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Department of Labor Extends Transition Period for Prohibited Transaction Exemptions Related to Its ERISA Fiduciary Rule

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On November 29, 2017, the Department of Labor (the "DOL") extended the Transition Period for certain prohibited transaction exemptions related to its Fiduciary Rule under the Employee Retirement Income Security Act of 1974 ("ERISA"), including the Best Interest Contract Exemption ("BIC Exemption"), the Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs ("PTE Exemption"), and amendments to Prohibited Transaction Exemption 84-24 ("PTE 84-24"). The Transition Period, which was set to end January 1, 2018, will now end eighteen months later on July 1, 2019.[1]

Fiduciary Rule & Related Exemptions
Under Section 3(21)(A)(ii) of ERISA, a person is a fiduciary "with respect to a plan to the extent... he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan..." For regulatory purposes, the DOL established a five-part test in 1975 to determine whether a person is a fiduciary under ERISA. In the more than 40 years since the DOL established that test, the world of retirement plans has changed dramatically. Instead of offering traditional pension plans, most employers now offer individual account plans such as profit-sharing and/or 401(k) plans. Moreover, participants in today's retirement plans usually have the responsibility to make their own investment decisions, and when they leave employment they must choose whether to leave their money in their former employer's plan, roll the money over to another plan or IRA, or take a taxable distribution. Because of these changes, the DOL felt that the five-part test was outdated, and therefore replaced it by issuing a new rule in April 2016 that established a new regulatory definition of fiduciary (the "Fiduciary Rule").

Pursuant to the Fiduciary Rule, a person is a fiduciary of an employee benefit plan for purposes of ERISA "as a result of giving investment advice to a plan or its participants or beneficiaries for a fee or other compensation."[2] In general, any recommendation to a retirement plan, a plan participant or beneficiary, or an IRA or IRA owner to buy, hold, sell or exchange securities or investment property of a retirement plan or IRA is considered "investment advice" under the Fiduciary Rule.[3] "Investment advice" includes a recommendation to take a distribution from a plan or IRA, to do a rollover or transfer from a plan or IRA, or how to invest the proceeds of such a distribution, rollover or transfer. The intent and effect of the Fiduciary Rule was to significantly expand the scope of advice that would make someone a "fiduciary" under ERISA.

By expanding the scope of advice that would be considered fiduciary advice under ERISA, the Fiduciary Rule also expanded the scope of relationships that would be considered prohibited transactions under ERISA absent an exemption. Therefore, along with the Fiduciary Rule, the DOL amended PTE 84-24 and created two new administrative exemptions—the BIC Exemption and the PTE Exemption—from ERISA's prohibited transaction rules.[4]

Postponed Applicability Date and Transition Period
The DOL initially intended for the Fiduciary Rule and related exemption changes to be applicable on April 10, 2017. However, a February 3, 2017 Presidential Memorandum directed the DOL to further review the implications of the administrative changes regarding fiduciaries. This prompted the DOL to solicit comments regarding the applicability date of the Fiduciary Rule and related exemption changes. Subsequently, the DOL delayed the applicability date of the Fiduciary Rule by sixty days and sought comments for review.

Although the Fiduciary Rule and related exemption changes became applicable on June 9, 2017, the DOL instituted a Transition Period during which the exemption requirements would be softened. During the Transition Period, the DOL generally considers its new exemptions to be satisfied if financial institutions and advisers follow the Fiduciary Rule's "Impartial Conduct Standards." These standards require that financial institutions and advisers give advice in the best interest of retirement investors, charge no more than reasonable compensation, and abstain from making misleading statements.

Prior to this most recent extension, the DOL designated January 1, 2018 as the Transition Period end date. The new DOL guidance, however, provided another extension to the Transition Period, which is now set to run until July 1, 2019. This means that financial institutions and advisers have eighteen more months to rely on the relaxed exemption standards of the Impartial Conduct Standards under the Fiduciary Rule.

The Exemptions After the Transition Period
The future of the BIC Exemption, PTE Exemption, and amendments to PTE 84-24 after the Transition Period is uncertain. The DOL is using the Transition Period to contemplate its options based on comments it has received over the past several months.

Though the exemptions are subject to change, the DOL provided guidance as to what the prohibited transaction exemption requirements may entail after the Transition Period. To comply with the BIC Exemption when providing advice to IRA owners, financial institutions will need to:

1. enter a contract with retirement investors that includes a promise to follow Impartial Conduct Standards, an acknowledgment of fiduciary status, and various disclosures;
2. implement policies and procedures ensuring that Impartial Conduct Standards are followed and that there are not incentives to entice advisors to give advice that is not in the best interest of retirement investors; and
3. warrant that the financial institution has implemented and will follow the required policies and procedures.

The PTE Exemption "permits investment advice fiduciaries to sell to or purchase from plans or IRAs 'principal traded assets' through 'principal transactions' and 'riskless principal transactions'—transactions involving the sale from or purchase for the Financial Institution's own inventory."[5] The PTE Exemption will require the contract, policy and procedures, and warranty needed for the BIC exemption as discussed above. Compliance will also entail standards for debt securities sold to plans and IRAs as well as related disclosures.

PTE 84-24 applies to fiduciary advisor transactions with plans and IRAs related to insurance contracts and annuities as well as mutual fund shares. The amendment regarding Impartial Conduct Standards was applicable as of July 9, 2017, but the various remaining PTE 84-24 amendments will not be applicable until July 1, 2019.

Implications of the Transition Period Extension

Though the DOL's guidance issued on November 29 did not make substantive changes to the Fiduciary Rule or the related exemptions, there are two significant take-aways. First, financial institutions and advisors should consider policies and procedures to comply with the Impartial Conduct Standards through the Transition Period. Second, financial institutions and advisors will need to keep the Fiduciary Rule and related exemptions on their radar as the DOL establishes final exemptions.

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[1] 18-Month Extension of Transaction Period and Delay of Applicability Dates; Best Interest Contract Exemption (PE 2016-01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (PTE 2016-02); Prohibited Transaction Exemption 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters (PTE 64-24), 82 Fed. Reg. 56545â€“48 (Nov. 29, 2017) (to be codified at 29 C.F.R. pt. 2550) [hereinafter *November Rule*].

[2] *Id*. at 56545.

[3] Although IRAs are not covered by ERISA, the Internal Revenue Code ("Code") has prohibited transaction rules that are nearly identical to those found in ERISA. Moreover, the DOL has rulemaking authority with respect to the Code's prohibited transaction provisions. The Fiduciary Rule therefore applies to certain non-ERISA arrangements, such as traditional IRAs, Roth IRAs and health savings accounts.

[4] Prohibited transactions include various types of transactions between employee benefit plans and a "party in interest." *See* 29 U.S.C. § 1106.

[5] *November Rule*, at 56547.
