

March 15, 2017

Mr. Joe Canary, Director
Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave., NW, Room N-5655
Washington, D.C. 20210

Re: Fiduciary Rule Examination – RIN 1210-AB79

Dear Mr. Canary:

The American Bankers Association¹ (ABA) appreciates the opportunity to provide comments to the Department of Labor (Department) on the agency's proposed 60-day delay to the applicability date (Applicability Date) of the Department's Fiduciary Rule (Fiduciary Rule or Rule).² If enacted as proposed, the Applicability Date would be moved from April 10, 2017 to June 9, 2017. During this 60-day period, the Department, in response to the Presidential Memorandum on the Fiduciary Rule³ (Memorandum) intends to examine the Fiduciary Rule in accordance with the Memorandum's directives and to provide an updated economic and legal analysis on the Rule's impact on retirement investors.

The Fiduciary Rule was finalized in April 2016. Notwithstanding the firm belief of ABA and other stakeholders that 36 months would be required to comply with the Rule's numerous and complex requirements resulting from a blanket restructuring of the retirement services industry,⁴ the Department permitted only 12 months for compliance with the Rule. We continue to believe that this is a rushed and unrealistic timetable, in spite of banks' continuous good-faith efforts to comply by the Applicability Date. We further believe, as described below, that the Fiduciary Rule remains fundamentally flawed and unworkable in critical areas, and thus requires substantial revision in order to be considered a functional rule, let alone a wise public policy.

¹ The American Bankers Association is the voice of the nation's \$17 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard \$13 trillion in deposits, and extend more than \$9 trillion in loans. Many of these banks are plan service providers, providing trust, custody, routine deposit/cash management, and other services for institutional clients, including employee benefit plans covered by the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (Code).

² The Fiduciary Rule (which the Department refers to as the "Conflict of Interest Rule") defines who is a "fiduciary" under (ERISA) as a result of giving investment advice to an employee benefit plan or other pension plan, or to its participants or beneficiaries. The Fiduciary Rule further defines a "fiduciary" to include anyone who gives investment advice to the owner of an individual retirement account (IRA) under the Code. *See* Department of Labor, Definition of the Term "Fiduciary," 82 *Fed. Reg.* 12,319 (2017).

³ *See* Presidential Memorandum on Fiduciary Duty Rule (Feb. 3, 2017).

⁴ *See* ABA Comment Letter to Proposed Rule on the Definition of the Term "Fiduciary" (July 21, 2015).

We request, therefore, that the Department delay the Applicability Date by at least 180 days beyond the proposed 60-day delay, not only to respond to the Memorandum's directives, but also to allow adequate opportunity to revise the Fiduciary Rule so that it can achieve functionality, permit certainty of compliance, and overall meet the standards of wise public policy that truly serves financial services customers.

I. Banking Industry Efforts to Comply with the Fiduciary Rule.

Since the Fiduciary Rule's effective date, banks have worked to understand and comply with the many provisions of the Rule. This has involved sustained and heightened time-, labor-, and cost-intensive efforts by banks to review, revise, and restructure their retirement products and services. Among other things, this has included a comprehensive and detailed review and evaluation of multiple lines of business, a review and renegotiation of contracts with vendors and third-party service providers, the design and/or updating of technology systems and software packages (including testing and remediation), the creation or modification of policies and procedures, and the drafting or revision of contracts and correspondence for new and/or existing retirement customers. An integral part of this process is the review of *every* customer account in order to ensure conformance to the Fiduciary Rule's requirements. Any revision, addition, or modification to a bank's offering of retirement services further must be reviewed and evaluated to ensure its ongoing compliance with bank legal and regulatory requirements under applicable federal and state banking laws.

II. Applicability Date Concerns.

Notwithstanding this comprehensive and wide-ranging implementation, banks are confronting three major challenges to achieving certainty of compliance by the Applicability Date. First, banks are grappling with the content and timing of client notices and communications regarding the impact of the Rule on their accounts, given the uncertainty of the Applicability Date. An immediate delay is necessary in order to prevent needless disruption and confusion that would result if a bank, reasonably assuming that the Applicability Date will take effect, were to proceed with client mailings, only to later find that the Rule subsequently has been delayed. We appreciate the Department's awareness of this challenge and its issuance of Field Assistance Bulletin (FAB) 2017-01, which promises no enforcement action by the Department if banks do not send out notices and communications to clients before the Applicability Date.⁵ The FAB, however, does *not* prevent banks' immediate and ongoing exposure to private litigation and IRS enforcement with respect to IRAs under the Rule.

Second, a number of banks are dependent on vendors and third-party servicers to provide the software or other materials required for compliance with the Rule. We are aware that at least some of these vendors and servicers have not been able to provide timely or complete delivery of products or services, which has adversely impacted these banks' timetables for compliance. In some cases, there has been little opportunity to test, and if necessary, remediate these vendor/servicer products and services, which may affect a bank's ability to service their retirement customers properly. In some cases, these banks have not been given assurance that vendor and servicer products and services will work fully as intended on the Applicability Date.

⁵ See DOL Field Assistance Bulletin 2017-01 (Mar. 10, 2017).

Third and most important, the Fiduciary Rule remains significantly hobbled by several critical provisions that are vague, incomplete, or simply unworkable. As a result, there is no way for banks to know with any certainty, despite all of their efforts, whether they are in compliance with the Fiduciary Rule. This is particularly true in at least three areas: (1) the definition of “recommendation”; (2) the Department’s authority to aggregate exempt activities in order to conclude that investment advice is being rendered, and therefore, that the bank has become a “fiduciary”; and (3) the Department’s silence on whether banks may rely on the applicable statutory exemption of ERISA or the Code to conduct their IRA/CD or similar programs without implicating the Fiduciary Rule.

A. Definition of “Recommendation.”

In general, the Fiduciary Rule considers a person to be a “fiduciary” if such person for compensation (i) makes a “recommendation” to invest in securities or other investment property, or (ii) makes a “recommendation” regarding the management of securities or other investment property, or with respect to rollovers, transfers, or distributions from a plan or IRA.⁶ The definition of “recommendation” therefore is foundational, since it drives whether or not a person is a “fiduciary” under the Rule. The Department further defines a “recommendation” as a communication that “would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action.”⁷ ABA has asserted that inclusion of the word “suggestion” in the definition is inherently subjective, leaving in doubt whether both parties (the bank and the retirement investor) truly understand whether, and on what basis, a fiduciary relationship has been established.

Although the Department frames the term “recommendation” as a “call to action,”⁸ the definition remains vague and subject to multiple (and often conflicting) interpretations. This places banks in a precarious position, as there will be numerous, repeated, and unanticipated situations in which the bank and its retirement customer may reasonably differ on whether a recommendation was in fact provided to the customer. Since the consequences of becoming a “fiduciary” are enormous – determining whether or not the Fiduciary Rule applies, with its attendant, significant liability and penalties for failure to comply – the definition of “recommendation” *must* provide certainty in order for the Fiduciary Rule to function. As written, it does not.

The Department has implicitly acknowledged this deficiency by publishing additional guidance on what constitutes a “recommendation” in a January 2017 agency release, which provides banks only a few months to adjust to and comply before the Applicability Date.⁹ Even with this guidance, the definition of “recommendation” begs the question as to what it does and does not include. This critical piece of the Rule, in other words, is still an incomplete and unfinished work. As a result, banks have had to take an unnecessarily constrained and restricted interpretation of the Rule in order to maximize compliance efforts. In doing so, banks (due to the liability risks, compliance costs, or both) have been compelled to reduce or forego offering

⁶ See Fiduciary Rule, 29 C.F.R. § 2510.3-21(a)(1).

⁷ Fiduciary Rule, 29 C.F.R. § 2510.3-21(b)(1).

⁸ See Department of Labor Conflict of Interest FAQs (Part II – Rule) (Jan. 2017), Q1.

⁹ See *id.*

altogether retirement products and services, thereby depriving their customers of the retirement assistance, guidance, and services that they have come to expect and rely upon.

We believe it is critical for the Department to use the delay period to revise the definition of “recommendation” so that this level of uncertainty – with the immediate and lasting damage it will cause consumers – is minimized or removed entirely. As we have stated previously, there are definitions of the term “recommendation” that would make this possible.¹⁰ We would be glad to provide the Department with information on formulating a definition that would accomplish the objectives of consumer protection while making the definition functional in the retirement marketplace.

B. Fiduciary Status from Aggregating Exempt Activities.

The Fiduciary Rule raises another significant obstacle for compliance that adversely impacts compliance efforts and the availability of retirement services. Under the definition of “recommendation,” the Rule states the following:

Furthermore, a series of actions, directly or indirectly (e.g., through or together with any affiliate) that may not constitute a recommendation when viewed individually may amount to a recommendation when considered in the aggregate.¹¹

This language purportedly was inserted to prevent an evasion of the Fiduciary Rule.¹² A bank, however, must be careful when relying on anything that would not be considered a “recommendation,” since it can be added to other non-recommending statements to become, in combination, a “recommendation” within the Rule. A series of exempt actions, in other words, can conspire to foist unintended fiduciary status on the bank. This provision makes it *virtually impossible* to know whether a bank is in compliance with the Rule since, at any time and with the benefit of hindsight, the Department could conclude that a bank’s program is still captured by the Rule, notwithstanding that it was reasonably structured in good faith to operate outside the Rule.

This imposes an enormous liability risk to the bank, a risk that is both unknown and unquantifiable. Moreover, this provision unreasonably and unrealistically assumes that a bank can monitor and control every action of its *affiliates* with all of its multiple contacts and touch points – conversations, brochures, responses to customer questions, etc. – that are individually and collectively intended not to implicate the Rule. This provision not only makes the Fiduciary

¹⁰ In its July 2015 comment letter, ABA proposed that “recommendation” be defined as a communication that reasonably would be viewed as “a clear, affirmative statement of active endorsement and support for the advice recipient to engage in or refrain from taking a particular investment course of action.” ABA believes that this would ensure that both the bank and the retirement customer would be able to know when a recommendation is genuinely taking place.

¹¹ Fiduciary Rule, 29 C.F.R. § 2510.3-21(b)(1).

¹² The Department supported adding this provision to the final rule in part by reasoning that the provision tracks similar FINRA guidance. *See* Fiduciary Rule, *supra*. This makes no regulatory sense. As stated herein, there is an *enormous* difference in the level and amount of liability and penalties for failure to comply with ERISA versus failure to comply with FINRA guidance.

Rule unworkable, but also interferes with the operations of routine banking activities and programs (as well as those of bank affiliates) that should be well outside the Rule's reach.

C. Bank IRA/CD Programs.

Bank IRA/CD programs are a primary retirement service at many banks, particularly at community and midsize banks. Under this program, the IRA account owner invests the assets in his or her IRA in one or more bank deposit products, such as a certificate of deposit (CD). In providing this benefit to customers, banks have routinely relied on the statutory exemption available for bank deposit product programs under Section 4975(d)(4) of the Code. ABA has requested that the Department confirm that banks may continue to rely on the statutory provision of the Code (or Section 408(b)(4) of ERISA, as applicable to plans).¹³ Furthermore, ABA currently has been in discussions with Department staff regarding bank IRA/CD programs and the available statutory exemptions.¹⁴

In the absence of Department response or guidance, banks may reasonably be relying on Section 4975(d)(4) of the Code to continue operating their respective IRA/CD programs without implicating the Fiduciary Rule. However, if the Department were ever to conclude that the statutory exemption under ERISA or the Code cannot be relied upon, or can be only partially relied upon, then banks would need to completely restructure their bank IRA/CD programs, which process would take months to complete. In this event, the Department would need to allow sufficient additional time for banks to complete this process. ABA continues to believe that Section 4974(d)(4) of the Code and Section 408(b)(4) of ERISA apply to a bank operating its IRA/CD or similar program, consistent with the requirements of those statutory exemptions.

III. Presidential Memorandum's Directives.

The Memorandum requires the Department to provide an updated economic and legal analysis which must consider at least three factors: first, whether the Fiduciary Rule is likely to harm investors due to a reduction in access to retirement products and services; second, whether the Fiduciary Rule's anticipated applicability will result in dislocations or disruptions to the retirement services industry that may adversely affect investors or retirees; and third, whether the Fiduciary Rule is likely to cause an increase in litigation or in the prices that investors and retirees must pay to gain access to retirement services. Should the Labor Secretary find that the Fiduciary Rule is harmful under any of the three factors above, or if the Labor Secretary concludes for any other reason that the Fiduciary Rule is inconsistent with the priorities listed in the Memorandum, then the Secretary is directed to issue a proposed rule that would rescind or revise the Fiduciary Rule.¹⁵

As discussed above, ABA believes that it would be reasonable for the Secretary of Labor to conclude that one or more of these factors (reduction in access, dislocation/disruption to

¹³ See ABA Comment Letter (Sept. 22, 2015); ABA Comment Letter (July 15, 2015).

¹⁴ The law firm of Morgan, Lewis & Bockius LLP also has provided ABA with a white paper discussing the statutory exemption available for bank IRA deposit programs (Aug. 24, 2016). This white paper has been shared with ABA members and Department staff and is attached to this comment letter.

¹⁵ See Memorandum.

industry, increased litigation) will be triggered regarding banks' retirement customers. Therefore, the Department will require a substantial delay in order either to repeal or revise the Fiduciary Rule.

When updating the economic and legal analysis, the Department should consider and incorporate into its analysis *all* (not just selected) available studies, data, and reports that provide balance to the conclusions reached in the initial report. For instance, the Department has quoted often a 2015 study by the President's Council of Economic Advisers (CEA) that attributed annual IRA investor losses of \$17 billion to advisory conflicts.¹⁶ Among other things, the updated analysis should account for the following:

- (1) The Department should acknowledge that the data comprising most of the studies relied on by CEA are from the late 1990s and early 2000s, when there was scant overlap in the marketing and sale of broker-sold funds versus no-load funds. The competitive landscape now is markedly different, with 90% of front-load mutual funds also having no-load shares.¹⁷
- (2) The author of one of the academic studies cited by CEA, Jonathan Reuter, issued an updated analysis that looked at more recent mutual fund performance (from 2003 to 2012) and concluded that broker-sold funds underperform no-load funds by an average of 18 basis points, significantly narrower than the 100-basis point difference cited by CEA. This means that CEA greatly overestimates with its projected \$17 billion figure.¹⁸
- (3) A survey of financial advisors by CoreData Research that was conducted after the Fiduciary Rule was finalized (October 2016) found that 71% plan to disengage from some mass-market investors due to the Fiduciary Rule. On average, these advisors further estimate that they will no longer service 25% of their mass-market clients, creating a significant likely advice gap for low-balance investors.¹⁹
- (4) As required in the third question of the Memorandum, the Department must determine whether the Fiduciary Rule will cause an increase in litigation or in the prices that retirement investors must pay to access retirement services. As the Department has acknowledged, the Rule specifically authorizes clients to pursue class-action claims in civil court rather than settle disputes through arbitration. This will inevitably raise insurance premiums for banks, which costs eventually will make their way to their customers. On this basis alone – increased litigation and raised prices for retirement investors – the Department will be required either to rescind or revise the Rule.

¹⁶ See Council of Economic Advisers, *The Effects of Conflicted Investment Advice on Retirement Savings* (Feb. 2015).

¹⁷ See Craig M. Lewis, "An Inflated \$17 Billion Talking Point from DOL," *Forbes* (Dec. 16, 2015).

¹⁸ *Id.* See also Economists Incorporated, "Good Intentions Gone Wrong: The Yet-To-Be-Recognized Costs of the Department of Labor's Proposed Fiduciary Rule" (July 2015).

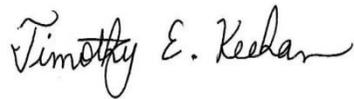
¹⁹ See CoreData Research, *The Fiduciary Rule* (Oct. 2016).

IV. Conclusion.

For the reasons stated herein, the Department should not only authorize a 60-day delay in the Applicability Date, but further should substantially increase the time it will need (by at least another 180 days) to reevaluate and either rescind or revise the Fiduciary Rule. In the proposal, the Department conjectures that a delay will impose a significant monetary cost on consumers. The Department's focus on foregone investor gains misses the point. Rather, any costs to delay are decisively outweighed by a Fiduciary Rule that, as it now stands, is neither functional nor effective. Speculating on dollar-amount losses serves only to obfuscate the Rule's inoperability in the first place. Until it is properly amended or withdrawn and re-proposed, the Fiduciary Rule is incapable of serving consumer interests or providing consumer access to retirement services.

Thank you for your consideration of these views. If you have any questions or require any additional information, please do not hesitate to contact the undersigned at 202-663-5479 (tkeehan@aba.com).

Sincerely,



Timothy E. Keehan
Vice President & Senior Counsel

Attachment: Morgan, Lewis & Bockius LLP, Department of Labor (DOL) Fiduciary Rule: Exemption for Bank IRA Deposit Programs (August 25, 2016)

Morgan Lewis



Department of Labor (DOL) Fiduciary Rule: Exemption for Bank IRA Deposit Programs

Prepared by Morgan, Lewis & Bockius LLP
for the American Bankers Association

August 24, 2016



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Executive Summary

The Department of Labor (DOL) recently finalized changes to its regulation on fiduciary status (Fiduciary Rule or Rule), which greatly expands the definition of an “investment advice” fiduciary for purposes of the ERISA and IRA prohibited transaction rules. In particular, a bank that provides “advice” in the course of marketing its retirement investment products and services, including IRA rollovers, may now be deemed a “fiduciary” under the Rule. If so, any compensation the bank receives as a result of such “advice” may be considered a “prohibited transaction” under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (Code) because the bank would be using its fiduciary advice role to cause itself to be paid additional fees. Absent an available exemption, the penalty could be to repay the fees, plus interest, plus an excise tax. Thus, for example, a bank’s receipt of compensation in connection with its advice to retail customers on IRA investments or IRA rollovers, or as a result of its routine marketing and sales practices in connection with these activities, may trigger prohibited transaction liability, unless the bank can rely on an exemption.

We believe that a statutory exemption – Section 4975(d)(4) of the Code – permits a bank to advise its customers on IRA investments and on IRA rollovers, so long as the IRA is designed to invest exclusively in the bank’s deposits. Thus, provided the conditions of this exemption are met, a bank may reasonably rely on Section 4975(d)(4) to conduct its bank IRA CD program (or other IRA bank deposit program), including accepting rollovers into that program, without triggering prohibited transaction liability, and without triggering the applicability or requirements of the Fiduciary Rule or the related exemptions.¹

¹ In order to address certain compensation and fiduciary liability issues raised by the expanded “investment advice” definition, the DOL has created a new regulatory exemption, known as the “Best Interest Contract Exemption” (BIC Exemption). Compliance with the BIC Exemption generally will allow an investment advice fiduciary to receive certain types of compensation for advice provided to a customer, without giving rise to prohibited transaction liability. The BIC Exemption’s requirements, however, are lengthy and complex, and raise numerous interpretive questions. A fiduciary, however, may rely on *any* available exemption from the prohibited transaction provisions of ERISA and the Code, not simply the BIC Exemption. Thus, where the Section 4975(d)(4) exemption is available, it should not be necessary to rely on the BIC Exemption in order to market rollovers into these types of IRAs.

Introduction

We have been asked to analyze the availability of the bank deposit exemption under Section 4975(d)(4) of the Internal Revenue Code of 1986, as amended (the “Code”), for an individual retirement account (an “IRA”) that invests exclusively in bank deposits, and for any rollover into an IRA that makes such investment, in light of the recent amendment to the DOL regulation defining fiduciary “investment advice” for purposes of the Section 4975 prohibited transaction rules (the “Amended Regulation”).²

This briefing paper describes the basis for the position that the Section 4975(d)(4) exemption, in conjunction with the Section 4975(d)(2) exemption for services, provides sufficient authority and relief to cover (1) an IRA’s investment in bank deposits (including bank certificates of deposit), and (2) rollovers into an IRA that invests exclusively in bank deposits (including bank certificates of deposit), such that reliance on Prohibited Transaction Exemption 2016-01, the newly-adopted Best Interest Contract (“BIC”) Exemption,³ is not necessary. While we believe this position to be reasonable and supportable for the reasons described below, because the Amended Regulation and BIC Exemption were only recently finalized (April 2016), and because there is no additional guidance as yet as to how they apply, there is no assurance that the DOL or a court would reach this conclusion. The DOL has informally indicated that it expects to provide additional guidance on the Amended Regulation and related exemptions before their April 10, 2017, applicability date, which may or may not address this issue.

This briefing paper begins with an overview of the features of a “deposit IRA” product for purposes of this discussion. It then provides relevant background on the Code Section 4975 prohibited transaction rules and the Section 4975(d)(4) bank deposits exemption. The paper then turns to the potential impact of the new Rule on the marketing and sales of deposit IRAs, followed by the reasons why the Section 4975(d)(4) exemption would be available to address those issues, including for IRA rollovers, in conjunction with a separate statutory exemption for IRA services under Section 4975(d)(2).

1. Overview of Deposit IRAs

In this briefing paper, we are assuming, for purposes of the legal analysis and in order to meet all the conditions of the bank deposit exemption, that an IRA that invests exclusively in bank deposits (a “Deposit IRA”) operates as follows:

- The Deposit IRA product is offered by a bank (“Bank”) that is incorporated and doing business under the laws of the United States or a State (including the District of Columbia) and is subject to supervision and examination by a Federal or State banking authority, such as the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation (FDIC), or a State banking commissioner.

² Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice, 81 Fed. Reg. 20,946 (2016).

³ Best Interest Contract Exemption – Adoption of Class Exemption, 81 Fed. Reg. 21,002 (2016), technical corrections, 81 Fed. Reg. 44,773 (2016).

- The Deposit IRA is opened in the same manner as any other type of IRA, and subject to the same contribution, withdrawal, and other rules applicable to IRAs under the Code, including the prohibited transaction rules and related exemptions under Section 4975.
- The Deposit IRA product is made available through a Bank or its branches, with the Bank serving as the IRA's trustee and/or custodian.
- The IRA owner elects in the opening documentation to limit IRA investments exclusively to deposits in the offering Bank. These may be certificates of deposit ("CDs") (including so-called "IRA CDs" that have special terms designed for IRA investors, such as the ability to make penalty-free withdrawals to meet the minimum required distribution rules), money market accounts, and savings accounts. All such deposits are insured by the Federal Deposit Insurance Corporation up to applicable limits.
- The Bank pays interest, and may impose service fees or other charges, in accordance with the terms it makes available for the particular types of deposit accounts. For example, CDs may be subject to early withdrawal penalties.
- The Deposit IRA may or may not be subject to trust or custody fees to cover the Bank's services as IRA trustee or custodian, as applicable.

2. Section 4975 Prohibited Transaction Rules

Section 4975 of the Code prohibits certain enumerated transactions between a "plan," defined in Section 4975(e)(1) to include an IRA, and a "disqualified person"⁴ with respect to the plan/IRA, as well as imposing certain additional prohibitions where the disqualified person is a fiduciary to the plan/IRA.⁵ The penalty for violation is an excise tax imposed on the disqualified person that participates in the prohibited transaction (other than a fiduciary acting only as such) or, if the disqualified person is the individual for whose benefit the IRA was established, loss of the IRA's tax-exempt status.⁶ Furthermore, to avoid additional excise taxes, the prohibited transaction must be "corrected," meaning that the transaction must be undone to the extent possible, in any case placing the plan/IRA in a financial position not worse than as if the prohibited transaction had not occurred.⁷

Most IRAs are not "employee benefit plans" subject to Title I of ERISA,⁸ so the general fiduciary standards of ERISA do not apply to them. Under current law, however, interpretations of and exemptions from the Section 4975 prohibited transaction rules generally are issued by the DOL, and DOL interpretations of the

⁴ The term "disqualified person" is defined in Section 4975(e)(2) to include, among others, a fiduciary or person providing services to the plan/IRA, as well as certain affiliates of the fiduciary or service provider.

⁵ Because the focus of this briefing paper is on IRAs, the term "IRA" is used where, in most cases, the text can refer either to a plan or to an IRA.

⁶ Code §§ 408(e)(2), 4975(a).

⁷ Code §§ 4975(b), (f)(5).

⁸ See 29 C.F.R. § 2510.3-2(d) (stating the general rule that IRAs are not "plans" under ERISA, except in certain circumstances).

parallel prohibited transaction and exemption provisions in Sections 406 and 408 of ERISA generally apply in determining how the Section 4975 prohibited transaction rules apply to non-ERISA IRAs.⁹

3. Bank Deposits Covered by a Statutory Exemption

As a provider of trust and/or custody services to an IRA, the Bank would be a “disqualified person” with respect to the IRA within the meaning of Section 4975(e)(2)(B). Consequently, certain types of transactions between the Bank and the IRA would be prohibited by Section 4975, absent an exemption.

The categories of prohibited transactions in Section 4975(c)(1) include the lending of money or other extension of credit between an IRA and a disqualified person (Section 4975(c)(1)(B)), and the use of IRA assets by or for the benefit of a disqualified person (Section 4975(c)(1)(D)). According to guidance from the DOL, the deposit of an IRA’s funds in a bank deposit account would be viewed as an extension of credit from the IRA to the bank and also a “use” of the IRA’s funds for the benefit of the bank, thereby requiring an exemption if the bank is a disqualified person.¹⁰ In addition, where the bank has investment discretion or provides investment advice that makes it a fiduciary with respect to the IRA, the transaction may raise issues under the prohibitions on fiduciary self-dealing and conflicts of interest in Section 4975(c)(1)(E) and (F).

Recognizing this potential issue, Congress included in the statute an exemption for a bank to invest an IRA’s assets in its own deposit accounts. This exemption is found in Section 4975(d)(4) of the Code and Section 408(b)(4) of ERISA. It provides exemptive relief for “the investment of all or part of [an IRA’s] assets in deposits which bear a reasonable interest rate in a bank or similar financial institution supervised by the United States or a State,” subject to conditions contained in the statute and described further by regulation.¹¹ The exemption covers the extension of credit between the IRA and the bank that is inherent in the IRA’s investment in the bank’s deposits and the bank’s use of the deposited assets, as well as fiduciary self-dealing and conflicts of interest otherwise prohibited by Section 4975(c)(1)(E).¹² The term

⁹ See Reorganization Plan No. 4 of 1978, § 102, 43 Fed. Reg. 47,713 (1978) (transfer of IRS authority to issue regulations, rulings, opinions and exemptions under Section 4975 transferred to DOL, with limited exceptions).

In focusing on the application of Section 4975 of the Code, this white paper assumes that the Deposit IRAs would not be employee benefit plans subject to Title I of ERISA. It also is possible that an IRA would, depending principally on the level of employer involvement, be considered part of an ERISA Title I plan. For example, IRAs that are part of a “simplified employee pension,” or SEP, or a “simple retirement account” would be considered part of an ERISA Title I plan if the employer makes any contributions to those IRAs. If so, the same general analysis still would apply under the largely parallel prohibited transaction rules and exemptions of ERISA, which are subject to the same DOL interpretations as described herein.

¹⁰ For a description of bank deposits as raising these issues, see Proposed Exemptions; Deutsche Bank AG, 68 Fed. Reg. 10,035, 10,038 n.6 (2003) (in the absence of the ERISA Section 408(b)(4) exemption being available, a bank could rely on another exemption “to exempt the extension of credit and the use of plan assets by the foreign [bank] party in interest inherent in the investment in that [bank’s] deposits”).

¹¹ Treas. Reg. § 54.4975-6(b) and 29 C.F.R. § 2550.408b-4 (IRS and DOL regulations, respectively).

¹² Under the regulations, the exemption does not provide relief from Section 4975(c)(1)(F) (and its ERISA equivalent, Section 406(b)(3)), which prohibits an IRA fiduciary from receiving consideration for the fiduciary’s own personal account from any party dealing with the IRA in connection with a transaction involving IRA assets. The DOL, however, has taken the position that the normal benefit a bank would receive from holding deposits – decreased overnight borrowing needs from Federal institutions – is not received from a “party dealing with” the IRA so as to violate Section 406(b)(3). DOL Advisory Opinion 2009-01A (Jan. 13, 2009).

“deposits” is broadly defined to include “any account, temporary or otherwise, upon which a reasonable rate of interest is paid, including a certificate of deposit issued by a bank.”¹³

In providing coverage where the bank is a fiduciary, the exemption and the regulation do not draw any distinction as to the capacity or role in which the bank is serving as a fiduciary. For example, the exemption does not specify whether the bank has to be a fiduciary by reason of having investment discretion over the IRA’s assets, versus acting in a non-discretionary investment advisory capacity.

In addition to requiring that the deposits bear a “reasonable” interest rate (generally measured by reference to interest rates available to other customers of the same bank and from other banks in the same geographic area¹⁴), the exemption also requires authorization of the bank deposits as an investment for the particular IRA. According to the regulation, to meet this condition, the investment must be either expressly authorized by a provision of the IRA trust or custody agreement, or by a fiduciary of the IRA – other than the bank – who has authority to make such investments and who has no interest in the transaction that may affect the exercise of its best judgment as a fiduciary. If in the IRA trust or custody agreement, then the authorization must name the bank and must state that the bank may make investments in deposits that bear a reasonable rate of interest in itself or an affiliate.¹⁵

4. Prohibited Transaction Issues Raised by the Amended Regulation

A. Amended Regulation Expands the Definition of Fiduciary “Investment Advice”

The Amended Regulation amends the definition of the term “fiduciary” under both ERISA and Section 4975 of the Code, effective April 10, 2017, to expand what is considered fiduciary “investment advice” for purposes of these provisions.¹⁶

As relevant here, the fiduciary definition in the statute includes any person who “renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of

¹³ Treas. Reg. § 54.4975-6(b)(4)(iii); 29 C.F.R. § 2550.408b-4(c)(3).

¹⁴ While the concept of a “reasonable” rate of interest is not defined in the exemption itself or the related regulation, it is defined in an individual exemption based on Section 4975(d)(4), as “a rate of interest determinable by reference to short-term rates available to other customers of the bank, those offered by other banks, those available from money market funds, those applicable to short-term instruments such as repurchase agreements, or by reference to a benchmark such as sovereign short term debt (e.g., in the U.S., treasury bills), all in the jurisdiction where the rate is being evaluated.” Prohibited Transaction Exemption 2003-11, §III(f), 68 Fed. Reg. 34,648 (2003).

¹⁵ Treas. Reg. § 54.4975-6(b)(3)(i); 29 C.F.R. § 2550.408b-4(b)(2).

¹⁶ While the technical “effective date” of the Amended Regulation was June 7, 2016, the new rules actually take effect on the Amended Regulation’s “applicability date” of April 10, 2017.

While there is a separate regulation under Section 4975 on the definition of a “fiduciary” – Treas. Reg. § 54.4975-9 – that provision has not been specifically amended by the recent change. Rather, the DOL regulation under ERISA now cross-references the relevant subsection under Section 4975, effectively superseding the 1975 Treasury regulation. Commenters on the proposed regulation challenged the DOL’s authority to regulate IRAs that are not subject to ERISA and therefore under a different statute; the DOL responded that it has such authority under Reorganization Plan No. 4 of 1978, cited above, including the authority to interpret the definition of the term “fiduciary” under Section 4975(e)(3). 81 Fed. Reg. at 20,991.

such plan, or has any authority or responsibility to do so.”¹⁷ A 1975 regulation created what has been referred to as a “five-part” test for determining whether advice constitutes “investment advice” for this purpose.¹⁸

The Amended Regulation considerably revises the five-part test and expands the categories of “recommendations” that can, subject to certain other factors, constitute fiduciary “investment advice.” These now include recommendations with respect to:

1. the advisability of acquiring, holding, disposing of, or exchanging securities or other investment property;
2. 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;
3. how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred or distributed from a plan or IRA; and
4. the management of securities or other investment property, including, among other things, with regard to:
 - investment policies or strategies,
 - portfolio composition,
 - selection of other persons to provide investment advice or investment management services, or
 - selection of investment account arrangements (*e.g.*, brokerage versus advisory).¹⁹

The 1975 regulation, by its terms, effectively only covered the first category, although there were DOL interpretations extending the definition to parts of the fourth category. The second and third categories are new, representing in part the reversal of a 2005 DOL position that recommendations as to distribution options, even if accompanied by a recommendation as to where the distribution would be invested, were not fiduciary investment advice.²⁰

B. Prohibited Transaction Issues in Marketing and Selling Deposit IRAs

The Amended Regulation raises the following question: To what extent may the marketing and sales of Deposit IRAs, including discussions of rollovers from qualified plans or other IRAs into a Deposit IRA,

¹⁷ Code § 4975(e)(3)(B). The ERISA definition, in Section 3(21)(A)(ii), includes the additional language “to the extent,” so that a person is a fiduciary only “to the extent” the person performs the enumerated functions. While “to the extent” is missing from the Code definition, it is reflected in the associated regulation (see Treas. Reg. § 54.4975-9(c)(2)), and DOL interpretations do not draw any distinction on this basis.

¹⁸ Treas. Reg. § 54.4975-9; 29 C.F.R. § 2510.3-21. See 40 Fed. Reg. 50,840 (1975) (adopting these regulations).

¹⁹ 29 C.F.R. § 2510.3-21(a)(1), as amended by the Amended Regulation.

²⁰ See 81 Fed. Reg. at 20,964, indicating that the Amended Regulation supersedes DOL Advisory Opinion 2005-23A (Dec. 7, 2005).

now constitute fiduciary investment advice subject to the prohibited transaction rules? Because the DOL declined to exclude recommendations of bank CDs from the categories of recommendations that may result in fiduciary status, fees or other compensation received as a result of recommending CD investments may require an exemption.²¹

In its explanation of the Amended Regulation, the DOL clarified that so-called “hire me” discussions are not covered investment advice, as follows:

[T]he final rule was revised to state, as an example of a covered recommendation on investment management, a recommendation on the selection of “other persons” to provide investment advice or investment management services. Accordingly, a person or firm can tout the quality of his, her, or its own advisory or investment management services or those of any other person known by the investor to be, or fairly identified by the adviser as, an affiliate, without triggering fiduciary obligations.²²

However, the DOL cautioned that the Amended Regulation does not necessarily exempt a person from being a fiduciary merely because the person is recommending its own services. The same passage in the preamble states:

The final rule draws a line between an adviser’s marketing of the value of its own advisory or investment management services, on the one hand, and making recommendations to retirement investors on how to invest or manage their savings, on the other. An adviser can recommend that a retirement investor enter into an advisory relationship with the adviser without acting as a fiduciary. But when the adviser recommends, for example, that the investor pull money out of a plan or invest in a particular fund, that advice is given in a fiduciary capacity even if part of a presentation in which the adviser is also recommending that the person enter into an advisory relationship. ... Thus, when a recommendation to “hire me” effectively includes a recommendation on how to invest or manage plan or IRA assets (*e.g.*, whether to roll assets into an IRA or plan or how to invest assets if rolled over), that recommendation would need to be evaluated separately under the provisions in the final rule.²³

5. Reasons Why the Section 4975(d)(4) Exemption Would be Available

The following discussion assumes that the conditions of Section 4975(d)(4) are otherwise being met, including the reasonable rate of interest and authorization requirements, and that the only type of IRA that the Bank is making available to the customer is a Deposit IRA.

²¹ 81 Fed. Reg. at 20,962 (“the definition of investment property ... should include bank CDs and similar investment products,” because the DOL “does not see any basis for differentiating advice regarding investments in CDs ... from other investment products. ... To the extent an adviser will receive a fee or other compensation as a result of a recommended investment in a CD, that communication presents the type of conflict of interest that is the focus of the rule.”).

²² *Id.* at 20,968.

²³ *Id.*

A. Section 4975(d)(4) Exemption Covers Fiduciary Investment Advice

The threshold question is whether the exemptive relief provided by Section 4975(d)(4) extends to non-discretionary “investment advice” fiduciaries. There is no indication that this would *not* be the case. As noted above, the statute and regulation use the term “fiduciary” without distinguishing in which capacity the bank is acting as a fiduciary.

This interpretation is confirmed by the DOL’s preamble to the final BIC Exemption, which indicates that Section 4975(d)(4), like the BIC Exemption, can provide exemptive relief for compensation received as a result of “investment advice” recommendations. In response to a request for broader supplemental relief for the extensions of credit viewed as being inherent in a bank deposit and certificate of deposit transaction, where such deposits may be recommended by an “investment advice” fiduciary in accordance with Section I of the exemption, the DOL said that while the final exemption did not include such relief, this relief is generally available under existing statutory exemptions such as ERISA Section 408(b)(4) and Code Section 4975(d)(4).²⁴

B. Section 4975(d)(4) Exemption Can Cover Rollover Advice

The next question is whether Section 4975(d)(4) can cover any investment advice that the Amended Regulation would deem to occur in connection with an individual’s rollover of qualified plan or IRA assets into a Deposit IRA.

When Section 4975(d)(4) was enacted and the related regulation was adopted, rollover advice was not considered fiduciary investment advice. However, once the definition of fiduciary investment advice is expanded to include rollovers, any reference to fiduciary status in the statute or the regulations should presumably now be interpreted to include rollover advice as well, whether as part of a prohibition or part of an exemption from a prohibition. Therefore, the term fiduciary as used in Section 4975(d)(4) can now reasonably be viewed to cover a person that is a fiduciary by reason of providing rollover advice, to the extent such advice triggers fiduciary status, unless there were a reason to interpret the exemption by its terms to exclude rollover transactions.

If other investments were available within an IRA, or alternative forms of IRA were available, then additional exemptive relief could be necessary to address conflicts of interest in recommending between, for example, a Deposit IRA versus a brokerage account IRA that permits investments in a wide range of securities. If the only available form of IRA is a Deposit IRA and the only available investments within

²⁴ 81 Fed. Reg. at 21,064. In the same discussion, the DOL pointed out that a statutory exemption that could be available for purchases of debt securities – ERISA Section 408(b)(17) and Code Section 4975(d)(20) – would not provide relief where the issuer is a fiduciary, requiring a separate exemption to provide fiduciary relief. However, the DOL did not draw any such distinction with regard to ERISA Section 408(b)(4) and Code Section 4975(d)(4).

This result is consistent with the position that the DOL took when a similar question arose in connection with an administrative exemption for a plan fiduciary to execute securities transactions for a fee through itself or an affiliate. Prohibited Transaction Exemption (“PTE”) 86-128, 51 Fed. Reg. 41,686 (1986), most recently amended at 81 Fed. Reg. 21,181 (2016). The DOL took the view that PTE 86-128, by its terms, provides relief for covered transactions engaged in by any person who meets the definition of a fiduciary under ERISA (and, by extension, the Code), including a person who is a fiduciary solely by reason of rendering investment advice. The DOL said that while the exemption specifically excludes relief for plan administrators and plan sponsors, it contains no exclusion for “investment advice” fiduciaries. DOL Advisory Opinion 2011-08A (June 21, 2011).

the IRA are Bank deposits, however, then a Bank’s recommendation of a rollover into a Deposit IRA would be the same as a recommendation to invest in the Bank’s deposits. As that is what the Section 4975(d)(4) exemption covers, it is reasonable to read the exemption as covering all aspects of the investment advice that leads to the Bank deposit investments, including the rollover advice.²⁵

6. Separate Exemptive Relief Is Available for IRA Trust and Custody Services

The Section 4975(d)(4) exemption would not cover the Bank’s role as trustee or custodian of a Deposit IRA, or any fees or other compensation the Bank receives for its trust or custody services. As a general matter, the Bank’s compensation for such services would be covered by a separate exemption, Section 4975(d)(2), which provides relief for reasonable arrangements for the provision by a disqualified person of services necessary for the establishment or operation of an IRA, if no more than reasonable compensation is paid for the services. However, this exemption has been interpreted not to provide relief from the prohibition against fiduciary self-dealing.²⁶ The question, then, would be whether a Bank’s advice with regard to using a Deposit IRA to which the Bank provides trust or custody services, for compensation, could be viewed as raising a separate prohibited self-dealing issue under the new definition that is not covered by the Section 4975(d)(2) exemption.²⁷

There are two arguments as to why retaining the Bank as a Deposit IRA trustee or custodian should not be considered to be the result of fiduciary investment advice. The first is that the Bank, in marketing its IRA trust and custody services, should come within the so-called “hire me” exception described in Section IV.B. above, because the Bank would only be marketing its own services. The second is that, unless the Bank is at the same time marketing its services as an investment adviser or investment manager for the IRA (including as part of its role as trustee, if applicable), it has not done anything that comes within the scope of an investment advice recommendation as contemplated by the Amended Regulation. The preamble to the final regulation clarified this view in response to concerns as to whether recommendations of service providers who are not fiduciary investment advisers or investment managers

²⁵ We note that one of the administrative class exemptions that was amended in conjunction with the Amended Regulation, PTE 84-24 (which permits “investment advice” fiduciaries to receive compensation in connection with the purchase of insurance and annuity contracts and mutual fund shares), was specifically revised to include rollover and distribution transactions within the scope of relief. Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters, 81 Fed. Reg. 21,147 (2016). Notably, though, the DOL did not originally include this revision in its proposed changes to PTE 84-24. In response to comments that expressed concern as to whether the amended exemption would cover transactions resulting from a rollover or distribution, the DOL responded that it had intended the exemption’s original language to cover such transactions, but it nevertheless amended the text to state specifically that it applies. 81 Fed. Reg. at 21,155. Thus, consistent with the reading of Section 4975(d)(4) described here, the DOL’s position is that inclusion of rollover/distribution language is not necessary for an exemption otherwise providing exemptive relief to fiduciaries to reach such transactions.

An additional consideration is whether a rollover recommendation to an ERISA plan participant brings into consideration Title I of ERISA. In the preamble to the Amended Regulation, the DOL took the view that recommendations on distributions from an ERISA plan, including rollovers, would be covered by Title I of ERISA. 81 Fed. Reg. at 20,964. If that is the case, then the same analysis should apply under the parallel provisions of ERISA, including the parallel bank deposit exemption under ERISA Section 408(b)(4).

²⁶ Treas. Reg. § 54.4975-6(a)(1).

²⁷ If the Bank does not charge separately for its trust or custody services, however, there would not be a separate fiduciary self-dealing issue. See Treas. Reg. § 54.4975-6(a)(5)(iii) (“Services without compensation,” stating that if a fiduciary provides services to a plan without the receipt of compensation, the provision of the services would not, in and of itself, constitute prohibited self-dealing).

may be considered fiduciary advice. The DOL stated that it did not intend the regulation to reach recommendations of persons to provide services, such as non-discretionary execution of securities transactions or recordkeeping, that did not come within these categories.²⁸

A possible question on these arguments is raised by the DOL's distinction, in its "hire me" discussion, that recommending whether to roll over assets into an IRA would not come within the "hire me" exception and would need to be evaluated separately under the provisions in the final rule.²⁹ But in the context of a rollover to a Deposit IRA that exclusively invests in bank deposits, this separate evaluation would then lead to looking to the Section 4975(d)(4) exemption to cover that particular recommendation, as discussed above. The DOL did not say that a discussion of rollovers or investments results in the "hire me" discussion becoming investment advice, only that such discussions are not within the "hire me" exception. Thus, where the retention of the Bank as IRA trustee or custodian is ancillary to the advice to roll over into a Deposit IRA, these statements should not affect the ability to treat the recommendation of the Bank's IRA trust or custody services, standing alone, as coming within that exception.

7. Conclusion

The expanded definition of fiduciary investment advice under the Amended Regulation has called into question a number of practices that now, according to the DOL, will become subject to fiduciary status and the prohibited transaction rules. Nevertheless, where a Bank is making available only a Deposit IRA that will invest exclusively in the Bank's deposits, it should be reasonable for the Bank to take the position that any additional prohibited transaction issues raised by the expanded definition in its marketing of Deposit IRAs would be covered by the Section 4975(d)(4) exemption for bank deposit investments, and by the Section 4975(d)(2) exemption to the extent necessary to cover the Bank's IRA trust or custody services. A bank, therefore, may reasonably rely on these statutory exemptions, rather than on the BIC Exemption, to cover (1) an IRA's investment in bank deposits (including bank CDs), and (2) rollovers into an IRA that invests exclusively in bank deposits (including bank CDs).

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²⁸ 81 Fed. Reg. at 20,968.

²⁹ 81 Fed. Reg. at 20,968.