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## A Summary of Comments from the DOL Hearing on the Proposed Conflict of Interest Rule

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On August 13, 2015, the Department of Labor (the “DOL”) concluded a four-day public hearing on its proposed conflict of interest rule (the “Proposed Rule”).<sup>1</sup> The approximately 75 witnesses generally fell into two groups: the financial services industry (the “Industry Group”) and consumer groups (the “Consumer Group” and collectively, the “Witness Groups”).<sup>2</sup>

During the hearing, each witness read a prepared statement before responding to questions from a panel of DOL employees. While the prepared statement of each witness was tailored to the specific needs and objectives of the party represented by the witness, certain comments and suggestions were common across many witnesses within each Witness Group. This client publication summarizes some of those comments and suggestions.

<sup>1</sup> The Proposed Rule can be found at: <http://www.dol.gov/ebsa/regs/conflictsinterest.html>. You may also wish to review the Shearman & Sterling LLP client publication on the Proposed Rule, which can be found at: <http://www.shearman.com/~media/Files/NewInsights/Publications/2015/04/Times-are-Changing-A-First-Look-at-DOLs-New-Fiduciary-Paradigm-ECEB-042415.pdf>.

<sup>2</sup> A complete list of the witnesses can be found at: <http://www.dol.gov/ebsa/regs/1210-AB32-2-HearingAgenda.html>.

## Comments from the Industry Group

- Re-propose the BIC Exemption, as it is unworkable in its current form. One of the more prevalent comments made by the Industry Group witnesses was that the best interest contract exemption (the “BIC Exemption”) is unworkable due to its complexity and needs to be re-proposed. The BIC Exemption is a prohibited transaction exemption that allows financial services firms to continue to set their own compensation practices so long as they enter into a contract (the “BIC”) in which, generally, they agree to put their client’s best interest first and disclose any conflicts that may prevent them from doing so. The Proposed Rule requires that the BIC be executed before the financial services firm recommends that the client purchase, hold or sell any of the assets covered by the BIC Exemption. Many of the Industry Group witnesses argued that this execution timing requirement was unworkable. They also stated that the BIC Exemption should not be a contract, but rather a statement or “bill of rights” that is presented to the potential client and that sets forth the firm’s commitment to act in the best interests of the client for reasonable compensation and to provide certain disclosures.
- Expand the assets covered by the BIC Exemption. Under the Proposed Rule, only certain asset types qualify for the BIC Exemption. Certain Industry Group witnesses requested that the list of covered assets be expanded to include, for example, listed options, non-traded business development companies and non-traded REITs. Other witnesses stated that the BIC Exemption should not be limited to a specified list of assets.
- Lengthen the transition period. Some Industry Group witnesses expressed concern about the proposed eight-month transition period, stating that the Proposed Rule would take at least two to three years to implement.
- Expand the Seller’s Exception to avoid harm to small investors. Certain Industry Group witnesses stated that the carve-out for the provision of investment advice to large plan fiduciaries with financial expertise (the “Seller’s Exception”) needs to be expanded to cover sales to small investors. Accordingly, recommendations to retail investors and small plan providers would not be covered by the Seller’s Exception and would be subject to the BIC Exemption, which the Industry Group stated would result in the loss of availability of investment advice to such investors.
- Permit investment advice on variable annuities to IRAs via PTE 84-24, not the BIC Exemption. Industry Group witnesses representing parties that provide advice on investments in annuity contracts expressed the view that such advice should continue to be covered by Prohibited Transaction Class Exemption (“PTE”) 84-24, and not the BIC Exemption. Currently, PTE 84-24 allows fiduciaries to receive commissions when plans and IRAs enter into certain insurance and mutual fund transactions recommended by the fiduciaries. The Proposed Rule amends PTE 84-24 to exclude IRA transactions involving annuity contracts that are securities (including variable annuity contracts) and mutual fund shares. In proposing that the BIC Exemption cover certain annuity transactions, the DOL reasoned that the BIC Exemption would provide better protection for these IRA owners, given that, because they are not covered by ERISA, IRAs generally do not benefit from the protections afforded by the fiduciary duties plan sponsors owe to their employee benefit plans.
- Permit certain product specific references in investment education. Many Investment Group witnesses stated that investment education should be expanded to include references to certain specific products that the investor may consider (for example, references to investment options in an employer’s 401(k) plan). The Proposed Rule creates a carve-out from fiduciary status for investment education provided to IRA owners, plan sponsors and plan participants, but classifies materials that reference specific products that the investor may consider buying as investment advice.

- Consolidate and harmonize fiduciary standards. Many Industry Group witnesses called for a universal best interest standard. They stated that the different ERISA, SEC and FINRA fiduciary standards may lead to confusion, especially since the same investors may have both retirement and non-retirement accounts and may have trouble understanding that the ERISA standard applies only to some of their investments.

### Comments from the Consumer Group

- General support for the Proposed Rule. The witnesses from the Consumer Group generally expressed support for the Proposed Rule and testified as to the reasons why they believe the rule change is necessary. They testified that a disclosure-only regime would not adequately protect consumers.
- Mandatory arbitration in the BIC Exemption. Several Consumer Group witnesses stated that the BIC Exemption should not permit mandatory dispute resolution via arbitration. A BIC can require that individual disputes be handled through arbitration, but it must give clients the right to bring class action lawsuits in court if a group of people is harmed. This feature of the BIC Exemption is modeled on the rules of the Financial Industry Regulatory Authority (“FINRA”) and would allow advisors to require clients to bring complaints through FINRA’s arbitration panels. The Consumer Group expressed concern that these arbitration proceedings might be biased against individual investors. Several Consumer Group witnesses did state that permitting only voluntary arbitration may alleviate some of their concerns.
- BIC Exemption will not reduce services to small investors. The Consumer Group witnesses did not voice concern that the BIC Exemption, or any other aspect of the Proposed Rule, would result in a reduction of services available to small investors. The Consumer Group was generally confident that there would be many financial advisors willing to service these retirement and IRA investors.

### Next Steps

The DOL has reopened the comment period on the Proposed Rule until 14 days after the official transcript for the public hearing is posted on the DOL web site. Despite the various requests to re-propose the Proposed Rule, it appears that the DOL will move forward with finalizing it.<sup>3</sup> The DOL’s current plan appears to be to have the final rule be effective 60 days after publication in the Federal Register and to have the requirements of the final rule generally become applicable eight months after its publication. According to the DOL, the BIC Exemption will be available eight months after the final rule is published in the Federal Register.

<sup>3</sup> See Letter from Thomas E. Perez, Secretary of Labor, to Hon. Ann Wagner, Member, United States House of Representatives (August 7, 2015) ([http://op.bna.com/pen.nsf/id/sfos-9zdr6/\\$File/Perez-Wagner%20Letter.pdf](http://op.bna.com/pen.nsf/id/sfos-9zdr6/$File/Perez-Wagner%20Letter.pdf)).

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