DOL Conflict of Interest Rule Considerations

Complying With the Best Interest Contract Exemption

Under the Department of Labor (DOL) Conflict of Interest rule, any advisor who provides investment advice for a retirement account will likely need to rely on the new Best Interest Contract Exemption to conduct and get paid for retirement business.

The Best Interest Contract Exemption is a component of the regulatory package that aligns individual advisors’ interests with those of the retirement plan or IRA investor, while leaving the advisor and firm flexibility in designing a business model that best serves their retirement clients. Rollover recommendations in particular, which are now characterized as fiduciary investment advice, will require advisors to comply with the Best Interest Contract Exemption.

Specifically, the Best Interest Contract Exemption allows firms to continue to use certain compensation arrangements that might otherwise be forbidden so long as they, among other things:

› Commit to putting their client’s best interest first,
› Adopt anti-conflict policies and procedures (including avoiding certain incentive practices), and
› Disclose any conflicts of interest that could affect their best judgment as a fiduciary rendering advice.

Many traditional forms of advisor compensation—including commissions and the receipt of 12b-1 fees in connection with mutual fund transactions—represent prohibited sources of revenue that create fiduciary conflict, unless a prohibited transaction exemption is available to permit the receipt of those payments. One purpose of the Best Interest Contract Exemption is to exempt the receipt of commissions, 12b-1 fees and other forms of third-party compensation received in connection with rollover recommendations and other forms of investment advice to plan participants and IRA holders.

In collaboration with Thomas Roberts, a member of Groom Law Group’s Fiduciary practice group

Rollover recommendations in particular, which are now characterized as fiduciary investment advice, will require advisors to comply with the Best Interest Contract Exemption.

This guide is part of a series that provides a framework for analyzing the impact of the DOL’s Conflict of Interest rule. It contains a high-level overview of the Best Interest Contract Exemption.

The Conflict of Interest rule contains very specific conditions. This document is a broad overview of considerations to help you get started. Review the full scope of the rule at http://www.dol.gov/ebsa/regs/conflictsofinterest.html.

For professional use only. Not for distribution to the public.
Best Interest Contract Exemption requirements

According to the DOL, the Best Interest Contract Exemption will allow firms to continue to set their own compensation practices as long as they, among other things, commit to putting their client’s best interest first—and disclose any conflicts that may prevent them from doing so. Broker-dealers and registered investment advisors need to consider how they will comply with the Best Interest Contract Exemption. In most cases, firms will need to disclose very specific information in a mutual contract with retirement investors beginning on January 1, 2018.

The Best Interest Contract may be a stand-alone document, or it may be incorporated into another agreement between the investor and the firm. Some of the key items firms will need to disclose to retirement investors:

1. State the Best Interest standard that will be provided by the firm and advisor
2. Inform investors of the services that will be provided by the firm and advisor
3. Explain how investors will pay for services, directly or through third-party payments
4. Describe material conflicts of interest, including any fees or charges the firm, its affiliates or the advisor will charge investors or their retirement accounts—and the types of compensation that the firm, its affiliates, and the advisor expect to receive from third parties in connection with investment recommendations
5. Inform investors that they have the right to obtain copies of the firm’s written description of its policies and procedures, as well as specific disclosure of costs, fees and compensation, including third-party payments
6. Include a link to the firm’s website, which must include the model contract disclosures updated on a quarterly basis and the firm’s written description of its policies and procedures
7. Disclose whether the firm offers proprietary products or receives third-party payments with respect to any recommended transaction—and if investment recommendations are limited, in whole or in part, to proprietary products or investments that generate third-party payments
8. Provide investors with contact information for a firm representative
9. Describe how the advisor and firm will monitor investments and alert investors about any recommended changes as well as the frequency and the reasons for alerts

Please note that this summary is for informational purposes. Visit the DOL website for complete details on these disclosures.

What is “best interest”? Best interest is defined to mean advice that, at the time it is given: “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 advisor, firm, or any affiliate, related entity, or other party.”¹
Streamlined Best Interest Contract Exemption for level-fee fiduciaries

A streamlined version of the Best Interest Contract Exemption is available for level-fee fiduciaries who provide rollover advice to plan participants or any retirement investor. It requires:

› A written statement of fiduciary status;
› Compliance with standards of impartial conduct (providing advice in an investor’s best interest, receiving reasonable compensation for transactions and not making materially misleading statements to investors about recommendations);
› Written documentation of the reasons the rollover recommendation is in the client’s best interest.

Restructuring compensation

For most firms, a restructuring of individual advisor compensation will clearly be a critical component of compliance with the Best Interest Contract Exemption. The challenge will be to create compensation structures that properly reward productivity, while assuring individual advisor adherence to the Impartial Conduct Standards.

Pershing can help

As you assess the implementation complexity and risk exposure of this new rule, your firm will likely need to pursue multiple business and compliance strategies. Pershing will make available a broad set of solutions that aligns with those strategies, including a robust suite of configurable exemption solutions.

For more information

Look for future Pershing Client Guides. Also talk to your Pershing Relationship Manager about how Pershing’s open-architecture platform can support your strategies to comply with the Conflict of Interest rule. Additional information can be found in Pershing’s DOL Resource Center in the Marketing Center in NetX360®.
Thomas Roberts is a member of Groom Law Group's Fiduciary practice group. Mr. Roberts has an extensive background in retirement services and the insurance industry. His expertise focuses on ERISA fiduciary, tax, securities and state insurance laws affecting defined contribution plan product and service offerings.

Updates and further information on this topic are available at www.groom.com.

The information provided in this article is general and educational in nature, and is not intended to be, and should not be construed as legal advice. Complying with the terms of the Best Interest Contract Exemption will depend on each firm’s particular treatment pursuant to the rule. Failure to comply with the conditions of an exemption can result in the firm engaging in a prohibited transaction.

1 Source: federalregister.gov, Best Interest Contract Exemption

©2016 Pershing LLC. Pershing LLC, member FINRA, NYSE, SIPC, is a wholly owned subsidiary of The Bank of New York Mellon Corporation (BNY Mellon). Trademark(s) belong to their respective owners. For professional use only. Not for distribution to the public.

The information provided in this article is general and educational in nature, and is not intended to be, and should not be construed as legal advice. Federal and state laws and regulations governing broker-dealer and registered investment adviser conduct are complex and subject to change. Please consult your attorney for legal advice about your firm’s particular situation.