



DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

ZRIN 1210-ZA25

[Application Number D-11687]

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 [insert date that is 60 days after publication of this final amendment in the FEDERAL REGISTER].

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 Code. The Regulation amends a prior regulation 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 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 amendment to PTE 75-1, Part V, allows broker-dealers that are investment advice fiduciaries to receive compensation when they extend credit to plans and IRAs to avoid failed securities transactions entered into by the plan or IRA. 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 from lending money or otherwise extending credit to plans and IRAs, and from receiving compensation in return.

ERISA section 408(a) specifically authorizes the Secretary of Labor to grant and amend administrative exemptions from ERISA's prohibited transaction provisions.¹ Regulations at 29

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

CFR 2570.30 to 2570.52 describe the procedures for applying for an administrative exemption.

In granting this amended 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 amendment to PTE 75-1, Part V, allows investment advice fiduciaries that are broker-dealers to receive compensation when they lend money or otherwise extend credit to plans or IRAs to avoid the failure of a purchase or sale of a security. The exemption contains conditions that the broker-dealer lending money or otherwise extending credit must satisfy in order to take advantage of the exemption. In particular, the potential failure of the securities transaction may not be caused by the fiduciary or an affiliate, and the terms of the extension of credit must be at least as favorable to the plan or IRA as terms the plan or IRA could obtain in an arm's length transaction with an unrelated party. Certain advance written disclosures must be made to the plan or IRA, in particular, with respect to the rate of interest or other fees charged for the loan or other extension of credit.

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

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 amended exemption provides relief from the indicated prohibited transaction provisions of both ERISA and the Code.

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)(4) 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.

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 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.² 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.³ When fiduciaries violate ERISA’s fiduciary duties or the prohibited transaction rules, they may be held personally liable for the breach.⁴ 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

² ERISA section 404(a).

³ ERISA section 406. ERISA also prohibits certain transactions between a plan and a “party in interest.”

⁴ ERISA section 409; *see also* ERISA section 405.

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 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 ERISA section 3(21)(A)(ii) (the "1975 regulation").⁵ 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

⁵ The Department of Treasury issued a virtually identical regulation, at 26 CFR 54.4975-9(c), which interprets Code section 4975(e)(3).

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 with smaller account balances 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 2020.⁶ 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

⁶ Cerulli Associates, "Retirement Markets 2015."

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.⁷ 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 section 223(d) of the Code.

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:

⁷ 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.

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

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. The lending of money or other extension of credit between a fiduciary and a plan or IRA, and the plan's or IRA's payment of compensation to the fiduciary in return may be prohibited by ERISA section 406(a)(1)(B) and Code section 4975(c)(1)(B) and (D). Further, 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.⁸ 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, or from causing a person in which the fiduciary has an interest which may affect its best judgment as a fiduciary to receive such compensation.⁹

As relevant to this notice, the Department understands that broker-dealers can be required, as part of their relationships with clearing houses, to complete securities transactions entered into by the broker-dealer’s customers, even if a particular customer does not perform on its obligations. If a broker-dealer is required to advance funds to settle a trade entered into by a

⁸ 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”).

⁹ 29 CFR 2550.408b-2(e); 26 CFR 54.4975-6(a)(5).

plan or IRA, or purchase a security for delivery on behalf of a plan or IRA, the result can potentially be viewed as a loan of money or other extension of credit to the plan or IRA. Further, in the event a broker-dealer steps into a plan's or IRA's shoes in any particular transaction, it may charge interest or other fees to the plan or IRA. These transactions potentially violate ERISA section 406(a)(1)(B) and Code section 4975(c)(1)(B) and (D).

Prohibited Transaction Exemptions

As reflected in the prohibited transaction provisions, ERISA and the Code strongly disfavor conflicts of interest. In appropriate cases, however, the statutes provide exemptions from the broad prohibitions on conflicts of interest. For example, ERISA section 408(b)(14) and Code section 4975(d)(17) specifically exempt transactions involving the provision of fiduciary investment advice to a participant or beneficiary of an individual account plan or IRA owner, including extensions of short term credit for settlements of securities trades, if the advice, resulting transaction, and the adviser's fees meet stringent conditions carefully designed to guard against 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.

Pursuant to its exemption authority, the Department has previously granted several conditional administrative class exemptions that are available to fiduciary advisers in defined circumstances. The Department has, for example, permitted investment advice fiduciaries to receive compensation from a plan (i.e., a commission) for executing or effecting securities transactions as agent for the plan.¹⁰ Elsewhere in this issue of the FEDERAL REGISTER, a new “Best Interest Contract Exemption” is granted for the receipt of compensation by fiduciaries that provide investment advice to IRAs, plan participants and beneficiaries, and certain plan fiduciaries. Receipt by fiduciaries of compensation that varies, or compensation from third parties, as a result of advice to plans, would otherwise violate ERISA section 406(b) and Code section 4975(c). As part of the Department’s regulation defining a fiduciary under ERISA section 3(21)(A)(ii), the Department is conditioning these existing and newly-granted exemptions on the fiduciary’s commitment to adhere to certain impartial professional conduct standards; in particular, when providing investment advice that results in varying or third-party compensation, investment advice fiduciaries will be required to act in the best interest of the plans and IRAs they are advising.

The class exemptions described above do not provide relief for any extensions of credit that may be related to a plan’s or IRA’s investment transactions. PTE 75-1, Part V,¹¹ permits such an extension of credit to a plan or IRA by a broker-dealer in connection with the purchase or sale of securities. Specifically, the Department has acknowledged that the exemption is

¹⁰ See PTE 86-128, Exemption for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers, 51 FR 41686 (November 18, 1986), as amended, 67 FR 64137 (October 17, 2002), as further amended elsewhere in this issue of the FEDERAL REGISTER.

¹¹ 40 FR 50845 (October 31, 1975), as amended, 71 FR 5883 (February 3, 2006).

available for extensions of credit for: the settlement of securities transactions; short sales of securities; the writing of option contracts on securities, and purchasing of securities on margin.¹²

Relief under PTE 75-1, Part V, was historically limited in that the broker-dealer extending credit was not permitted to have or exercise any discretionary authority or control (except as a directed trustee) with respect to the investment of the plan or IRA assets involved in the transaction, *nor render investment advice within the meaning of 29 CFR 2510.3-21(c) with respect to those plan assets*, unless no interest or other consideration was received by the broker-dealer or any affiliate of the broker-dealer in connection with the extension of credit. Therefore, broker-dealers that are considered fiduciaries under the amended regulation would not be able to receive compensation for extending credit under PTE 75-1, Part V, as it existed prior to this amendment.

As part of its development of the Regulation, the Department considered public input indicating the need for additional prohibited transaction exemptions for investment advice fiduciaries. The Department was informed that relief was needed for broker-dealers to extend credit to plans and IRAs to avoid failed securities transactions, and to receive compensation in return. In the Department's view, the extension of credit to avoid a failed securities transaction currently falls within the contours of the existing relief provided by PTE 75-1, Part V, for extensions of credit "[i]n connection with the purchase or sale of securities." Accordingly, broker-dealers that are not fiduciaries, e.g., those who execute transactions but do not provide advice, were permitted receive compensation for extending credit to avoid a failed securities transaction under the exemption as originally granted. The Department proposed this amendment to extend such relief to investment advice fiduciaries.

¹²See Preamble to PTE 75-1, Part V, 40 FR 50845 (Oct. 31, 1975); ERISA Advisory Opinion 86-12A (March 19, 1986).

This amended exemption follows a lengthy public notice and comment process, which gave interested persons an extensive opportunity to comment on the proposed Regulation and 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.¹³ The Department has reviewed all comments, and after careful consideration of the comments, has decided to grant the amendment to PTE 75-1, Part V, as described herein. For the sake of convenience, the entire text of PTE 75-1, Part V, as amended, has been reprinted at the end of this notice.

Discussion of the Final Amendment

I. Scope of Section (c)

As amended, PTE 75-1, Part V, Section (c) provides that a fiduciary within the meaning of ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B) may receive reasonable

¹³ 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.

compensation for extending credit to a plan or IRA to avoid a failed purchase or sale of securities involving the plan or IRA. One commenter requested that Section (c) be broadened to cover all transactions that are covered by other sections of PTE 75-1, Part V, including short sales, options trading and margin transactions, but did not suggest any additional protective conditions. The commenter stated that extension of credit relief is critical to such transactions.

The Department declined to accept this request. As noted above, this amendment was intended to be a narrow expansion of the existing exemption to permit investment advice fiduciaries to receive compensation for extending credit to avoid a failed securities transaction. As a condition of the exemption, the proposal stated that the potential failure of the transaction could not be the result of the action or inaction by the fiduciary or an affiliate. The proposal further stated that, due to that limitation, the Department considered it unnecessary to condition the amended exemption on the protective impartial conduct standards that were proposed to apply to the other new and amended exemptions applicable to investment advice fiduciaries acting in conflicted transactions.

Extensions of credit entered into in connection with short sales, options trading and margin transactions expose retirement investors to the potential of losses that exceed their account value. Expanding the scope of the exemption to permit investment advice fiduciaries to provide advice on these transactions and earn compensation from the extension of credit would not be protective under the conditions of the amended exemption.

In the Department's view, this relief is not critical to all short sales, options and margin transactions. For example, the Department understands that some options transactions can occur in a cash account that does not involve an extension of credit. In addition, self-directed investors can still engage in the full extent of transactions that were permitted prior to the Applicability

Date of the Regulation, and broker-dealers that are not fiduciaries will still be able to rely on the exemption to receive compensation. Finally, investors can receive unconflicted advice from an adviser regarding margin transactions entered into with an unaffiliated broker-dealer.

II. Conditions of Relief

In conjunction with the expanded relief in the amended exemption, Section (c) includes several conditions. First, the potential failure of the purchase or sale of the securities may not be caused by the broker-dealer or any affiliate. The Department changed the phrasing of this requirement in response to a comment, which said that the proposed phrasing -- requiring that the potential failure could not be “the result of action or inaction by such fiduciary or affiliate” -- was too vague, possibly overbroad, and would require a fact-intensive inquiry for every failure of the purchase or sale of securities, leading to a chaotic aftermath of each failed transaction and increasing cost to the investor.

According to the commenter, broker-dealers regularly “work out” issues relating to settlement failures and have policies and procedures to allocate costs, including not charging clients when it is the broker-dealer’s fault. Thus, the commenter suggested that the language be revised to state that the failure “was not caused” by the fiduciary or an affiliate.

The Department accepted this comment. This condition was intended to ensure that broker-dealers will not profit from charging interest on settlement failures for which they are responsible. The Department has determined that the suggested change in phrasing is sufficiently protective of the plans and IRAs that may be paying interest.

Additionally, under the final amendment, the terms of the extension of credit must be at least as favorable to the plan or IRA as the terms available in an arm’s length transaction

between unaffiliated parties. The Department did not receive comments on this point and did not make any changes to the proposed requirement.

Finally, the plan or IRA must receive written disclosure of certain terms prior to the extension of credit. This disclosure does not need to be made on a transaction by transaction basis, and can be part of an account opening agreement or a master agreement. The disclosure must include the rate of interest or other fees that will be charged on such extension of credit, and the method of determining the balance upon which interest will be charged. The plan or IRA must additionally be provided with prior written disclosure of any changes to these terms.

The required disclosures are intended to be consistent with the requirements of Securities and Exchange Act Rule 10b-16,¹⁴ which governs broker-dealers' disclosure of credit terms in margin transactions. The Department understands that it is the practice of many broker-dealers to provide such disclosures to all customers, regardless of whether the customer is presently opening a margin account. To the extent such disclosure is provided, the disclosure terms of the exemption is satisfied. The Department received a comment that this is an appropriate disclosure standard.

III. Definitions and Recordkeeping

Consistent with other class exemptions published elsewhere in this edition of the Federal Register, the amendment defines the term "IRA" as any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.¹⁵ The amendment also revises the recordkeeping provisions of PTE 75-1, Part V, to

¹⁴ 17 CFR 240.10b-16.

¹⁵ The Department has previously determined, after consulting with the Internal Revenue Service, that plans described in 4975(e)(1) of the Code are included within the scope of relief

require the broker-dealer engaging in the covered transaction, as opposed to the plan or IRA, to maintain the records.

In response to comments received specific to some of the other exemptions adopted or amended elsewhere in this edition of the FEDERAL REGISTER, the Department has modified the recordkeeping provision to clarify which parties may view the records that are maintained by the broker-dealer. As revised, the exemption requires the records be “reasonably” available, rather than “unconditionally available,” and does not authorize plan fiduciaries, participants, beneficiaries, contributing employers, employee organizations with members covered by the plan, and IRA owners to examine records regarding a transaction involving another investor. In addition, broker-dealers are not required to disclose privileged trade secrets or privileged commercial or financial information to any of the parties other than the Department. The Department has made these changes to PTE 75-1, Part V for consistency with the other exemptions adopted or amended today.

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

The amended exemption does 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 or between an IRA and a disqualified person. The provision of investment advice to a plan or IRA is a service to the plan or IRA and compliance with this

provided by PTE 75-1 because it was issued jointly by the Department and the Service. *See* PTE 2002-13, 67 FR 9483 (March 1, 2002) (preamble discussion). For simplicity and consistency with the other new exemptions and amendments to other existing exemptions published elsewhere in this issue of the FEDERAL REGISTER, the Department has adopted this specific definition of IRA.

exemption will not relieve an investment advice fiduciary of the need to comply with ERISA section 408(b)(2), Code section 4975(d)(2), and applicable regulations thereunder. The disclosure standards under 408(b)(2) were recently finalized, and the Department took care to tailor those disclosure conditions for the plan marketplace. The Department believes that uniform standards are desirable and will promote broad compliance in this respect.

Applicability Date

The Regulation will become effective [insert date that is 60 days after the date of publication of this final exemption in the FEDERAL REGISTER] and this amended exemption is issued on that same date. The Regulation is effective at the earliest possible effective date under the Congressional Review Act. For the exemption, the issuance date serves as the date on which the amended exemption is intended to take effect for purposes of the Congressional Review Act. This date was selected in order to provide certainty to plans, plan fiduciaries, plan participants and beneficiaries, IRAs, and IRA owners that the new protections afforded by the Regulation are 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 amended 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 financial services and other service providers to adjust to

the basic change from non-fiduciary to fiduciary status. This amendment has the same Applicability Date; parties may rely on the amended exemption as of the Applicability Date.

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 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 published as part of the Department's proposal to amend its 1975 rule that defines when a person who provides investment advice to an employee benefit plan or IRA becomes a fiduciary, solicited comments on the information collections included therein. 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 proposed regulation, 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 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 final 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, the Department submitted an ICR to OMB for its request of a revision to OMB Control Number 1210-0059. The Department will notify the public when OMB approves the revised 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, Section (c)(3) of the amendment requires that prior to the extension of credit, the plan must receive from the fiduciary written disclosure of (i) the rate of interest (or other fees) that will apply and (ii) the method of determining the balance upon which interest will be charged in the event that the fiduciary extends credit to avoid a failed purchase or sale of securities, as well as, prior written disclosure of any changes to these terms. Section (d) requires broker-dealers engaging in the transactions to maintain records demonstrating compliance with the conditions of the PTE. These requirements are information collection requests (ICRs) subject to the Paperwork Reduction Act.

The Department believes that this disclosure requirement is consistent with the disclosure requirement mandated by the Securities and Exchange Commission (SEC) in 17 CFR 240.10b-16(1) for margin transactions. Although the SEC does not mandate any recordkeeping requirement, the Department believes that it would be a usual and customary business practice for financial institutions to maintain any records necessary to prove that required disclosures had been distributed in compliance with the SEC's rule. Therefore, the Department concludes that these ICRs impose no additional burden on respondents.

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 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 discharge his or her duties respecting the plan solely in the interests of the plan's participants and beneficiaries and in a prudent fashion in accordance with ERISA section 404(a)(1)(B);

(2) The Department finds that the class exemption as amended is administratively feasible, in the interests of the plan and of its participants and beneficiaries and IRA owners, and protective of the rights of the plan's participants and beneficiaries and IRA owners;

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

(4) This amended class 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

The restrictions of section 406 of the Employee Retirement Income Security Act of 1974 (the Act) and the taxes imposed by section 4975(a) and (b) of the Internal Revenue Code of 1986 (the Code), by reason of section 4975(c)(1) of the Code, shall not apply to any extension of credit to an employee benefit plan or an individual retirement account (IRA) by a party in interest or a disqualified person with respect to the plan or IRA, provided that the following conditions are met:

(a) The party in interest or disqualified person:

(1) Is a broker or dealer registered under the Securities Exchange Act of 1934;

and

(2) Does not have or exercise any discretionary authority or control (except as a directed trustee) with respect to the investment of the plan or IRA assets involved in the transaction, nor does it render investment advice (within the meaning of 29 CFR 2510.3-21) with respect to those assets, unless no interest or other consideration is received by the party in interest or disqualified person or any affiliate thereof in connection with such extension of credit.

(b) Such extension of credit:

(1) Is in connection with the purchase or sale of securities;

(2) Is lawful under the Securities Exchange Act of 1934 and any rules and regulations promulgated thereunder; and

(3) Is not a prohibited transaction within the meaning of section 503(b) of the Code.

(c) Notwithstanding section (a)(2), a fiduciary under section 3(21)(A)(ii) of the Act or Code section 4975(e)(3)(B) may receive reasonable compensation for extending credit to a plan or IRA to avoid a failed purchase or sale of securities involving the plan or IRA if:

(1) The potential failure of the purchase or sale of the securities is not caused by such fiduciary or an affiliate;

(2) The terms of the extension of credit are at least as favorable to the plan or IRA as the terms available in an arm's length transaction between unaffiliated parties;

(3) Prior to the extension of credit, the plan or IRA receives written disclosure of (i) the rate of interest (or other fees) that will apply and (ii) the method of determining the balance upon which interest will be charged, in the event that the fiduciary extends credit to avoid a failed purchase or sale of securities, as well as prior written disclosure of any changes to these terms. This Section (c)(3) will be considered satisfied if the plan or IRA receives the disclosure described in the Securities and Exchange Act Rule 10b-16;¹⁶ and

(d) The broker-dealer engaging in the covered transaction maintains or causes to be maintained for a period of six years from the date of such transaction in a manner that is reasonably accessible for examination, such records as are necessary to enable the persons described in paragraph (e) of this exemption to determine whether the conditions of this exemption have been met with respect to a transaction, except that:

(1) No party other than the broker-dealer engaging in the covered transaction shall be subject to the civil penalty which may be assessed under section 502(i) of the Act, or to the taxes imposed by section 4975(a) and (b) of the Code, if such records are not maintained, or are not available for examination as required by paragraph (e) below; and

¹⁶ 17 CFR 240.10b-16.

(2) A prohibited transaction will not be deemed to have occurred if, due to circumstances beyond the control of the broker-dealer, such records are lost or destroyed prior to the end of such six-year period.

(e)(1) Except as provided in paragraph (e)(2) of this exemption, and notwithstanding anything to the contrary in subsections (a)(2) and (b) of section 504 of the Act, the records referred to in paragraph (d) are reasonably available at their customary location for examination during normal business hours by:

(A) An authorized employee or representative of the Department of Labor or the Internal Revenue Service,

(B) Any fiduciary of a plan that engaged in a transaction pursuant to this exemption, or any authorized employee or representative of such fiduciary;

(C) Any contributing employer and any employee organization whose members are covered by a plan described in paragraph (e)(1)(B), or any authorized employee or representative of these entities; or

(D) Any participant or beneficiary of a plan described in paragraph (e)(1)(B), IRA owner or the authorized representative of such participant, beneficiary or owner.

(2) None of the persons described in paragraph (e)(1)(B)-(D) of this exemption are authorized to examine records regarding a recommended transaction involving another investor, or privileged trade secrets or privileged commercial or financial information, of the broker-dealer engaging in the covered transaction, or information identifying other individuals.

(3) Should the broker-dealer engaging in the covered transaction refuse to disclose information on the basis that the information is exempt from disclosure, the broker-dealer 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.

For purposes of this exemption, the terms “party in interest,” “disqualified person” and “fiduciary” shall include such party in interest, disqualified person, or fiduciary, and any affiliates thereof, and the term “affiliate” shall be defined in the same manner as that term is defined in 29 CFR 2510.3-21 and 26 CFR 54.4975-9. Also for the purposes of this exemption, the term “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 section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

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

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration,

Department of Labor.

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