governing compliance. It would be inappropriate, in the Department's view, to create a self-correction mechanism for conduct that was imprudent or unreasonable. For example, the Best Interest standard requires that the Adviser and Financial Institution providing the advice act 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 Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party. Similarly, the policies and procedures requirement under Section II(d) turns to a significant degree on adherence to standards of prudence and reasonableness. Thus, under Section II(d)(1), the Financial Institution is required to adopted and comply with written policies and procedures *reasonably and prudently designed* to ensure that its individual Advisers adhere to the Impartial Conduct Standards set forth in Section II(c).

Additionally, the provision allowing mandatory arbitration of individual claims is also responsive to the practicalities of resolving disputes over small claims. The Department also stresses that violations of the exemption's conditions with respect to a particular Retirement Investor or transaction, eliminates the availability of the exemption for that investor or transaction. Such violations do not render the exemption unavailable with respect to other Retirement Investors or other transactions.

D. Jurisdiction

The Department received a number of comments questioning the Department's jurisdiction and legal authority to proceed with the proposal. A number of commenters focused on the Department's authority to impose certain conditions as part of this exemption, specifically including the contract requirement and the Impartial Conduct Standards. Some commenters asserted that by requiring a contract for all Retirement Investors, and thereby facilitating contract claims by such parties, the proposal would expand upon the remedies established by Congress under ERISA and the Code. Commenters stated that ERISA preempts state law actions, including breach-of-contract actions. With respect to IRAs and non-ERISA plans, commenters stated that Congress provided that the enforcement of the prohibited transaction rules should be carried out by the Internal Revenue Service, not private plaintiffs. These commenters argued that the Department's proposal would impermissibly create a private right of action in violation of Congressional intent.

Commenters' arguments regarding the Impartial Conduct Standards were based generally on the fact that the standards, as noted above, are consistent with longstanding principles of prudence and loyalty set forth in ERISA section 404, but which have no counterpart in the Code. Commenters took the position that because Congress did not choose to impose the standards of prudence and loyalty on fiduciaries with respect to IRAs and non-ERISA plans, the Department exceeded its authority in proposing similar standards as a condition of relief in a prohibited transaction exemption.

With respect to ERISA plans, commenters stated that Congress' separation of the duties of prudence and loyalty (in ERISA section 404) from the prohibited transaction provisions (in ERISA section 406), showed an intent that the two should remain separate. Commenters additionally questioned why the conduct standards were necessary for ERISA plans, when such plans already have an enforceable right to fiduciary conduct that is both prudent and loyal. Commenters asserted that imposing the Impartial Conduct Standards as conditions of the exemption improperly created strict liability for prudence violations.

Some commenters additionally took the position that Congress, in the Dodd-Frank Act, gave the SEC the authority to establish standards for broker-dealers and investment advisers and therefore, the Department did not have the authority to act in that area.

The Department disagrees that the exemption exceeds its authority. The Department has clear authority under ERISA section 408(a) and the Reorganization Plan [63] to grant administrative exemptions from the prohibited transaction provisions of both ERISA and the Code. Congress gave the Department broad discretion to grant or deny exemptions and to craft conditions for those exemptions, subject only to the overarching requirement that the exemption be administratively feasible, in the interests of plans, plan participants and beneficiaries and IRA owners, and protective of their rights.[64] Nothing in ERISA or the Code suggests

[63] *See* fn. 1, *supra,* discussing of Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)).

[64] *See* ERISA section 408(a) and Code section 4975(c)(2).

that, in exercising its express discretion to fashion appropriate conditions, the Department cannot condition exemptions on contractual terms or commitments, or that, in crafting exemptions applicable to fiduciaries, the Department is forbidden to borrow from time-honored trust-law standards and principles developed by the courts to ensure proper fiduciary conduct.

In addition, this exemption does not create a cause of action for plan fiduciaries, participants or IRA owners to directly enforce the prohibited transaction provisions of ERISA and the Code in a federal or state-law contract action. Instead, with respect to ERISA plans and participants and beneficiaries, the exemption facilitates the existing statutory enforcement framework by requiring Financial Institutions to acknowledge in writing their fiduciary status and the fiduciary status of their Advisers. With respect to IRAs and non-ERISA plans, the exemption requires Advisers and Financial Institutions to make certain enforceable commitments to the advice recipient. Violation of the commitments can result in contractual liability to the Adviser and Financial Institution separate and apart from the legal consequences of a non-exempt prohibited transaction (*e.g.,* an excise tax).

There is nothing new about a prohibited transaction exemption requiring certain written documentation between the parties. The Department's widely-used exemption for Qualified Professional Asset Managers (QPAM), requires that an entity acting as a QPAM acknowledge in a written management agreement that it is a fiduciary with respect to each plan that has retained it.[65] Likewise, PTE 2006–16, an exemption applicable to compensation received by fiduciaries in securities lending transactions, requires the compensation to be paid in accordance with the terms of a written instrument.[66] Surely, the terms of these documents can be enforced by the parties. In this regard, the statutory authority permits, and in fact requires, that the Department incorporate conditions in administrative exemptions designed to protect the interests of plans, participants and beneficiaries, and IRA owners. The Department has determined that the contract requirement in the final exemption serves a critical protective function.

Likewise, the Impartial Conduct Standards represent, in the Department's view, baseline standards of fundamental fair dealing that must be present when fiduciaries make conflicted investment recommendations to Retirement Investors. After careful consideration, the Department determined that broad relief could be provided to investment advice fiduciaries receiving conflicted compensation only if such fiduciaries provided advice in accordance with the Impartial Conduct Standards—*i.e.,* if they provided prudent advice without regard to the interests of such fiduciaries and their Affiliates and Related Entities, in exchange for reasonable compensation and without misleading investors. These Impartial Conduct Standards are necessary to ensure that Advisers' recommendations reflect the Best interest of their Retirement Investor customers, rather than the conflicting financial interests of the Advisers and their Financial Institutions. As a result, Advisers and Financial Institutions bear the burden of showing compliance with the exemption and face liability for engaging in a non-exempt prohibited transaction if they fail to provide advice that is prudent or otherwise in violation of the standards. The Department does not view this as a flaw in the exemption, as commenters suggested, but rather as a significant deterrent to violations of important conditions under an exemption that accommodates a wide variety of potentially dangerous compensation practices.

The Department similarly disagrees that Congress' directive to the SEC in the Dodd-Frank Act limits its authority to establish appropriate and protective conditions in the context of a prohibited transaction exemption. Section 913 of the Dodd-Frank Act directs the SEC to conduct a study on the standards of care applicable to brokers-dealers and investment advisers, and issue a report containing, among other things:

> an analysis of whether [sic] any identified legal or regulatory gaps, shortcomings, or overlap in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers.[67]

Section 913 of the Dodd-Frank Act authorizes, but does not require, the SEC to issue rules addressing standards of care for broker-dealers and investment advisers for providing personalized investment advice about securities to retail customers.[68] Nothing in the Dodd-Frank Act indicates that Congress meant to preclude the Department's regulation of fiduciary investment advice under ERISA or its application of such a regulation to securities brokers or dealers. To the contrary, the Dodd-Frank Act in directing the SEC study specifically directed the SEC to consider the effectiveness of existing legal and regulatory standard of care under other federal and state authorities.[69] The Dodd-Frank Act did not take away the Department's responsibility with respect to the definition of fiduciary under ERISA and in the Code; nor did it qualify the Department's authority to issue exemptions that are administratively feasible, in the interests of plans, participants and beneficiaries, and IRA owners, and protective of the rights of participants and beneficiaries of the plans and IRA owners. If the Department were unable to rely on contract conditions and trust-law principles, it would be unable to grant broad relief under this exemption from the rigid application of the prohibited transaction rules. This enforceable standards-based approach enabled the Department to grant relief to a much broader range of practices and compensation structures than would otherwise have been possible.

Additionally, the Department notes that nothing in ERISA or the Code requires any Adviser or Financial Institution to use this exemption. Exemptions, including this class exemption, simply provide a means to engage in a transaction otherwise prohibited by the statutes. The conditions to an exemption are not equivalent to a regulatory mandate that conflicts with or changes the statutory remedial scheme. If Advisers or Financial Institutions do not want to be subject to contract claims, they can (1) change their trading practices and avoid committing a prohibited transaction, (2) use the statutory exemptions in ERISA section 408(b)(14) and section 408(g), or Code section 4975(d)(17) and (f)(8), or (3) apply to the Department for individual exemptions tailored to their particular situations.

E. Defer to the Securities and Exchange Commission

Many commenters suggested that a uniform standard applicable to all retail accounts would be preferable to the Department's proposal, and that the Department should work with other

[65] *See* Section VI(a) of PTE 84–14, 49 FR 9494, March 13, 1984, as amended at 70 FR 49305 (August 23, 2005) and as amended at 75 FR 38837 (July 6, 2010).

[66] *See* Section IV(c) of PTE 2006–16, 71 FR 63786 (Oct. 31, 2006).

[67] Dodd-Frank Act, sec. 913(d)(2)(B).

[68] 15 U.S.C. 80b–11(g)(1).

[69] Dodd-Frank Act, sec. 913(b)(1) and (c)(1).

regulators, such as the SEC and FINRA, to fashion such an approach. Others suggested that the Department should wait and defer to the SEC's determination of an appropriate standard for broker-dealers under the Dodd-Frank Act. Still others suggested that the Department should provide exemptions based on fiduciary status under securities laws, or based on compliance with other applicable laws or regulations. FINRA indicated that the proposal should be based on existing principles in federal securities laws and FINRA rules but acknowledged that additional rulemaking would be required.

The Department disagrees with the commenters, and believes it is important to move forward with this proposal to remedy the ongoing injury to Retirement Investors as a result of conflicted advice arrangements. ERISA and the Code create special protections applicable to investors in tax qualified plans. The fiduciary duties established under ERISA and the Code are different from those applicable under securities laws, and would continue to differ even if both regimes were interpreted to attach fiduciary status to exactly the same parties and activities. Reflecting the special importance of plan and IRA investments to retirement and health security, this statutory regime flatly prohibits fiduciaries from engaging in transactions involving self-dealing and conflicts of interest unless an exemption applies. Under ERISA and the Code, the Department of Labor has the authority to craft exemptions from these stringent statutory prohibitions, and the Department is specifically charged with ensuring that any exemptions it grants are in the interests of Retirement Investors and protective of these interests. Moreover, the fiduciary provisions of ERISA and the Code broadly protect all investments by Retirement Investors, not just those regulated by the SEC. As a consequence, the Department uniquely has the ability to assure that these fiduciary rules work in harmony for all Retirement Investors, regardless of whether they are investing in securities, insurance products that are not securities, or other types of investments.

The Department has taken very seriously its obligation to harmonize the Department's regulation with other applicable laws, including the securities laws. In pursuing its consultations with other regulators, the Department aimed to coordinate and minimize conflicting or duplicative provisions between ERISA, the Code and federal securities laws. The Department has coordinated—and will continue to coordinate—its efforts with other federal agencies to ensure that the various legal regimes are harmonized to the fullest extent possible. The resulting exemption provides Advisers and Financial Institutions with a choice to provide advice on an unconflicted basis or comply with this exemption or another exemption, which now all require advice to be provided in accordance with basic fiduciary norms. Far from confusing investors, the standards set forth in the exemption ensure that Retirement Investors can uniformly expect to receive advice that is in their best interest with respect to their retirement investments. Moreover, the best interest standard reflects what many investors have believed they were entitled to all along, even though it was not legally required.

In this regard, waiting for the SEC to act, as some commenters suggested, would delay the implementation of these important, updated safeguards to plan and IRA investors, and impose substantial costs on them as current harms from conflicted advice would continue.

F. Applicability Date and Transition Rules

The Regulation will become effective June 7, 2016 and this exemption is issued on this same date. The Regulation is effective at the earliest possible date under the Congressional Review Act. For the exemption, the issuance date serves as the date on which the exemption is intended to take effect for purposes of the Congressional Review Act. This date was selected to provide certainty to plans, plan fiduciaries, plan participants and beneficiaries, IRAs, and IRA owners that the new protections afforded by the final rule are now officially part of the law and regulations governing their investment advice providers, and to inform financial services providers and other affected service providers that the rule and exemption are final and not subject to further amendment or modification without additional public notice and comment. The Department expects that this effective date will remove uncertainty as an obstacle to regulated firms allocating capital and other resources toward transition and longer term compliance adjustments to systems and business practices.

The Department has also determined that, in light of the importance of the Regulation's consumer protections and the significance of the continuing monetary harm to retirement investors without the rule's changes, an Applicability Date of April 10, 2017, is appropriate for plans and their affected service providers to adjust to the basic change from non-fiduciary to fiduciary status. This exemption has the same Applicability Date; parties may rely on it as of the Applicability Date.

Section VII provides a transition period under which relief from the prohibited transaction provisions of ERISA and the Code is available for Financial Institutions and Advisers during the period between the Applicability Date and January 1, 2018 (the ''Transition Period''). For the Transition Period, full relief under the exemption will be available for Financial Institutions and Advisers subject to more limited conditions than the full set of conditions described above. This period is intended to provide Financial Institutions and Advisers time to prepare for compliance with the conditions of Section II–IV set forth above, while safeguarding the interests of Retirement Investors. The Transition Period conditions set forth in Section VII are subject to the same exclusions in Section I(c), for advice from fiduciaries with discretionary authority over the customer's investments and specified advice concerning in-house plans.

The transitional conditions of Section VII require the Financial Institution and its Advisers to comply with the Impartial Conduct Standards when making recommendations regarding principal transactions and riskless principal transactions to Retirement Investors. The Impartial Conduct Standards required in Section VII are the same as required in Section II(c) but are repeated for ease of use.

During the Transition Period, the Financial Institution must additionally provide a written notice to the Retirement Investor prior to or at the same time as the execution of the principal transaction or riskless principal transaction, which may cover multiple transactions or all transactions taking place within the Transition Period, affirmatively stating its and its Adviser(s) fiduciary status under ERISA or the Code or both with respect to the recommendation. The Financial Institution must also state in writing that it and its Advisers will comply with the Impartial Conduct Standards. Further, the Financial Institution's notice must disclose the circumstances under which the Adviser and Financial Institution may engage in principal transactions and riskless principal transactions with the Plan, participant or beneficiary account or IRA, and its Material Conflicts of Interest. The disclosure may be provided in person, electronically or by mail, and it may be provided in the same document as the notice required in the transition period for exemption in Section IX of the Best Interest Contract Exemption.

Similar to the disclosure provisions of Section II(e), the transitional exemption in Section VII provides for exemptive relief to continue despite errors and omissions in the disclosures, if the Financial Institution acts in good faith and with reasonable diligence.

In addition, the Financial Institution must designate a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards.

Finally, the Financial Institution must comply with the recordkeeping provision of Section V(a) and (b) of the exemption regarding the transactions entered into during the Transition Period.

After the Transition Period, however, the exemption provided in Section VII will no longer be available. After that date, Financial Institutions and Advisers must satisfy all of the applicable conditions described in Sections II–V for the relief in Section I(b) to be available for any prohibited transactions occurring after that date. This includes the requirement to enter into a contract with a Retirement Investor, where required. Financial Institutions relying on the negative consent procedure set forth in Section II(a)(1)(ii) must provide the contractual provisions to Retirement Investors with Existing Contracts prior to January 1, 2018, and allow those Retirement Investors 30 days to terminate the contract. If the Retirement Investor does terminate the contract within that 30-day period, this exemption will provide relief for 14 days after the date on which the termination is received by the Financial Institution.

The proposed exemption, with the proposed Best Interest Contract Exemption, the proposed Regulation and other exemption proposals, generally set forth an Applicability Date of eight months, although the proposals sought comment on a phase in of conditions. As with other sections of this preamble, the Department is addressing comments regarding the Applicability Date as a cohesive whole. Some commenters, concerned about the ongoing harm to Retirement Investors, urged the Department to implement the Regulation and related exemptions quickly. However, the majority of industry commenters requested a two- to three-year transition period. These commenters requested time to enter into contracts with Retirement Investors (including developing and implementing the policies and procedures and incentive practices that meet the terms of Section II(d)). Some commenters requested the Department allow good faith compliance during the transition period. Others requested the Department phase in the requirements over time. One commenter requested the Best Interest standard become effective immediately, with the other conditions becoming effective within one year. Another comment expressed concern about phasing in the conditions over time, referring to this as a ''piecemeal'' approach, which would not be helpful to implementing a system to protect Retirement Investors. Other commenters wrote that the Department should re-propose the exemption or adopt it as an interim final exemption and seek additional comments.

The transition provisions in Section VII of the final exemption respond to commenters' concerns about ongoing economic harm to Retirement Investors during the period in which Financial Institutions develop systems to comply with the exemption. The provisions require prompt implementation of certain core protections of the exemption in the form of the acknowledgment of fiduciary status, compliance with the Impartial Conduct Standards, and certain important disclosures, to safeguard Retirement Investors' interests. The provisions recognize, however, that the Financial Institutions will need time to develop policies and procedures and supervisory structures that fully comport with the requirements of the final exemption. Accordingly, during the Transition Period, Financial Institutions are not required to execute the contract or give Retirement Investors warranties or disclosures on their anti-conflict policies and procedures. While the Department expects that Advisers and Financial Institutions will, in fact, adopt prudent supervisory mechanisms to prevent violations of the Impartial Conduct Standards (and potential liability for such violations), the exemption will not require the Financial Institutions to make specific representations on the nature or quality of the policies and procedures during this Transition Period. The Department will be available to respond to Financial Institutions' request for guidance during this period, as they develop the systems necessary to comply with the exemption's conditions.

The transition provisions also accommodate Financial Institutions' need for time to prepare for full compliance with the exemption, and therefore full compliance with all the final exemption's applicable conditions is delayed until January 1, 2018. The Department selected that period, rather than two to three years, as requested by some commenters, in light of the significant adjustments in the final exemption that significantly eased compliance burdens. Although the Department believes that the conditions of the exemption set forth in Section II–V are required to support the Department's findings required under ERISA section 408(a), and Code section 4975(c)(2) over the long term, the Department recognizes that Financial Institutions may need time to achieve full compliance with these conditions. The Department therefore finds that the provisions set forth in Section VII satisfy the criteria of ERISA section 408(a) and Code section 4975(c)(2) for the transition period because they provide the significant protections to Retirement Investors while providing Financial Institutions with time necessary to achieve full compliance. A similar transition period is provided for the companion Best Interest Contract Exemption due to the corresponding provisions in that exemption that may require time for Financial Institutions to begin compliance.

The Department considered, but did not elect, delaying the application of the rule defining fiduciary investment advice until such time as Financial Institutions could make the changes to their practices and compensation structures necessary to comply with Sections II through V of this exemption. The Department believed that delaying the application of the new fiduciary rule would inordinately delay the basic protections of loyalty and prudence that the rule provides. Moreover, a long period of delay could incentivize Financial Institutions to increase efforts to provide conflicted advice to Retirement Investors before it becomes subject to the new rule. The Department understands that many of the concerns regarding the applicability date of the rule are related to the prohibited transaction provisions of ERISA and the Code rather than the basic fiduciary standards. This transition period exemption addresses these concerns by giving Financial Institutions and Advisers necessary time to fully comply with Sections II–V of the exemption.

The Department also considered the views of commenters that requested re-proposal of the Regulation and exemptions, or issuing the rule and exemptions as interim final rules with requests for additional comment. After reviewing all the comments on the 2015 proposal, which was itself a re-proposal, the Department has concluded that it is in a position to publish a final rule and exemptions. It has carefully considered and responded to the significant issues raised in the comments in drafting the final rule and exemptions. Moreover, the Department has concluded that the difference between the final documents and the proposals are also responsive to the commenters' concerns and could be reasonably foreseen by affected parties.

No Relief From ERISA Section 406(a)(1)(C) or Code Section 4975(c)(1)(C) for the Provision of Services

This exemption will not provide relief from a transaction prohibited by ERISA section 406(a)(1)(C), or from the taxes imposed by Code section 4975(a) and (b) by reason of Code section 4975(c)(1)(C), regarding the furnishing of goods, services or facilities between a plan and a party in interest. The provision of investment advice to a plan under a contract with a fiduciary is a service to the plan and compliance with this exemption will not relieve an Adviser or Financial Institution of the need to comply with ERISA section 408(b)(2), Code section 4975(d)(2), and applicable regulations thereunder.

Paperwork Reduction Act Statement

In accordance with the requirements of the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506(c)(2)), the Department solicited comments on the information collections included in the proposed Exemption for Principal Transactions in Certain Debt Securities Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs. 80 FR 21989 (Apr. 20, 2015). The Department also submitted an information collection request (ICR) to OMB in accordance with 44 U.S.C. 3507(d), contemporaneously with the publication of the proposal, for OMB's review. The Department received two comments from one commenter that specifically addressed the paperwork burden analysis of the information collections. Additionally many comments were submitted, described elsewhere in this preamble and in the preamble to the accompanying final rule, which contained information relevant to the costs and administrative burdens attendant to the proposals. The Department took into account such public comments in connection with making changes to the prohibited transaction exemption, analyzing the economic impact of the proposals, and developing the revised paperwork burden analysis summarized below.

In connection with publication of this prohibited transaction exemption, the Department is submitting an ICR to OMB requesting approval of a new collection of information under OMB Control Number 1210–0157. The Department will notify the public when OMB approves the ICR.

A copy of the ICR may be obtained by contacting the PRA addressee shown below or at *http://www.RegInfo.gov.* PRA ADDRESSEE: G. Christopher Cosby, Office of Policy and Research, U.S. Department of Labor, Employee Benefits Security Administration, 200 Constitution Avenue NW., Room N–5718, Washington, DC 20210. Telephone: (202) 693–8410; Fax: (202) 219–4745. These are not toll-free numbers.

As discussed in detail below, the class exemption will permit principal transactions and riskless principal transactions in certain principal traded assets between a plan, participant or beneficiary account, or an IRA, and an Adviser or Financial Institution, and the receipt of a mark-up or mark-down or other payment by the Adviser or Financial Institution for themselves or Affiliates as a result of investment advice. The class exemption will require Financial Institutions to enter into a contractual arrangement with Retirement Investors regarding principal transactions and riskless principal transactions with IRAs and plans not subject to Title I of ERISA (non-ERISA plans), adopt written policies and procedures, make disclosures to Retirement Investors (including with respect to ERISA plans), and on a publicly available Web site, and maintain records necessary to prove that the conditions of the exemption have been met for a period of six (6) years from the date of each principal transaction or riskless principal transaction. In addition, the exemption provides a transition period from the Applicability Date, to January 1, 2018. As a condition of relief during the transition period, Financial Institutions must make a disclosure (transition disclosure) to all Retirement Investors (in ERISA plans, IRAs, and non-ERISA plans) prior to or at the same time as the execution of recommended transactions. These requirements are ICRs subject to the PRA.

The Department has made the following assumptions in order to establish a reasonable estimate of the paperwork burden associated with these ICRs:

• 51.8 percent of disclosures to Retirement Investors with respect to ERISA plans [70] and 44.1 percent of contracts with and disclosures to Retirement Investors with respect to IRAs and non-ERISA plans [71] will be distributed electronically via means already used by respondents in the normal course of business and the costs arising from electronic distribution will be negligible, while the remaining contracts and disclosures will be distributed on paper and mailed at a cost of $0.05 per page for materials and $0.49 for first class postage;

• Financial Institutions will use existing in-house resources to distribute required contracts and disclosures;

• Tasks associated with the ICRs performed by in-house personnel will be performed by clerical personnel at an hourly wage rate of $55.21;[72]

• Financial Institutions will hire outside service providers to assist with nearly all other compliance costs;

• Outsourced legal assistance will be billed at an hourly rate of $335.00;[73]

• Approximately 6,000 Financial Institutions [74] will utilize the exemption

[70] According to data from the National Telecommunications and Information Agency (NTIA), 33.4 percent of individuals age 25 and over have access to the internet at work. According to a Greenwald & Associates survey, 84 percent of plan participants find it acceptable to make electronic delivery the default option, which is used as the proxy for the number of participants who will not opt out that are automatically enrolled (for a total of 28.1 percent receiving electronic disclosure at work). Additionally, the NTIA reports that 38.9 percent of individuals age 25 and over have access to the internet outside of work. According to a Pew Research Center survey, 61 percent of internet users use online banking, which is used as the proxy for the number of internet users who will opt in for electronic disclosure (for a total of 23.7 percent receiving electronic disclosure outside of work). Combining the 28.1 percent who receive electronic disclosure at work with the 23.7 percent who receive electronic disclosure outside of work produces a total of 51.8 percent who will receive electronic disclosure overall.

[71] According to data from the NTIA, 72.4 percent of individuals age 25 and older have access to the internet. According to a Pew Research Center survey, 61 percent of internet users use online banking, which is used as the proxy for the number of internet users who will opt in for electronic disclosure. Combining these data produces an estimate of 44.1 percent of individuals who will receive electronic disclosures.

[72] For a description of the Department's methodology for calculating wage rates, see *http://www.dol.gov/ebsa/pdf/labor-cost-inputs-used-in-ebsa-opr-ria-and-pra-burden-calculations-march-2016.pdf.* The Department's methodology for calculating the overhead cost input of its wage rates was adjusted from the proposed PTE to the final PTE. In the proposed PTE, the Department based its overhead cost estimates on longstanding internal EBSA calculations for the cost of overhead. In response to a public comment stating that the overhead cost estimates were too low and without any supporting evidence, the Department incorporated published U.S. Census Bureau survey data on overhead costs into its wage rate estimates.

[73] This rate is the average of the hourly rate of an attorney with 4–7 years of experience and an attorney with 8–10 years of experience, taken from the Laffey Matrix. See *http://www.justice.gov/sites/default/files/usao-dc/legacy/2014/07/14/Laffey%20Matrix_2014-2015.pdf*

[74] One commenter questioned the basis for the Department's assumption regarding the number of

Continued

to engage in principal transactions and riskless principal transactions.

Compliance Costs for Financial Institutions

The Department believes that nearly all Financial Institutions will contract with outside service providers to implement the various compliance requirements of this exemption. As described in the regulatory impact analysis, per-Financial Institution costs for broker-dealers (BDs) were calculated by allocating the total cost reductions in the medium assumptions scenario across the Financial Institution size categories, and then subtracting the cost reductions from the per-Financial Institution average costs derived from the Oxford Economics study. The methodology for calculating the per-Financial Institution costs for registered investment advisers (RIAs) is described in detail in the regulatory impact analysis. The Department is attributing 50 percent of the compliance costs for BDs and RIAs to this Exemption and 50 percent of the compliance costs for BDs and RIAs to the Best Interest Contract Exemption, published elsewhere in today's **Federal Register**. With the above assumptions, the per-Financial Institution costs are as follows:

- Start-Up Costs for Large BDs: $3.7 million
- Start-Up Costs for Large RIAs: $3.2 million
- Start-Up Costs for Medium BDs: $889,000
- Start-Up Costs for Medium RIAs: $662,000
- Start-Up Costs for Small BDs: $278,000
- Start-Up Costs for Small RIAs: $219,000
- Ongoing Costs for Large BDs: $918,000
- Ongoing Costs for Large RIAs: $803,000
- Ongoing Costs for Medium BDs: $192,000
- Ongoing Costs for Medium RIAs: $143,000
- Ongoing Costs for Small BDs: $60,000
- Ongoing Costs for Small RIAs: $47,000

In order to engage in transactions and receive compensation covered under this exemption, Section II requires Financial Institutions to acknowledge, in writing, their fiduciary status and adopt written policies and procedures designed to ensure compliance with the Impartial Conduct Standards. Financial Institutions must make certain disclosures to Retirement Investors. Financial institutions must generally enter into a written contract with Retirement Investors with respect to principal transactions and riskless principal transactions with IRAs and non-ERISA plans with certain required provisions, including affirmative agreement to adhere to the Impartial Conduct Standards and, if they are FINRA members, to comply with FINRA rules 2121 and 5310.

Section IV requires Financial Institutions and Advisers to make certain disclosures to the Retirement Investor. These disclosures include: (1) A pre-transaction disclosure; (2) a disclosure, on demand, of information regarding the principal traded asset, including its salient attributes; (3) an annual disclosure; (4) transaction confirmations; and (5) a web-based disclosure.

Section VII requires Financial Institutions to make a transition disclosure, acknowledging their fiduciary status and that of their Advisers with respect to the Advice, stating the Best Interest standard of care, and describing the circumstances under which principal transactions and riskless principal transactions may occur and the associated Material Conflicts of Interest, prior to engaging in any transactions during the transition period from the Applicability Date to January 1, 2018. The transition disclosure can cover multiple transactions, or all transactions occurring in the transition period.

The Department is able to disaggregate an estimate of many of the legal costs from the costs above; however, it is unable to disaggregate any of the other costs. The Department received a comment on the proposed PTE stating that the estimates for legal professional time to draft disclosures were not supported by any empirical evidence. The Department also received multiple comments on the proposed PTE stating that its estimate of 60 hours of legal professional time during the first year a financial institution used the exemption and then no legal professional time in subsequent years was too low.

In response to a recommendation made during the Department's August 2015, public hearing on the proposed rule and exemptions, and in an attempt to create estimates with a clearer empirical evidentiary basis, the Department drafted certain portions of the required disclosures, including a sample contract, the one-time disclosure to the Department, and the transition disclosure. The Department believes that the time spent updating existing contracts and disclosures in future years would be no longer than the time necessary to create the original contracts and disclosures. The Department did not attempt to draft the complete set of required disclosures because it expects that the amount of time necessary to draft such disclosures will vary greatly among firms. For example, the Department did not attempt to draft sample policies and procedures, pre-transaction disclosures, disclosures regarding the principal traded assets, or confirmation slips. The Department expects the amount of time necessary to complete these disclosures will vary significantly based on a variety of factors including the nature of a firm's compensation structure, and the extent to which a firm's policies and procedures require review and signatures by different individuals. The Department further believes that pre-transaction disclosures will be provided orally at de minimis cost, facts and circumstances will vary too widely to accurately depict the disclosures regarding the principal traded assets, and providing confirmation slips is a regular and customary business practice

Financial Institutions likely to use the exemption. According to the ''2015 Investment Management Compliance Testing Survey,'' Investment Adviser Association, cited in the regulatory impact analysis for the accompanying rule, 63 percent of Registered Investment Advisers service ERISA-covered plans and IRAs. The Department conservatively interprets this to mean that all of the 113 large Registered Investment Advisers (RIAs), 63 percent of the 3,021 medium RIAs (1,903), and 63 percent of the 24,475 small RIAs (15,419) work with ERISA-covered plans and IRAs. The Department assumes that all of the 42 large broker-dealers, and similar shares of the 233 medium broker-dealers (147) and the 3,682 small broker-dealers (2,320) work with ERISA-covered plans and IRAs. According to SEC and FINRA data, cited in the regulatory impact analysis, 18 percent of broker-dealers are also registered as RIAs. Removing these firms from the RIA counts produces counts of 105 large RIAs, 1,877 medium RIAs, and 15,001 small RIAs that work with ERISA-covered plans and IRAs and are not also registered as broker-dealers. Further, according to Hung et al. (2008) (see Regulatory Impact Analysis for complete citation), approximately 13 percent of RIAs report receiving commissions. Additionally, 20 percent of RIAs report receiving performance based fees; however, at least 60 percent of these RIAs are likely to be hedge funds. Thus, as much as 8 percent of RIAs providing investment advice receive performance based fees. Combining the 8 percent of RIAs receiving performance based fees with the 13 percent of RIAs receiving commissions creates a conservative estimate of 21 percent of RIAs that might need exemptive relief. Although the Department believes that very few RIAs that are not also broker-dealers engage in principal transactions and riskless principal transactions, its data to support this belief is limited, so the Department is conservatively assuming that the same RIAs that receive performance-based fees and commissions are the types of RIAs that might engage in principal transactions and riskless principal transactions. In total, the Department estimates that 2,509 broker-dealers and 3,566 RIAs receiving performance-based fees and commissions will use this exemption. As described in detail in the regulatory impact analysis, the Department believes a de minimis number of banks may also use the exemption.

producing de minimis additional burden.

Considered in conjunction with the estimates provided in the proposal, the Department estimates that outsourced legal assistance to draft standard contracts, contract disclosures, annual disclosures, and transition disclosures will cost an average of $3,676 per Financial Institution for a total of $22.3 million during the first year. In subsequent years, it will cost an average of $2,978 per Financial Institution for a total of $18.1 million annually to update the contracts, contract disclosures, and annual disclosures.

The legal costs of these disclosures were disaggregated from the total compliance costs because these disclosures are expected to be relatively uniform. Although the tested disclosures generally took less time than many of the commenters said they would, the Department acknowledges that the disclosures that were not tested are those that are expected to be the most time consuming. Importantly, as explained in greater detail in section 5.3 of the regulatory impact analysis, the Department is primarily relying on cost data provided by the Securities Industry and Financial Markets Association (SIFMA) and the Financial Services Institute (FSI) to calculate the total cost of the legal disclosures, rather than its own internal drafting of disclosures. Accordingly, in the event that any of the Department's estimates understate the time necessary to create and update the disclosures, it does not impact the total burden estimates. The total burden estimates were derived from SIFMA and FSI's all-inclusive costs. Therefore, in the event that legal costs are understated, other cost estimates in this analysis would be overstated in an equal manner.

In addition to legal costs for creating the contracts and disclosures, the start-up cost estimates include the costs of implementing and updating the IT infrastructure, creating the web disclosures, gathering and maintaining the records necessary to produce the various disclosures, developing policies and procedures, addressing material conflicts of interest, monitoring Advisers' adherence to the Impartial Conduct Standards, and any other steps necessary to ensure compliance with the conditions of the Exemption not described elsewhere. In addition to legal costs for updating the contracts and disclosures, the ongoing cost estimates include the costs of updating the IT infrastructure, updating the web disclosures, reviewing processes for gathering and maintaining the records necessary to produce the various disclosures, reviewing the policies and procedures, producing the detailed disclosures regarding principal traded assets on request, monitoring investments as agreed upon with the Retirement Investor, addressing material conflicts of interest, monitoring Advisers' adherence to the Impartial Conduct Standards, and any other steps necessary to ensure compliance with the conditions of the exemption not described elsewhere. These costs total $1.9 billion during the first year and $412.2 million in subsequent years. These costs do not include the costs of producing of distributing disclosures and contracts, which are discussed below.

Distribution of Disclosures and Contracts

The Department estimates that 14,000 Retirement Investors with respect to ERISA plans and 2.4 million Retirement Investors with respect to IRAs and non-ERISA plans will receive a three-page transition disclosure during the first year. Additionally, 14,000 Retirement Investors with respect to ERISA plans will receive a fifteen-page contract disclosure, and 2.4 million Retirement Investors with respect to IRAs and non-ERISA plans will receive a fifteen-page contract during the first year. In subsequent years, 4,000 Retirement Investors with respect to ERISA plans will receive a fifteen-page contract disclosure and 490,000 Retirement Investors with respect to IRAs and non-ERISA plans will receive a fifteen-page contract. To the extent that Financial Institutions use both the Best Interest Contract Exemption and the Principal Transactions Exemption, these estimates may represent overestimates because significant overlap exists between the requirements of the transition disclosure and the contract for both exemptions. If Financial Institutions choose to use both exemptions with the same clients, they will probably combine the documents.

The transition disclosure will be distributed electronically to 51.8 percent of ERISA plan investors and 44.1 percent of IRAs and non-ERISA plan investors during the first year. Paper disclosures will be mailed to the remaining 48.2 percent of ERISA plan investors and 55.9 percent of IRAs and non-ERISA plan investors. The contract disclosure will be distributed electronically to 51.8 percent of the ERISA plan investors during the first year or during any subsequent year in which the plan investor begins a new advisory relationship. Paper contract disclosures will be mailed to 48.2 percent of ERISA plan investors. The contract will be distributed electronically to 44.1 percent of IRAs and non-ERISA plan participants during the first year or during any subsequent year in which the investor begins a new advisory relationship. Paper contracts will be mailed to 55.9 percent of IRAs and non-ERISA plan investors. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution will cost approximately $2.5 million during the first year and $342,000 during subsequent years. Paper distribution will also require two minutes of clerical time to print and mail the disclosure or contract,[75] resulting in 85,000 hours at an equivalent cost of $4.7 million during the first year and 9,000 hours at an equivalent cost of $508,000 during subsequent years.

The Department estimates that 2.5 million Retirement Investors for ERISA plans, IRAs and non-ERISA plans will receive a two-page annual disclosure during the second year and all subsequent years. The disclosure will be distributed electronically to 51.8 percent of ERISA plan investors and 44.1 percent of IRA holders and non-ERISA plan investors. Paper statements will be mailed to 48.2 percent of ERISA plan investors and 55.9 percent of IRA owners and non-ERISA plan participants. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution will cost approximately $812,000.[76] Paper distribution will also require two minutes of clerical time to print and mail the statement, resulting in 46,000 hours at an equivalent cost of $2.5 million annually.

The Department estimates that Financial Institutions will receive ten requests per year for more detailed principal traded asset information during the second year and all subsequent years. The detailed disclosures will be distributed electronically for 51.8 percent of the ERISA plan investors and 44.1 percent of the IRA holders and non-ERISA plan participants. The Department believes that requests for additional information will be proportionally likely with each Retirement Investor type. Therefore, approximately 34,000 detailed disclosures will be distributed on paper. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution

[75] One commenter questioned the basis for this estimate. The Department worked with clerical staff to determine that most notices and disclosures can be printed and prepared for mailing in less than one minute per disclosure. Therefore, an estimate of two minutes per disclosure is a conservative estimate.

[76] This cost includes $0.05 per page for materials and $0.49 per mailing for postage.

will cost approximately $25,000. Paper distribution will also require two minutes of clerical time to print and mail the statement, resulting in 1,000 hours at an equivalent cost of $62,000 annually.

Overall Summary

Overall, the Department estimates that in order to meet the conditions of this Exemption, Financial Institutions and Advisers will distribute approximately 4.9 million disclosures and contracts during the first year and 3.0 million disclosures and contracts during subsequent years. Distributing these disclosures and contracts will result in a total of 85,000 hours of burden during the first year and 56,000 hours of burden in subsequent years. The equivalent cost of this burden is $4.7 million during the first year and $3.1 million in subsequent years. This exemption will result in an outsourced labor, materials, and postage cost burden of $2.0 billion during the first year and $431.5 million during subsequent years.

These paperwork burden estimates are summarized as follows:

Type of Review: New collection.

Agency: Employee Benefits Security Administration, Department of Labor.

Titles: (1) Prohibited Transaction Exemption for Principal Transactions in Certain Assets between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs and (2) Final Investment Advice Regulation.

OMB Control Number: 1210–0157.

Affected Public: Businesses or other for-profits; not for profit institutions.

Estimated Number of Respondents: 6,075.

Estimated Number of Annual Responses: 4,927,605 during the first year and 3,018,574 during subsequent years.

Frequency of Response: When engaging in exempted transaction; Annually.

Estimated Total Annual Burden Hours: 85,457 hours during the first year and 56,197 hours in subsequent years.

Estimated Total Annual Burden Cost: $1,956,129,694 during the first year and $431,468,619 in subsequent years.

Regulatory Flexibility Act

This exemption, which is issued pursuant to ERISA section 408(a) and Code section 4975(c)(2), is part of a broader rulemaking that includes other exemptions and a final regulation published in today's **Federal Register**. The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) imposes certain requirements with respect to Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act (5 U.S.C. 551 *et seq.*), or any other laws. Unless the head of an agency certifies that a final rule is not likely to have a significant economic impact on a substantial number of small entities, section 604 of the RFA requires that the agency present a final regulatory flexibility analysis (FRFA) describing the rule's impact on small entities and explaining how the agency made its decisions with respect to the application of the rule to small entities.

The Secretary has determined that this rulemaking, including this exemption, will have a significant economic impact on a substantial number of small entities. The Secretary has separately published a Regulatory Impact Analysis (RIA) which contains the complete economic analysis for this rulemaking including the Department's FRFA for the rule and the related prohibited transaction exemptions. This section of this preamble sets forth a summary of the FRFA. The RIA is available at *www.dol.gov/ebsa.*

As noted in section 6.1 of the RIA, the Department has determined that regulatory action is needed to mitigate conflicts of interest in connection with investment advice to Retirement Investors. The Regulation is intended to improve plan and IRA investing to the benefit of retirement security. In response to the proposed rulemaking, organizations representing small businesses submitted comments expressing particular concern with three issues: the carve-out for investment education, the Best Interest Contract Exemption, and the carve-out for persons acting in the capacity of counterparties to plan fiduciaries with financial expertise. Section 2 of the RIA contains an extensive discussion of these concerns and the Department's response.

As discussed in section 6.2 of the RIA, the Small Business Administration (SBA) defines a small business in the Financial Investments and Related Activities Sector as a business with up to $38.5 million in annual receipts. In response to a comment received from the SBA's Office of Advocacy on our Initial Regulatory Flexibility Analysis, the Department contacted the SBA, and received from them a dataset containing data on the number of Financial Institutions by NAICS codes, including the number of Financial Institutions in given revenue categories. This dataset would allow the estimation of the number of Financial Institutions with a given NAICS code that fall below the $38.5 million threshold and therefore be considered small entities by the SBA. However, this dataset alone does not provide a sufficient basis for the Department to estimate the number of small entities affected by the rule. Not all Financial Institutions within a given NAICS code would be affected by this rule, because being an ERISA fiduciary relies on a functional test and is not based on industry status as defined by a NAICS code. Further, not all Financial Institutions within a given NAICS code work with ERISA-covered plans and IRAs.

Over 90 percent of broker-dealers, registered investment advisers, insurance companies, agents, and consultants are small businesses according to the SBA size standards (13 CFR 121.201). Applying the ratio of entities that meet the SBA size standards to the number of affected entities, based on the methodology described at greater length in the RIA, the Department estimates that the number of small entities affected by this rule is 2,438 BDs, 16,521 RIAs, 496 Insurers, and 3,358 other ERISA service providers.

For purposes of the RFA, the Department continues to consider an employee benefit plan with fewer than 100 participants to be a small entity. Further, while some large employers may have small plans, in general small employers maintain most small plans. The definition of small entity considered appropriate for this purpose differs, however, from a definition of small business that is based on size standards promulgated by the SBA. These small pension plans will benefit from the rule, because as a result of the rule, they will receive non-conflicted advice from their fiduciary service providers. The 2013 Form 5500 filings show nearly 595,000 ERISA covered retirement plans with less than 100 participants.

Section 6.5 of the RIA summarizes the projected reporting, recordkeeping, and other compliance costs of the rule and exemptions, which are discussed in detail in section 5 of the RIA. Among other things, the Department concludes that it is likely that some small service providers may find that the increased costs associated with ERISA fiduciary status outweigh the benefits of continuing to service the ERISA plan market or the IRA market. The Department does not believe that this outcome will be widespread or that it will result in a diminution of the amount or quality of advice available to small or other retirement savers, because some Financial Institutions will fill the void and provide services the ERISA plan and IRA market. It is also possible that the economic impact of the rule and exemptions on small entities would not be as significant as it would be for large entities, because anecdotal evidence indicates that small entities do not have as many business arrangements that give rise to conflicts of interest. Therefore, they would not be confronted with the same costs to restructure transactions that would be faced by large entities.

Section 5.3.1 of the RIA includes a discussion of the changes to the proposed rule and exemptions that are intended to reduce the costs affecting both small and large business. These include elimination of data collection and annual disclosure requirements in the Best Interest Contract Exemption, and changes to the implementation of the contract requirement in the exemption. Section 7 of the RIA discusses significant regulatory alternatives considered by the Department and the reasons why they were rejected.

Congressional Review Act

This exemption, along with related exemptions and a final rule published elsewhere in this issue of the **Federal Register**, is part of a rulemaking that is subject to the Congressional Review Act provisions of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801, *et seq.*) and, will be transmitted to Congress and the Comptroller General for review. This rulemaking, including this exemption is treated as a ''major rule'' as that term is defined in 5 U.S.C. 804, because it is likely to result in an annual effect on the economy of $100 million or more.

General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under ERISA section 408(a) and Code section 4975(c)(2) does not relieve a fiduciary or other party in interest or disqualified person with respect to a plan or IRA from certain other provisions of ERISA and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of ERISA section 404 which require, among other things, that a fiduciary act prudently and discharge his or her duties respecting the plan solely in the interests of the participants and beneficiaries of the plan. Additionally, the fact that a transaction is the subject of an exemption does not affect the requirement of Code section 401(a) that the plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries;

(2) The Department finds that the exemption is administratively feasible, in the interests of the plan and of its participants and beneficiaries, and protective of the rights of participants and beneficiaries of the plan;

(3) The exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the exemption; and

(4) The exemption is supplemental to, and not in derogation of, any other provisions of ERISA and the Code, including statutory or administrative exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

Exemption

Section I—Exemption

(a) In general. ERISA and the Internal Revenue Code prohibit fiduciary advisers to employee benefit plans (Plans) and individual retirement plans (IRAs) from self-dealing, including receiving compensation that varies based on their investment recommendations. ERISA and the Code also prohibit fiduciaries from engaging in securities purchases and sales with Plans or IRAs on behalf of their own accounts (Principal Transactions). This exemption permits certain persons who provide investment advice to Retirement Investors (*i.e.,* fiduciaries of Plans, Plan participants or beneficiaries, or IRA owners) to engage in certain Principal Transactions and Riskless Principal Transactions as described below.

(b) Exemption. This exemption permits an Adviser or Financial Institution to engage in the purchase or sale of a Principal Traded Asset in a Principal Transaction or Riskless Principal Transaction with a Plan, participant or beneficiary account, or IRA, and receive a mark-up, mark-down or other similar payment as applicable to the transaction for themselves or any Affiliate, as a result of the Adviser's and Financial Institution's advice regarding the Principal Transaction or Riskless Principal Transaction. As detailed below, Financial Institutions and Advisers seeking to rely on the exemption must acknowledge fiduciary status, adhere to Impartial Conduct Standards in rendering advice, disclose Material Conflicts of Interest associated with Principal Transactions and Riskless Principal Transactions and obtain the consent of the Plan or IRA. In addition, Financial Institutions must adopt certain policies and procedures, including policies and procedures reasonably designed to ensure that individual Advisers adhere to the Impartial Conduct Standards; and retain certain records. This exemption provides relief from ERISA section 406(a)(1)(A) and (D) and section 406(b)(1) and (2), and the taxes imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A), (D), and (E). The Adviser and Financial Institution must comply with the conditions of Sections II–V.

(c) Scope of this exemption: This exemption does not apply if:

(1) The Adviser: (i) Has or exercises any discretionary authority or discretionary control respecting management of the assets of the Plan, participant or beneficiary account, or IRA involved in the transaction or exercises any discretionary authority or control respecting management or the disposition of the assets; or (ii) has any discretionary authority or discretionary responsibility in the administration of the Plan, participant or beneficiary account, or IRA; or

(2) The Plan is covered by Title I of ERISA and (i) the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the Plan, or (ii) the Adviser or Financial Institution is a named fiduciary or plan administrator (as defined in ERISA section 3(16)(A)) with respect to the Plan, or an Affiliate thereof, that was selected to provide investment advice to the plan by a fiduciary who is not Independent.

Section II—Contract, Impartial Conduct, and Other Conditions

The conditions set forth in this section include certain Impartial Conduct Standards, such as a Best Interest standard, that Advisers and Financial Institutions must satisfy to rely on the exemption. In addition, this section requires Financial Institutions to adopt anti-conflict policies and procedures that are reasonably designed to ensure that Advisers adhere to the Impartial Conduct Standards, and requires disclosure of important information about the Principal Transaction or Riskless Principal Transaction. With respect to IRAs and Plans not covered by Title I of ERISA, the Financial Institutions must agree that they and their Advisers will adhere to the exemption's standards in a written contract that is enforceable by the Retirement Investors. To minimize compliance burdens, the exemption provides that the contract terms may be incorporated into account opening documents and similar commonly-used agreements with new customers, and the exemption permits reliance on a negative consent process with respect to existing contract holders. The contract does not need to be executed before the provision of advice to the Retirement Investor to engage in a Principal Transaction or Riskless Principal Transaction. However, the contract must cover any advice given prior to the contract date in order for the exemption to apply to such advice. There is no contract requirement for recommendations to Retirement Investors about investments in Plans covered by Title I of ERISA, but the Impartial Conduct Standards and other requirements of Section II(b)–(e) must be satisfied in order for relief to be available under the exemption, as set forth in Section II(g). Section II(a) imposes the following conditions on Financial Institutions and Advisers:

(a) Contracts with Respect to Principal Transactions and Riskless Principal Transactions Involving IRAs and Plans Not Covered by Title I of ERISA. If the investment advice resulting in the Principal Transaction or Riskless Principal Transaction concerns an IRA or a Plan that is not covered by Title I, the advice is subject to an enforceable written contract on the part of the Financial Institution, which may be a master contract covering multiple recommendations, that is entered into in accordance with this Section II(a) and incorporates the terms set forth in Section II(b)–(d). The Financial Institution additionally must provide the disclosures required by Section II(e). The contract must cover advice rendered prior to the execution of the contract in order for the exemption to apply to such advice and related compensation.

(1) Contract Execution and Assent.

(i) New Contracts. Prior to or at the same time as the execution of the Principal Transaction or Riskless Principal Transaction, the Financial Institution enters into a written contract with the Retirement Investor acting on behalf of the Plan, participant or beneficiary account, or IRA, incorporating the terms required by Section II(b)–(d). The terms of the contract may appear in a standalone document or they may be incorporated into an investment advisory agreement, investment program agreement, account opening agreement, insurance or annuity contract or application, or similar document, or amendment thereto. The contract must be enforceable against the Financial Institution. The Retirement Investor's assent to the contract may be evidenced by handwritten or electronic signatures.

(ii) Amendment of Existing Contracts by Negative Consent. As an alternative to executing a contract in the manner set forth in the preceding paragraph, the Financial Institution may amend Existing Contracts to include the terms required in Section II(b)–(d) by delivering the proposed amendment and the disclosure required by Section II(e) to the Retirement Investor prior to January 1, 2018, and considering the failure to terminate the amended contract within 30 days as assent. An Existing Contract is an investment advisory agreement, investment program agreement, account opening agreement, insurance contract, annuity contract, or similar agreement or contract that was executed before January 1, 2018, and remains in effect. If the Financial Institution elects to use the negative consent procedure, it may deliver the proposed amendment by mail or electronically, provided such means is reasonably calculated to result in the Retirement Investor's receipt of the proposed amendment, but it may not impose any new contractual obligations, restrictions, or liabilities on the Retirement Investor by negative consent.

(2) Notice. The Financial Institution maintains an electronic copy of the Retirement Investor's contract on the Financial Institution's Web site that is accessible by the Retirement Investor.

(b) Fiduciary. The Financial Institution affirmatively states in writing that the Financial Institution and the Adviser(s) act as fiduciaries under ERISA or the Code, or both, with respect to any investment advice regarding Principal Transactions and Riskless Principal Transactions provided by the Financial Institution or the Adviser subject to the contract, or in the case of an ERISA Plan, with respect to any investment advice regarding Principal Transactions and Riskless Principal Transactions between the Financial Institution and the Plan or participant or beneficiary account.

(c) Impartial Conduct Standards. The Financial Institution states that it and its Advisers agree to adhere to the following standards and, they in fact, comply with the standards:

(1) When providing investment advice to a Retirement Investor regarding the Principal Transaction or Riskless Principal Transaction, the Financial Institution and Adviser provide investment advice that is, at the time of the recommendation, in the Best Interest of the Retirement Investor. As further defined in Section VI(c), such advice reflects 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 Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution, or any Affiliate or other party;

(2) The Adviser and Financial Institution seek to obtain the best execution reasonably available under the circumstances with respect to the Principal Transaction or Riskless Principal Transaction.

(i) Financial Institutions that are FINRA members shall satisfy this Section II(c)(2) if they comply with the terms of FINRA rules 2121 (Fair Prices and Commissions) and 5310 (Best Execution and Interpositioning), or any successor rules in effect at the time of the transaction, as interpreted by FINRA, with respect to the Principal Transaction or Riskless Principal Transaction.

(ii) The Department may identify specific requirements regarding best execution and/or fair prices imposed by another regulator or self-regulatory organization relating to additional Principal Traded Assets pursuant to Section VI(j)(1)(iv) in an individual exemption that may be satisfied as an alternative to the standard set forth in Section II(c)(2) above.

(3) Statements by the Financial Institution and its Advisers to the Retirement Investor about the Principal Transaction or Riskless Principal Transaction, fees and compensation related to the Principal Transaction or Riskless Principal Transaction, Material Conflicts of Interest, and any other matters relevant to a Retirement Investor's decision to engage in the Principal Transaction or Riskless Principal Transaction, will not be materially misleading at the time they are made.

(d) Warranty. The Financial Institution affirmatively warrants, and in fact complies with, the following:

(1) The Financial Institution has adopted and will comply with written policies and procedures reasonably and prudently designed to ensure that its individual Advisers adhere to the Impartial Conduct Standards set forth in Section II(c);

(2) In formulating its policies and procedures, the Financial Institution has specifically identified and documented its Material Conflicts of Interest associated with Principal Transactions and Riskless Principal Transactions;

adopted measures reasonably and prudently designed to prevent Material Conflicts of Interest from causing violations of the Impartial Conduct Standards set forth in Section II(c); and designated a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards;

(3) The Financial Institution's policies and procedures require that neither the Financial Institution nor (to the best of the Financial Institution's knowledge) any Affiliate uses or relies on quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended or would reasonably be expected to cause individual Advisers to make recommendations regarding Principal Transactions and Riskless Principal Transactions that are not in the Best Interest of the Retirement Investor. Notwithstanding the foregoing, the requirement of this Section II(d)(3) does not prevent the Financial Institution or its Affiliates from providing Advisers with differential compensation (whether in type or amount, and including, but not limited to, commissions) based on investment decisions by Plans, participant or beneficiary accounts, or IRAs, to the extent that the policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of Advisers with the interests of the Retirement Investors they serve as fiduciaries;

(4) The Financial Institution's written policies and procedures regarding Principal Transactions and Riskless Principal Transactions address how credit risk and liquidity assessments for Debt Securities, as required by Section III(a)(3), will be made.

(e) Transaction Disclosures. In the contract, or in a separate single written disclosure provided to the Retirement Investor or Plan prior to or at the same time as the execution of the Principal Transaction or Riskless Principal Transaction, the Financial Institution clearly and prominently:

(1) Sets forth in writing (i) the circumstances under which the Adviser and Financial Institution may engage in Principal Transactions and Riskless Principal Transactions with the Plan, participant or beneficiary account, or IRA, (ii) a description of the types of compensation that may be received by the Adviser and Financial Institution in connection with Principal Transactions and Riskless Principal Transactions, including any types of compensation that may be received from third parties, and (iii) identifies and discloses the Material Conflicts of Interest associated with Principal Transactions and Riskless Principal Transactions;

(2) Except for Existing Contracts, documents the Retirement Investor's affirmative written consent, on a prospective basis, to Principal Transactions and Riskless Principal Transactions between the Adviser or Financial Institution and the Plan, participant or beneficiary account, or IRA;

(3) Informs the Retirement Investor (i) that the consent set forth in Section II(e)(2) is terminable at will upon written notice by the Retirement Investor at any time, without penalty to the Plan or IRA, (ii) of the right to obtain, free of charge, copies of the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d), as well as information about the Principal Traded Asset, including its purchase or sales price, and other salient attributes, including, as applicable: The credit quality of the issuer; the effective yield; the call provisions; and the duration, provided that if the Retirement Investor's request is made prior to the transaction, the information must be provided prior to the transaction, and if the request is made after the transaction, the information must be provided within 30 business days after the request, (iii) that model contract disclosures or other model notice of the contractual terms which are reviewed for accuracy no less than quarterly and updated within 30 days as necessary are maintained on the Financial Institution's Web site, and (iv) that the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d) is available free of charge on the Financial Institution's Web site; and

(4) Describes whether or not the Adviser and Financial Institution will monitor the Retirement Investor's investments that are acquired through Principal Transactions and Riskless Principal Transactions and alert the Retirement Investor to any recommended change to those investments and, if so, the frequency with which the monitoring will occur and the reasons for which the Retirement Investor will be alerted.

(5) The Financial Institution will not fail to satisfy this Section II(e), or violate a contractual provision based thereon, solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, or if the Web site is temporarily inaccessible, provided that (i) in the case of an error or omission on the web, the Financial Institution discloses the correct information as soon as practicable, but not later than 7 days after the date on which it discovers or reasonably should have discovered the error or omission, and (ii) in the case of other disclosures, the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. To the extent compliance with this requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

(f) Ineligible Contractual Provisions. Relief is not available under the exemption if a Financial Institution's contract contains the following:

(1) Exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms;

(2) Except as provided in paragraph (f)(4) of this section, a provision under which the Plan, IRA or the Retirement Investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution, or in an individual or class claim agrees to an amount representing liquidated damages for breach of the contract; provided that, the parties may knowingly agree to waive the Retirement Investor's right to obtain punitive damages or rescission of recommended transactions to the extent such a waiver is permissible under applicable state or federal law; or

(3) Agreements to arbitrate or mediate individual claims in venues that are distant or that otherwise unreasonably limit the ability of the Retirement

Investors to assert the claims safeguarded by this exemption.

(4) In the event provision on pre-dispute arbitration agreements for class or representative claims in paragraph (f)(2) of this section is ruled invalid by a court of competent jurisdiction, this provision shall not be a condition of this exemption with respect to contracts subject to the court's jurisdiction unless and until the court's decision is reversed, but all other terms of the exemption shall remain in effect.

(g) ERISA Plans. For recommendations to Retirement Investors regarding Principal Transactions and Riskless Principal Transactions with Plans that are covered by Title I of ERISA, relief under the exemption is conditioned upon the Adviser and Financial Institution complying with certain provisions of Section II, as follows:

(1) Prior to or at the same time as the execution of the Principal Transaction or Riskless Principal Transaction, the Financial Institution provides the Retirement Investor with a written statement of the Financial Institution's and its Advisers' fiduciary status, in accordance with Section II(b).

(2) The Financial Institution and the Adviser comply with the Impartial Conduct Standards of Section II(c).

(3) The Financial Institution adopts policies and procedures incorporating the requirements and prohibitions set forth in Section II(d)(1)-(4), and the Financial Institution and Adviser comply with those requirements and prohibitions.

(4) The Financial Institution provides the disclosures required by Section II(e).

(5) The Financial Institution and Adviser do not in any contract, instrument, or communication purport to disclaim any responsibility or liability for any responsibility, obligation, or duty under Title I of ERISA to the extent the disclaimer would be prohibited by ERISA section 410, waive or qualify the right of the Retirement Investor to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution, or require arbitration or mediation of individual claims in locations that are distant or that otherwise unreasonably limit the ability of the Retirement Investors to assert the claims safeguarded by this exemption.

Section III—General Conditions

The Adviser and Financial Institution must satisfy the following conditions to be covered by this exemption:

(a) Debt Security Conditions. Solely with respect to the purchase of a Debt Security by a Plan, participant or beneficiary account, or IRA:

(1) The Debt Security being purchased was not issued by the Financial Institution or any Affiliate;

(2) The Debt Security being purchased is not purchased by the Plan, participant or beneficiary account, or IRA in an underwriting or underwriting syndicate in which the Financial Institution or any Affiliate is an underwriter or a member;

(3) Using information reasonably available to the Adviser at the time of the transaction, the Adviser determines that the Debt Security being purchased:

(i) Possesses no greater than a moderate credit risk; and

(ii) Is sufficiently liquid that the Debt Security could be sold at or near its carrying value within a reasonably short period of time.

(b) Arrangement. The Principal Transaction or Riskless Principal Transaction is not part of an agreement, arrangement, or understanding designed to evade compliance with ERISA or the Code, or to otherwise impact the value of the Principal Traded Asset.

(c) Cash. The purchase or sale of the Principal Traded Asset is for cash.

Section IV—Disclosure Requirements

This section sets forth the Adviser's and the Financial Institution's disclosure obligations to the Retirement Investor.

(a) Pre-Transaction Disclosure. Prior to or at the same time as the execution of the Principal Transaction or Riskless Principal Transaction, the Adviser or the Financial Institution informs the Retirement Investor, orally or in writing, of the capacity in which the Financial Institution may act with respect to such transaction.

(b) Confirmation. The Adviser or the Financial Institution provides a written confirmation of the Principal Transaction or Riskless Principal Transaction. This requirement may be satisfied by compliance with Rule 10b–10 under the Securities Exchange Act of 1934, or any successor rule in effect at the time of the transaction, or for Advisers and Financial Institutions not subject to the Securities Exchange Act of 1934, similar requirements imposed by another regulator or self-regulatory organization.

(c) Annual Disclosure. The Adviser or the Financial Institution sends to the Retirement Investor, no less frequently than annually, written disclosure in a single disclosure:

(1) A list identifying each Principal Transaction and Riskless Principal Transaction executed in the Retirement Investor's account in reliance on this exemption during the applicable period and the date and price at which the transaction occurred; and

(2) A statement that (i) the consent required pursuant to Section II(e)(2) is terminable at will upon written notice, without penalty to the Plan or IRA, (ii) the right of a Retirement Investor in accordance with Section II(e)(3)(ii) to obtain, free of charge, information about the Principal Traded Asset, including its salient attributes, (iii) model contract disclosures or other model notice of the contractual terms, which are reviewed for accuracy no less frequently than quarterly and updated within 30 days if necessary, are maintained on the Financial Institution's Web site, and (iv) the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d) are available free of charge on the Financial Institution's Web site.

(d) The Financial Institution will not fail to satisfy this Section IV solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, or if the Web site is temporarily inaccessible, provided that (i) in the case of an error or omission on the web, the Financial Institution discloses the correct information as soon as practicable, but not later than 7 days after the date on which it discovers or reasonably should have discovered the error or omission, and (ii) in the case of other disclosures, the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. To the extent compliance with the disclosure requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, the exemption provides that they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

(e) The Financial Institution prepares a written description of its policies and procedures and makes it available on its Web site and additionally, to Retirement Investors, free of charge, upon request. The description must accurately describe or summarize key components of the policies and procedures relating to conflict-mitigation and incentive practices in a manner that permits Retirement Investors to make an informed judgment about the stringency of the Financial Institution's protections against conflicts of interest. Additionally, Financial Institutions must provide their complete policies and procedures to the Department upon request.

Section V—Recordkeeping

This section establishes record retention and availability requirements that a Financial Institution must meet in order for it to rely on the exemption.

(a) The Financial Institution maintains for a period of six (6) years from the date of each Principal Transaction or Riskless Principal Transaction, in a manner that is reasonably accessible for examination, the records necessary to enable the persons described in Section V(b) to determine whether the conditions of this exemption have been met, except that:

(1) If such records are lost or destroyed, due to circumstances beyond the control of the Financial Institution, then no prohibited transaction will be considered to have occurred solely on the basis of the unavailability of those records; and

(2) No party other than the Financial Institution that is engaging in the Principal Transaction or Riskless Principal Transaction shall be subject to the civil penalty that may be assessed under ERISA section 502(i) or to the taxes imposed by Code sections 4975(a) and (b) if the records are not maintained or are not available for examination as required by Section V(b).

(b)(1) Except as provided in Section V(b)(2) or as precluded by 12 U.S.C. 484, and notwithstanding any provisions of ERISA sections 504(a)(2) and 504(b), the records referred to in Section V(a) are reasonably available at their customary location for examination during normal business hours by:

(i) Any duly authorized employee or representative of the Department or the Internal Revenue Service;

(ii) any fiduciary of the Plan or IRA that was a party to a Principal Transaction or Riskless Principal Transaction described in this exemption, or any duly authorized employee or representative of such fiduciary;

(iii) any employer of participants and beneficiaries and any employee organization whose members are covered by the Plan, or any authorized employee or representative of these entities; and

(iv) any participant or beneficiary of the Plan, or the beneficial owner of an IRA.

(2) None of the persons described in subparagraph (1)(ii) through (iv) are authorized to examine records regarding a Prohibited Transaction involving another Retirement Investor, or trade secrets of the Financial Institution, or commercial or financial information which is privileged or confidential; and

(3) Should the Financial Institution refuse to disclose information on the basis that such information is exempt from disclosure, the Financial Institution must by the close of the thirtieth (30th) day following the request, provide a written notice advising the requestor of the reasons for the refusal and that the Department may request such information.

(4) Failure to maintain the required records necessary to determine whether the conditions of this exemption have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions.

Section VI—Definitions

For purposes of this exemption:

(a) ''Adviser'' means an individual who:

(1) Is a fiduciary of a Plan or IRA solely by reason of the provision of investment advice described in ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B), or both, and the applicable regulations, with respect to the Assets involved in the transaction;

(2) Is an employee, independent contractor, agent, or registered representative of a Financial Institution; and

(3) Satisfies the applicable federal and state regulatory and licensing requirements of banking, and securities laws with respect to the covered transaction.

(b) ''Affiliate'' of an Adviser or Financial Institution means:

(1) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution. For this purpose, the term ''control'' means the power to exercise a controlling influence over the management or policies of a person other than an individual;

(2) Any officer, director, partner, employee, or relative (as defined in ERISA section 3(15)) of the Adviser or Financial Institution; or

(3) Any corporation or partnership of which the Adviser or Financial Institution is an officer, director, or partner of the Adviser or Financial Institution.

(c) Investment advice is in the ''Best Interest'' of the Retirement Investor when the Adviser and Financial Institution providing the advice act 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 Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution, any Affiliate or other party.

(d) ''Debt Security'' means a ''debt security'' as defined in Rule 10b–10(d)(4) of the Exchange Act that is:

(1) U.S. dollar denominated, issued by a U.S. corporation and offered pursuant to a registration statement under the Securities Act of 1933;

(2) An ''Agency Debt Security'' as defined in FINRA rule 6710(l) or its successor;

(3) An ''Asset Backed Security'' as defined in FINRA rule 6710(m) or its successor, that is guaranteed by an Agency as defined in FINRA rule 6710(k) or its successor, or a Government Sponsored Enterprise as defined in FINRA rule 6710(n) or its successor; or

(4) A ''U.S. Treasury Security'' as defined in FINRA rule 6710(p) or its successor.

(e) ''Financial Institution'' means the entity that (i) employs the Adviser or otherwise retains such individual as an independent contractor, agent or registered representative, and (ii) customarily purchases or sells Principal Traded Assets for its own account in the ordinary course of its business, and that is:

(1) Registered as an investment adviser under the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 *et seq.*) or under the laws of the state in which the adviser maintains its principal office and place of business;

(2) A bank or similar financial institution supervised by the United States or state, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1))); and

(3) A broker or dealer registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(f) ''Independent'' means a person that:

(1) Is not the Adviser or Financial Institution or an Affiliate;

(2) Does not receive or is not projected to receive within the current federal income tax year, compensation or other consideration for his or her own account from the Adviser, Financial Institution or an Affiliate in excess of 2% of the person's annual revenues based upon its prior income tax year; and

(3) Does not have a relationship to or an interest in the Adviser, Financial Institution or an Affiliate that might affect the exercise of the person's best judgment in connection with transactions described in this exemption.

(g) ''Individual Retirement Account'' or ''IRA'' means any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in Code section 408(a) and a health savings account described in Code section 223(d).

(h) A ''Material Conflict of Interest'' exists when an Adviser or Financial Institution 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 a Retirement Investor.

(i) ''Plan'' means an employee benefit plan described in ERISA section 3(3) and any plan described in Code section 4975(e)(1)(A).

(j) ''Principal Traded Asset'' means:

(1) For purposes of a purchase by a Plan, participant or beneficiary account, or IRA,

(i) a Debt Security, as defined in subsection (d) above;

(ii) a certificate of deposit (CD);

(iii) an interest in a Unit Investment Trust, within the meaning of Section 4(2) of the Investment Company Act of 1940, as amended; or

(iv) an investment that is permitted to be purchased under an individual exemption granted by the Department under ERISA section 408(a) and/or Code section 4975(c), after the effective date of this exemption, that provides relief for investment advice fiduciaries to engage in the purchase of the investment in a Principal Transaction or a Riskless Principal Transaction with a Plan or IRA under the same conditions as this exemption; and

(2) for purposes of a sale by a Plan, participant or beneficiary account, or IRA, securities or other investment property.

(k) ''Principal Transaction'' means a purchase or sale of a Principal Traded Asset in which an Adviser or Financial Institution is purchasing from or selling to a Plan, participant or beneficiary account, or IRA on behalf of the Financial Institution's own account or the account of a person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Financial Institution. For purposes of this definition, a Principal Transaction does not include a Riskless Principal Transaction as defined in Section VI(m).

(l) ''Retirement Investor'' means:

(1) A fiduciary of a non-participant directed Plan subject to Title I of ERISA or described in Code section 4975(c)(1)(A) with authority to make investment decisions for the Plan;

(2) A participant or beneficiary of a Plan subject to Title I of ERISA or described in Code section 4975(c)(1)(A) with authority to direct the investment of assets in his or her Plan account or to take a distribution; or

(3) The beneficial owner of an IRA acting on behalf of the IRA.

(m) ''Riskless Principal Transaction'' means a transaction in which a Financial Institution, after having received an order from a Retirement Investor to buy or sell a Principal Traded Asset, purchases or sells the asset for the Financial Institution's own account to offset the contemporaneous transaction with the Retirement Investor.

Section VII—Transition Period for Exemption

(a) In general. ERISA and the Internal Revenue Code prohibit fiduciary advisers to employee benefit plans (Plans) and individual retirement plans (IRAs) from receiving compensation that varies based on their investment recommendations. ERISA and the Code also prohibit fiduciaries from engaging in securities purchases and sales with Plans or IRAs on behalf of their own accounts (Principal Transactions). This transition period provides relief from the restrictions of ERISA section 406(a)(1)(A) and (D) and section 406(b)(1) and (2), and the taxes imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A), (D), and (E) for the period from April 10, 2017, to January 1, 2018 (the Transition Period) for Advisers and Financial Institutions to engage in certain Principal Transactions and Riskless Principal Transactions with Plans and IRAs subject to the conditions described in Section VII(d).

(b) Covered transactions. This provision permits an Adviser or Financial Institution to engage in the purchase or sale of a Principal Traded Asset in a Principal Transaction or a Riskless Principal Transaction with a Plan, participant or beneficiary account, or IRA, and receive a mark-up, mark-down or other similar payment as applicable to the transaction for themselves or any Affiliate, as a result of the Adviser's and Financial Institution's advice regarding the Principal Transaction or the Riskless Principal Transaction, during the Transition Period.

(c) Exclusions. This provision does not apply if:

(1) The Adviser: (i) Has or exercises any discretionary authority or discretionary control respecting management of the assets of the Plan or IRA involved in the transaction or exercises any discretionary authority or control respecting management or the disposition of the assets; or (ii) has any discretionary authority or discretionary responsibility in the administration of the Plan or IRA; or

(2) The Plan is covered by Title I of ERISA, and (i) the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the Plan, or (ii) the Adviser or Financial Institution is a named fiduciary or plan administrator (as defined in ERISA section 3(16)(A)) with respect to the Plan, or an Affiliate thereof, that was selected to provide advice to the Plan by a fiduciary who is not Independent;

(d) Conditions. The provision is subject to the following conditions:

(1) The Financial Institution and Adviser adhere to the following standards:

(i) When providing investment advice to the Retirement Investor regarding the Principal Transaction or Riskless Principal Transaction, the Financial Institution and the Adviser(s) provide investment advice that is, at the time of the recommendation, in the Best Interest of the Retirement Investor. As further defined in Section VI(c), such advice reflects 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 Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate or other party;

(ii) The Adviser and Financial Institution will seek to obtain the best execution reasonably available under the circumstances with respect to the

Principal Transaction or Riskless Principal Transaction. Financial Institutions that are FINRA members shall satisfy this requirement if they comply with the terms of FINRA rules 2121 (Fair Prices and Commissions) and 5310 (Best Execution and Interpositioning), or any successor rules in effect at the time of the transaction, as interpreted by FINRA, with respect to the Principal Transaction or Riskless Principal Transaction; and

(iii) Statements by the Financial Institution and its Advisers to the Retirement Investor about the Principal Transaction or Riskless Principal Transaction, fees and compensation related to the Principal Transaction or Riskless Principal Transaction, Material Conflicts of Interest, and any other matters relevant to a Retirement Investor's decision to engage in the Principal Transaction or Riskless Principal Transaction, are not materially misleading at the time they are made.

(2) Disclosures. The Financial Institution provides to the Retirement Investor, prior to or at the same time as the execution of the recommended Principal Transaction or Riskless Principal Transaction, a single written disclosure, which may cover multiple transactions or all transactions occurring within the Transition Period, that clearly and prominently:

(i) Affirmatively states that the Financial Institution and the Adviser(s) act as fiduciaries under ERISA or the Code, or both, with respect to the recommendation;

(ii) Sets forth the standards in paragraph (d)(1) of this section and affirmatively states that it and the Adviser(s) adhered to such standards in recommending the transaction; and

(iii) Discloses the circumstances under which the Adviser and Financial Institution may engage in Principal Transactions and Riskless Principal Transactions with the Plan, participant or beneficiary account, or IRA, and identifies and discloses the Material Conflicts of Interest associated with Principal Transactions and Riskless Principal Transactions.

(iv) The disclosure may be provided in person, electronically or by mail. It does not have to be repeated for any subsequent recommendations during the Transition Period.

(v) The Financial Institution will not fail to satisfy this Section VII(d)(2) solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, provided the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. To the extent compliance with this Section VII(d)(2) requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know, or unless they should have known, that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

(3) The Financial Institution must designate a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards.

(4) The Financial Institution complies with the recordkeeping requirements of Section V(a) and (b).

Signed at Washington, DC, this 1st day of April, 2016.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

[FR Doc. 2016–07926 Filed 4–6–16; 11:15 am]

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DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

[Application Number D–11687]

ZRIN 1210–ZA25

Amendment to Prohibited Transaction Exemption (PTE) 75–1, Part V, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks

AGENCY: Employee Benefits Security Administration (EBSA), U.S. Department of Labor.

ACTION: Adoption of amendment to PTE 75–1, Part V.

SUMMARY: This document contains an amendment to PTE 75–1, Part V, a class exemption from certain prohibited transactions provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (the Code). The provisions at issue generally prohibit fiduciaries of employee benefit plans and individual retirement accounts (IRAs), from lending money or otherwise extending credit to the plans and IRAs and receiving compensation in return. PTE 75–1, Part V, permits the extension of credit to a plan or IRA by a broker-dealer in connection with the purchase or sale of securities; however, it originally did not permit the receipt of compensation for an extension of credit by broker-dealers that are fiduciaries with respect to the assets involved in the transaction. This amendment permits investment advice fiduciaries to receive compensation when they extend credit to plans and IRAs to avoid a failed securities transaction. The amendment affects participants and beneficiaries of plans, IRA owners, and fiduciaries with respect to such plans and IRAs.

DATES: *Issuance date:* This amendment is issued June 7, 2016.

Applicability date: This amendment is applicable to transactions occurring on or after April 10, 2017. See *Applicability Date,* below, for further information.

FOR FURTHER INFORMATION CONTACT: Susan Wilker, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor, (202) 693–8824 (this is not a toll-free number).

SUPPLEMENTARY INFORMATION: The Department is amending PTE 75–1, Part V on its own motion, pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (76 FR 66637 (October 27, 2011)).

Executive Summary

Purpose of Regulatory Action

The Department grants this amendment to PTE 75–1, Part V, in connection with its publication today, elsewhere in this issue of the **Federal Register**, of a final regulation defining who is a ''fiduciary'' of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries (Regulation). The Regulation also applies to the definition of a ''fiduciary'' of a plan (including an IRA) under the