PRESENT LAW AND BACKGROUND RELATING TO PROHIBITED TRANSACTIONS, INVESTMENT ADVICE, AND FIDUCIARY STATUS WITH RESPECT TO RETIREMENT PLANS AND INDIVIDUAL ACCOUNTS

Scheduled for a Public Hearing
Before the
HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT
on September 30, 2015

Prepared by the Staff
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CONTENTS

Page

INTRODUCTION AND SUMMARY ... 1

I. PRESENT LAW ... 10
   A. Tax-Favored Retirement Savings ... 10
      1. In general ... 10
      2. Individual retirement arrangements (IRAs) ... 10
      3. Tax-favored employer-sponsored plans ... 12
      4. Rollovers and transfers between tax-favored retirement savings arrangements ... 20
   B. Other Tax-Favored Accounts ... 22
      1. Health savings accounts (HSAs) and Archer MSAs ... 22
      2. Coverdell education savings accounts (Coverdell ESAs) ... 23
   C. Prohibited Transactions ... 24
      1. In general ... 24
      2. Exemptions from prohibited transaction treatment ... 25
      3. Sanctions for violations ... 26
      4. Jurisdiction over the prohibited transaction rules ... 26
   D. Fiduciary Status Based on Investment Advice ... 29
      1. Existing DOL guidance ... 29
      2. Proposed regulations ... 32
   E. Prohibited Transaction Exemptions Relating to Investment Advice ... 39
      1. Statutory investment advice exemptions under the Pension Protection Act of 2006 ... 39
      2. New proposed best interest contract ("BIC") class exemption ... 42
      3. New proposed class exemption for principal transactions in certain debt securities ... 50
      4. Proposed changes to existing class exemptions ... 54

II. DATA RELATING TO CERTAIN TAX-FAVORED SAVINGS ACCOUNTS ... 59
      1. Individual retirement arrangements (IRAs) ... 59
      2. Private defined contribution plans ... 59
      3. Health savings accounts (HSAs), Medicare Advantage MSAs and Archer MSAs ... 60

INTRODUCTION AND SUMMARY

The Subcommittee on Oversight of the Committee on Ways and Means of the House of Representatives has scheduled a public hearing on September 30, 2015, on the Department of Labor's proposed fiduciary rule. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of present law relating to prohibited transactions, investment advice, and fiduciary status with respect to retirement plans and individual accounts and data relating to such plans and accounts.

Present Law

Tax-favored retirement savings

In general

The Internal Revenue Code (Code) provides two general vehicles for tax-favored retirement savings: individual retirement arrangements (IRAs) and employer-sponsored retirement plans.

Tax-favored treatment for these vehicles generally consists of pretax treatment of contributions (that is, contributions are either excluded from income or deductible), tax-exempt status of the trust or account holding assets, and income inclusion by an individual only at the time of distribution, with the option of deferring income inclusion by rolling the distribution over to another tax-favored retirement vehicle. To the extent after-tax contributions are made, the contributions result in basis, which reduces the amount included in income at the time of distribution. In the case of a Roth IRA or designated Roth contributions made to an employer-sponsored plan, contributions are always made on an after-tax basis, and certain distributions are fully excluded from income.

Individual retirement arrangements

There are two basic types of IRAs under present law: traditional IRAs, to which both deductible (that is, pretax) and nondeductible (that is, after-tax) contributions may be made, and Roth IRAs, contributions to which are not deductible (and thus are made on an after-tax basis). The total contributions made to all IRAs for a year cannot exceed $5,500 (for 2015), plus an additional $1,000 (which is not indexed) in catch-up contributions for individuals age 50 or older.

An individual may make deductible contributions to a traditional IRA if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan. If an individual (or the individual's spouse) is an active participant in an

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[1] This document may be cited as follows: *Joint Committee on Taxation, Present Law and Background Relating to Prohibited Transactions, Investment Advice, and Fiduciary Status with respect to Retirement Plans and Individual Accounts* (JCX-131-15), September 28, 2015. This document can also be found on the Joint Committee on Taxation website at www.jct.gov.

employer-sponsored retirement plan, the deduction is phased out for taxpayers with adjusted gross income ("AGI") for the taxable year over certain indexed levels. An individual who cannot make deductible contributions to a traditional IRA may make nondeductible contributions, regardless of AGI level, and an individual who is permitted to make deductible contributions may choose to treat them as nondeductible. An individual who has attained age 70½ by the close of a taxable year is not permitted to make contributions to a traditional IRA for that year. Nondeductible contributions result in basis in the IRA. Amounts held in a traditional IRA are includible in income when distributed, except for the portion of the distribution, if any, treated as a return of the individual's basis, or to the extent rolled over.

Individuals with AGI below certain levels may make contributions to a Roth IRA; the maximum annual contribution that can be made to a Roth IRA is phased out for taxpayers with AGI over certain indexed levels. Subject to the AGI limits, contributions to a Roth IRA may be made even after the account owner has attained age 70½. Amounts distributed from a Roth IRA in a qualified distribution are not includible in income. A qualified distribution is a distribution that (1) is made after the five-taxable-year period beginning with the first taxable year for which the individual first made a contribution to a Roth IRA, and (2) is made after attainment of age 59½, on account of death or disability, or is made for first-time homebuyer expenses of up to $10,000. A distribution from a Roth IRA that is not a qualified distribution is includible in income to the extent attributable to earnings.

Subject to exceptions, a distribution made before age 59½ from a traditional IRA or a Roth IRA is generally subject to a 10-percent additional tax to the extent the distribution is includible in income.

Tax-favored employer-sponsored plans

Whether to offer a tax-favored retirement plan to employees is a voluntary choice by an employer. A key element in an employer's decision is the value that employees place on being provided benefits under a retirement plan versus receiving current compensation. A basic reason for employees to value being provided benefits under an employer-sponsored retirement plan as a portion of their total compensation is the tax deferral and savings opportunity inherent in these plans. Subject to Code rules governing employer-sponsored retirement plans, an employer has a great deal of flexibility in deciding the structure of its retirement plan and the level of benefits as permitted under the types of plans available. The most common type of tax-favored employer-sponsored plan is a qualified retirement plan, which may be a defined benefit plan or a defined contribution plan. Additional options are available to certain tax-exempt or State or local government employers. Other options are a SIMPLE IRA plan (for a small employer) and a simplified employee pension plan, which are funded using IRAs for employees.

A qualified retirement plan is a plan that meets the qualification requirements under the Code. In addition to the tax-favored treatment described above, in the case of a taxable employer, the employer is entitled to a current deduction (within limits) for contributions. A qualified retirement plans must meet a number of requirements. Some define the rights of plan participants and beneficiaries. The nondiscrimination requirements prohibit a plan from discriminating in favor of highly compensated employees, so that qualified retirement plans further the goal of retirement security for both lower-paid and higher-paid employees. The

amount of contributions and benefits under a qualified retirement plan is subject to limits. Plan assets must be held in a trust or custodial account for the exclusive benefit of plan participants and beneficiaries. In addition, prohibited transaction rules prohibiting self-dealing with respect to plan assets by employers, plan fiduciaries, and other related persons. Private defined benefit plans and some private defined contribution plans are subject to minimum funding requirements.

Qualified retirement plans (other than, generally, governmental plans and church plans) are also subject to rules under the Employee Retirement Income Security Act of 1974 (ERISA), which generally is under the jurisdiction of the Department of Labor (DOL). Some of these rules parallel Code rules applicable to qualified retirement plans.

Enforcement of qualified retirement plan requirements depends on the source of the requirement. The Internal Revenue Service (IRS) enforces the requirements under the Code. If a plan fails the qualification requirements, favorable tax treatment for such plans may be denied. However, as a practical matter, the IRS rarely disqualifies a plan and instead may impose a lesser sanction and require the employer to correct a violation. Certain Code requirements for qualified plans are enforced through an excise tax rather than through disqualification. Requirements under ERISA may be enforced through administrative actions by DOL, through lawsuits by DOL, plan participants or beneficiaries, or plan fiduciaries, or through the imposition of civil penalties.

Qualified retirement plans are broadly classified into two categories, defined contribution plans and defined benefit plans, based on the nature of the benefits provided. Under a defined contribution plan, a separate account is maintained for each participant, to which contributions are allocated and investment earnings (and losses) are credited, and a participant's benefits are based solely on the participant's account balance. Under a defined benefit plan, benefits are determined under a plan formula. Benefits under a defined benefit plan are funded by the general assets of the trust established under the plan without individual accounts for participants. Certain types of plans are referred to as hybrid plans because they have features of both a defined benefit plan and a defined contribution plan.

Defined contribution plans may provide for nonelective contributions and matching contributions by employers and pretax or after-tax contributions by employees. Total contributions made to an employee's account for a year cannot exceed the lesser of $53,000 (for 2015) or the employee's compensation. Defined contribution plans may include special features, such as a qualified cash or deferred arrangement (called a section 401(k) plan) or an employee stock ownership plan. Under a section 401(k) plan, an employee may elect to have contributions made to the plan, rather than receive the same amount in cash. For 2015, elective deferrals of up to $18,000 may be made, plus, for employees aged 50 or older, up to $6,000 in catch-up contributions. Elective deferrals may be made on a pretax basis or in after-tax Roth form.

Section 403(b) plans are generally similar to qualified defined contribution plans, but may be maintained only by tax-exempt charitable organizations and public schools. A governmental section 457(b) plan is a plan maintained by a State or local government and is generally similar to a qualified cash-or deferred arrangement under a section 401(k) plan.

ERISA contains general fiduciary duty standards that apply to all fiduciary actions, including investment decisions. With respect to plan assets, a fiduciary must diversify the investments of the plan so as to minimize the risk of large losses unless under the circumstances it is clearly prudent not to do so. A plan fiduciary that breaches its fiduciary responsibilities is personally liable to make good to the plan any losses to the plan resulting from the breach. A special fiduciary rule applies to a defined contribution plan that permits participants to direct the investment of their accounts under the plan. Subject to certain conditions, under the special rule, a plan fiduciary is not liable for losses resulting from participants' investment decisions.

Employer-sponsored plans are not required to provide for distributions to participants before the later of attainment of normal retirement age under the plan or termination of employment. However, plans commonly allow distributions when a participant terminates employment, regardless of the participant's age. Although plans commonly allow distributions on termination of employment at any age, a plan of a private employer generally cannot require a participant who has terminated employment to take a distribution before age 62 unless the value of the participant's vested accrued benefit under the plan is $5,000 or less. Thus, a participant generally decides whether and when to take a distribution.

A distribution from an employer-sponsored plan is generally includible in income except to the extent consisting of basis recovery (as a result of after-tax contributions) or a qualified distribution from a designated Roth account. A distribution from a qualified retirement plan or section 403(b) plan before age 59½ is generally subject to a 10-percent early withdrawal tax to the extent the distribution is includible in income unless an exception applies or the distribution is rolled over to another IRA or employer-sponsored plan as discussed below.

Rollovers and transfers between tax-favored retirement savings arrangements

A distribution from a tax-favored employer-sponsored retirement plan or an IRA generally may be rolled over to another such plan or an IRA, either by a direct rollover or by contributing the distribution to the other plan or IRA within 60 days of receiving the distribution.

Other tax-favored accounts

Health savings accounts (HSAs) and Archer MSAs

An individual with a high deductible health plan (and, subject to exceptions, no other health plan) generally may make contributions to a health savings account (HSA). In some cases, such an individual may contribute to an Archer MSA. Subject to limits, an individual's HSA and Archer MSA contributions are deductible in determining adjusted gross income and are excludable from an employee's income and wages if made by an employer. HSA and Archer MSA distributions used for qualified medical expenses are not includible in gross income. Distributions may also be rolled over to another HSA or Archer MSA.

Coverdell education savings accounts (Coverdell ESAs)

A Coverdell education savings account (Coverdell ESA) is a trust or custodial account created exclusively for the purpose of paying qualified education expenses of a designated beneficiary. Subject to AGI limits, annual after-tax contributions up to $2,000 may be made

until a designated beneficiary reaches age 18. Earnings on contributions to a Coverdell ESA generally are includible in income when withdrawn; however, distributions are excludable from income up to the beneficiary's qualified education expenses for the year. Amounts in a Coverdell ESA may be rolled over to another Coverdell ESA for the same beneficiary or certain family members. In general, the balance in a Coverdell ESA is deemed distributed within 30 days after the date that the beneficiary reaches age 30.

Prohibited transactions

In general

The Code and ERISA prohibit certain transactions (prohibited transactions) between a qualified retirement plan and a disqualified person, including fiduciaries. The prohibited transaction rules under the Code apply also to IRAs, HSAs, Archer MSAs, and Coverdell ESAs. For this purpose, a fiduciary includes any person who (1) exercises any discretionary authority or discretionary control respecting management of the plan or exercises any authority or control respecting management or disposition of the plan's assets, (2) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of the plan, or has any authority or responsibility to do so, or (3) has any discretionary authority or discretionary responsibility in the administration of the plan. Prohibited transactions include (1) the sale or exchange or leasing of property, (2) the lending of money or other extension of credit, (3) the furnishing of goods, services or facilities, (4) the transfer to, or use by or for the benefit of, the income or assets of the plan, (5) in the case of a fiduciary, an act dealing with the plan's income or assets in the fiduciary's own interest or for the fiduciary's own account, and (6) the receipt by a fiduciary of any consideration for the fiduciary's own personal account from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

Exemptions from prohibited transaction treatment

Certain transactions are statutorily exempt from prohibited transaction treatment. In addition, in certain circumstances, administrative exemptions may be granted by DOL, on either an individual or class basis.

Sanctions for violations

Under the Code, a prohibited transaction may result in the imposition of an excise tax. In the case of an IRA, HSA, Archer MSA, or Coverdell ESA, a prohibited transaction may instead result in loss of tax-favored status. Under ERISA, a civil penalty or fiduciary suit may result from a prohibited transaction.

Jurisdiction over the prohibited transaction rules

As enacted in 1974, Title III of ERIS included certain provisions dealing with the coordination between the Department of the Treasury (Treasury) and DOL of administrative and enforcement action over retirement plans, including procedures in connection with prohibited transactions. In addition, jurisdiction over the Code provisions governing qualified plans and similar provisions under ERISA was divided between Treasury and DOL by Executive Order,

referred to as Reorganization Plan No. 4 of 1978. As part of this division, subject to certain exceptions, authority was transferred to DOL with respect to regulations, rulings, opinions, and exemptions under the prohibited transaction provisions of the Code. As a result, DOL regulations and other guidance relating to prohibited transactions applies for Code purposes, including with respect to IRAs, HSAs, Archer MSAs, and Coverdell ESAs.

Fiduciary status based on investment advice

Existing DOL guidance

Under DOL regulations issued in 1975, a person is deemed to be rendering "investment advice" for purposes of fiduciary status only if (1) the person renders advice to the plan as to the value of securities or other property, or makes recommendation as to the advisability of investing in, purchasing, or selling securities or other property, and (2) the person either directly or indirectly (for example, through or together with any affiliate) (a) has discretionary authority or control, whether or not pursuant to agreement, arrangement or understanding, with respect to purchasing or selling securities or other property for the plan, or (b) renders any advice as described above on a regular basis to the plan pursuant to a mutual agreement, arrangement or understanding, written or otherwise, between the person and the plan or a fiduciary with respect to the plan, that the person's services will serve as a primary basis for investment decisions with respect to plan assets, and that the person will render individualized investment advice to the plan based on the particular needs of the plan regarding matters such as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments. With respect to a person who does not have discretionary authority or control with respect to plan investments, the standard in the regulations (as described above) is sometimes referred to as a "five part test," with fiduciary status resulting only if all five parts are met.

Under DOL's Interpretive Bulletin 96-1, the furnishing of mere investment education to a participant or beneficiary in a participant-directed individual account plan does not constitute the rendering of "investment advice." For this purpose, investment education includes the following categories of information and materials, as described in Interpretive Bulletin 96-1: plan information, general financial and investment information, asset allocation models, and interactive investment materials. However, the information and materials described in these categories are merely examples of the type of information and materials that may be furnished without constituting "investment advice." Accordingly, Interpretive Bulletin 96-1 provides that no inferences should be drawn from the description of the four categories as to whether the furnishing of other information, materials or educational services constitutes "investment advice."

Proposed regulations

On April 20, 2015, DOL proposed regulations that would replace the current regulations relating to investment advice with a new standard as to whether a person is a fiduciary based on rendering investment advice, generally to be applicable eight months after final regulations are published. Under the proposed regulations, a person is a fiduciary based on rendering investment advice if the person (1) provides to a plan, a plan fiduciary, an IRA, or an IRA owner certain types of recommendations or statements that constitute investment advice with respect to

plan or IRA assets in exchange for a fee or other compensation, and (2) either represents or acknowledges that it is acting as a fiduciary with respect to the investment advice, or renders the advice pursuant to an agreement, arrangement or understanding that the advice is individualized to or specifically directed to the advice recipient for consideration in making investment or management decisions with respect to assets of the plan or IRA.

The proposed regulations provide exceptions for (1) certain counterparties in transactions with an employee benefit plan; (2) swap and security-based swap transactions with an employee benefit plan; (3) employees of an employee benefit plan sponsor; (4) platform providers to employee benefit plans; (5) persons providing selection and monitoring assistance to employee benefit plans; (6) financial reports and valuations (including to an IRA or IRA owner); and (7) investment education (including to an IRA or IRA owner), under standards somewhat different from Interpretive Bulletin 96-1. However, an exception does not apply if the person represents or acknowledges that it is acting as a fiduciary with respect to the advice. In conjunction with the proposed regulations, DOL has proposed two new class prohibited transaction exemptions, as well as proposing changes to various existing class exemptions.

Prohibited transaction exemptions relating to investment advice

Statutory investment advice exemptions under the Pension Protection Act of 2006 ("PPA")

Under PPA, in the case of investment advice provided by a fiduciary advisor through an eligible investment advice arrangement to participants and beneficiaries who direct the investment of their accounts under a defined contribution plan (and to IRA owners), if certain requirements are met, the following are exempt from prohibited transaction treatment: (1) the provision of investment advice, (2) an investment transaction pursuant to the advice, and (3) the receipt of fees or other compensation in connection with the provision of the advice or an investment transaction pursuant to the advice. An eligible investment advice arrangement is an arrangement that meets certain requirements and either (1) provides that any fees received by the fiduciary adviser do not vary depending on the basis of any investment option selected or (2) uses a computer model under an investment advice program in connection with the provision of investment advice to a participant or beneficiary. In the case of an eligible investment advice arrangement with respect to a defined contribution plan, the arrangement must be expressly authorized by a plan fiduciary other than the person offering the investment advice program or a person providing investment options under the plan. In order for an exemption to apply, various requirements with respect to notices and disclosure, recordkeeping and audits must be met.

New proposed best interest contract ("BIC") class exemption

In conjunction with issuing the April 2015 proposed regulations, DOL issued a new proposed prohibited transaction class exemption that allows financial institutions and related advisers to be compensated for rendering investment advice to retirement investors, subject to a requirement that the advice is in the best interest of the retirement investor and meets certain other requirements (referred to as the "best interest contract (or "BIC") class exemption"). Retirement investors means plan participants or beneficiaries who direct the investment of the assets in their accounts, IRA owners who make investment decisions with respect to their IRAs,

and a plan sponsor (or employee, officer, or director thereof) who is a fiduciary of a plan with fewer than 100 participants that does not provide for participant-directed investments. Under the proposed exemption, investment advice is in the best interest of a retirement investor when the adviser providing the advice acts with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor, without regard to the financial or other interests of the adviser or other party. In order for the exemption to apply, four categories of requirements must be met: contract, impartial conduct and other related requirements; range of investment options; cost and fee disclosures; and disclosures to DOL and recordkeeping. Supplementary exemptions are also proposed for the sale of insurance and annuity contracts by insurance companies that are financial institutions under the proposed BIC class exemption and for pre-existing transactions. The preamble to the proposed exemption also indicates that DOL is considering an additional class exemption for certain high-quality, low-fee investments (such as mutual funds) that would be subject to fewer conditions than the best interest contract exemption.

New proposed class exemption for principal transactions in certain debt securities

Prohibited transactions include the purchase or sale between an employer-sponsored plan or IRA and a fiduciary acting on behalf of its own account (that is, with respect to its own investment holdings), referred to as a "principal transaction." DOL has proposed a new class exemption to permit in some circumstances such transactions in certain debt securities between a retirement investor and a fiduciary that provides investment advice to the retirement investor. Subject to certain requirements and limitations, the proposed exemption permits an adviser to engage in the purchase or sale of a debt security in a principal transaction with a retirement investor and receive a payment as a result of the advice. In order for the exemption to apply, requirements must be met with respect to the contract between the adviser and the retirement investor, disclosure, and recordkeeping.

Proposed changes to existing class exemptions

In connection with the issuance of the proposed regulations and new proposed class exemptions, DOL has proposed changes to the following existing class exemptions: (1) transactions under prohibited transaction exemption 75-1, Parts I(b) and (c), II(2), III, IV and (V), (2) prohibited transaction exemption 84-24, and (3) prohibited transaction exemption 86-128.

Data relating to certain tax-favored savings accounts

Individual retirement arrangements (IRAs)

In 2012, traditional IRAs held approximately $4.7 trillion of assets across 42 million accounts. Roth IRAs held significantly less, with approximately $410 billion of assets across 17 million accounts. Rollover contributions from employer-sponsored plans or other IRAs totaled $313 billion of assets across approximately 4 million accounts.

Private defined contribution plans

In 2012, there were approximately 470,000 private defined contribution plans with some degree of participant-directed investment, accounting for 61.2 million active participants and assets totaling $3.4 trillion.

HSAs, Medicare Advantage MSAs and Archer MSAs

In 2012, HSAs and MSAs held approximately $14 billion of assets across 7 million accounts. Of these 7 million accounts, approximately 83 percent indicate the taxpayer made some sort of a contribution in 2012, including rollovers.

I. PRESENT LAW

A. Tax-Favored Retirement Savings[2]

1. In general

The Internal Revenue Code ("Code")[3] provides two general vehicles for tax-favored retirement savings: individual retirement arrangements ("IRAs") and employer-sponsored retirement plans.

Tax-favored treatment for these vehicles generally consists of pretax treatment of contributions (that is, contributions are either excluded from income or deductible),[4] tax-exempt status of the trust or account holding assets, and income inclusion by an individual only at the time of distribution, with the option of deferring income inclusion by rolling the distribution over to another tax-favored retirement vehicle.[5] To the extent contributions are made on an after-tax basis, the contributions result in basis, which reduces the amount included in income at the time of distribution. In the case of a Roth IRA or designated Roth contributions made to an employer-sponsored plan, contributions are always made on an after-tax basis, and certain distributions are fully excluded from income.

2. Individual retirement arrangements (IRAs)

<u>In general</u>

There are two basic types of IRAs under present law: traditional IRAs, to which both deductible (that is, pretax) and nondeductible (that is, after-tax) contributions may be made, and Roth IRAs, contributions to which are not deductible (and thus are made on an after-tax basis).[6] The principal difference between the two types of IRAs is the timing of income inclusion, as discussed below. The total contributions made to all IRAs for a year cannot exceed $5,500 (for

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[2] For more detailed discussions of tax-favored retirement savings generally and IRAs and defined contribution plans in particular, see Joint Committee on Taxation, *Present Law and Background Relating to Tax-Favored Retirement Savings* (JCX-98-14), September 15, 2014. This document is available at www.jct.gov.

[3] Unless otherwise stated, all section references herein are to the Internal Revenue Code of 1986, as amended.

[4] Employer contributions to tax-favored retirement plans are also exempt from Social Security and Medicare taxes applicable to wages under the Federal Insurance Contributions Act ("FICA").

[5] As discussed below, a distribution from a tax-favored retirement savings arrangement before age 59½ is generally subject to an additional 10-percent tax. Under the minimum distribution requirements of section 401(a)(9), distributions from a tax-favored retirement savings arrangement (other than a Roth IRA) are generally required to begin within a certain period after attainment of age 70½ and must be taken over the individual's life or life expectancy. Minimum distribution requirements also apply after a participant's death (including to Roth IRAs). An excise tax under section 4974may apply if required minimum distributions are not made.

[6] Secs. 219, 408 and 408A.

2015), plus an additional $1,000 (which is not indexed) in catch-up contributions for individuals age 50 or older. Certain individuals are not permitted to make deductible contributions to a traditional IRA or to make contributions to a Roth IRA, depending on their income.

Traditional IRAs

An individual may make deductible contributions to a traditional IRA if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan. If an individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the deduction is phased out for taxpayers with adjusted gross income ("AGI") for the taxable year over certain indexed levels. In the case of an individual who is an active participant in an employer-sponsored plan, the AGI phase-out ranges for 2015 are: (1) for single taxpayers, $61,000 to $71,000; (2) for married taxpayers filing joint returns, $98,000 to $118,000; and (3) for married taxpayers filing separate returns, $0 to $10,000. If an individual is not an active participant in an employer-sponsored retirement plan, but the individual's spouse is, the deduction is phased out for taxpayers with AGI for 2015 between $183,000 and $193,000.

An individual who cannot make deductible contributions to a traditional IRA may make nondeductible contributions, that is, after-tax, to a traditional IRA regardless of AGI level (that is, no AGI limits apply). In addition, an individual who would be permitted to deduct the contributions to a traditional IRA may choose to make nondeductible contributions.[7] Nondeductible contributions result in basis in the IRA.

An individual who has attained age 70½ by the close of a taxable year is not permitted to make contributions to a traditional IRA for that year.

Amounts held in a traditional IRA are includible in income when distributed, except for the portion of the distribution, if any, treated as a return of the individual's basis. A distribution from a traditional IRA generally may be rolled over to another traditional IRA or a tax-favored employer-sponsored retirement plan, as discussed below.

Roth IRAs

Individuals with AGI below certain levels may make contributions to a Roth IRA. Roth IRA contributions are not deductible, so all are made on an after-tax basis. The maximum annual contribution that can be made to a Roth IRA is phased out for taxpayers with AGI for the taxable year over certain indexed levels. The AGI phase-out ranges for 2015 are: (1) for single taxpayers, $116,000 to $131,000; (2) for married taxpayers filing joint returns, $183,000 to $193,000; and (3) for married taxpayers filing separate returns, $0 to $10,000. Subject to the AGI limits, contributions to a Roth IRA may be made even after the account owner has attained age 70½.

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[7] Sec. 408(o).

Amounts held in a Roth IRA that are distributed as a qualified distribution are not includible in income. A qualified distribution is a distribution that (1) is made after the five-taxable-year period beginning with the first taxable year for which the individual first made a contribution to a Roth IRA, and (2) is made after attainment of age 59½, on account of death or disability, or is made for first-time homebuyer expenses of up to $10,000.[8]

Distributions from a Roth IRA that are not qualified distributions are includible in income to the extent attributable to earnings (unless rolled over to another Roth IRA); amounts that are attributable to contributions (which are always after-tax) to the Roth IRA are not includible in income. All Roth IRAs are treated as a single IRA for purposes of determining the amount that is attributable to contributions. To determine the amount includible in income, a distribution that is not a qualified distribution is treated as made in the following order: (1) regular Roth IRA contributions (including contributions rolled over from other Roth IRAs), (2) conversion contributions (on a first-in, first-out basis), and (3) earnings.[9] To the extent a distribution is treated as made from a conversion contribution, it is treated as made first from the portion, if any, of the conversion contribution that was required to be included in income as a result of the conversion. Thus, nonqualified distributions from Roth IRAs are excludable from gross income until all amounts attributable to contributions have been distributed.

Early withdrawal tax

A distribution made before age 59½ from a traditional IRA or a Roth IRA is generally subject to a 10-percent additional tax ("early withdrawal tax") to the extent the distribution is includible in income unless an exception applies or the distribution is rolled over to another IRA or employer-sponsored plan as discussed below.[10]

3. Tax-favored employer-sponsored plans

In general

Whether to offer a tax-favored retirement plan to employees is a voluntary choice by an employer. As with other components of a compensation package, an employer may have a variety of motivations in deciding whether to offer a retirement plan. The motivations to offer a plan may be different for a large public company that is broadly owned by its stockholders than for an owner-operated company where the plan is providing retirement benefits for both the owners and their employees. For a large public company that is competing for employees with other employers that offer retirement plans, the motivation may be primarily recruitment and retention of employees. For an owner-operated company, providing for the owner's retirement

[8] Sec. 408A(d)(2).

[9] Sec. 408A(d)(4)(B). Conversion contributions generally refers to amounts included in income as a result of a rollover or conversion of amounts held in a traditional IRA (or an employer-sponsored plan other than in a designated Roth account) to a Roth IRA as described in section 408A(d)(3).

[10] Sec. 72(t).

may play a larger role, with providing benefits also to employees as a further consideration. For some employers, the decision to offer a plan may be subject to collective bargaining negotiations.

A key element in an employer's decision is the value that employees place on being provided benefits under a retirement plan versus receiving current compensation. A basic reason for employees to value being provided benefits under an employer-sponsored retirement plan as a portion of their total compensation is the tax deferral and savings opportunity inherent in these plans. For example, the amount of elective deferrals an employee can make to an employer-sponsored retirement plan is greater than the contributions an individual can make to an IRA. In addition, the employer may separately make nonelective or matching contributions.

For employers that decide to offer a tax-favored retirement plan, the Code provides rules as to the amount of contributions and benefits, the timing of benefit distributions, and the deductibility of contributions. The Code also imposes protections for employees to ensure that they receive the benefits promised under the plan, for example, by prohibiting previously earned benefits from being reduced and requiring plan assets to be held in trust. However, subject to these rules, an employer has a great deal of flexibility in deciding the structure of its retirement plan and the level of benefits, as permitted under the various types of plans available.

One element in a plan's structure is whether the employer offers retirement benefits as a unilateral benefit that the employee accepts implicitly by accepting employment with, or remaining employed by, the employer. Alternatively, within limits, the employer may allow a year-by-year choice by the employee whether to accept current compensation or make contributions to the plan. Employers may structure a retirement plan in part as a retention tool so that only employees who work for a certain number of years become vested in the benefits accrued under the plan (subject to vesting requirements). In the case of employees covered by a collective bargaining agreement, coverage under a retirement plan and the terms of the plan are subject to the bargaining process.

The most common type of tax-favored plan is a qualified retirement plan,[11] which may be a defined benefit plan or a defined contribution plan. Another option is a qualified annuity plan,[12] which is similar to and subject to requirements similar to those applicable to qualified retirement plans.

Additional options are available to certain tax-exempt or State or local government employers, including tax-deferred annuities (called section 403(b) plans)[13] and eligible deferred compensation plans (called governmental section 457(b) plans).[14] Certain small employers have

[11] Sec. 401(a).

[12] Sec. 403(a).

[13] Sec. 403(b).

[14] Sec. 457(b).

the option of maintaining a SIMPLE IRA plan,[15] or an employer may maintain a simplified employee pension ("SEP") plan,[16] both which are funded through direct contributions by the employer to an IRA established for each employee.

Qualified retirement plans and annuities

In general

A plan of deferred compensation that meets the qualification requirements under the Code (that is, a qualified retirement plan) is accorded tax-favored treatment as described above. In addition, in the case of a taxable employer, the employer is entitled to a current deduction (within limits) for contributions even though the contributions are not currently included in an employee's income. A qualified annuity plan is a type of retirement plan that is subject to the same requirements as qualified retirement plans and receives comparable tax-favored treatment, but plan assets consist of annuity contracts, rather than investments held in a trust or custodial account.

Present law imposes a number of requirements on qualified retirement plans that must be satisfied for favorable tax treatment to apply.[17] Some of these requirements define the rights of plan participants and beneficiaries, such as the minimum participation and vesting requirements.[18] A qualified retirement plan is prohibited from discriminating in favor of highly compensated employees, referred to as the nondiscrimination requirements, consisting of a minimum coverage requirement and general nondiscrimination requirements.[19] These requirements are intended to ensure that a qualified retirement plan provides meaningful benefits to an employer's rank-and-file employees as well as highly compensated employees, so that qualified retirement plans further the goal of retirement security for both lower-paid and higher-paid employees. The amount of contributions and benefits under a qualified retirement plan is subject to limits.[20]

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[15] Sec. 408(p).

[16] Sec. 408(k).

[17] In general, for purposes of these requirements, members of controlled groups under section 414(b) or (c) and affiliated service groups under section 414(m) or (o) are treated as a single employer.

[18] Secs. 401(a)(3) and (7), 410(a) and 411.

[19] Sections 401(a)(3) and 410(b) deal with the minimum coverage requirement; section 401(a)(4) deals with the general nondiscrimination requirements, with related rules in section 401(a)(5). Detailed regulations implement the statutory requirements. In addition to the minimum coverage and general nondiscrimination requirements, the group employees who accrue benefits under a defined benefit plan for a year must consist of at least 50 employees, or, if less, 40 percent of the workforce, subject to a minimum of two employees accruing benefits. Governmental plans are not subject to these requirements.

[20] Secs. 401(a)(16) and 415.

Assets of a qualified retirement plan must be held in a trust or custodial account for the exclusive benefit of plan participants and beneficiaries and may not be used for any other purpose.[21] In addition, as discussed further below, prohibited transaction rules (that is, rules prohibiting self-dealing by employers, plan fiduciaries, and other related persons) apply to plan assets.[22] Defined benefit plans and some defined contribution plans are subject to minimum funding requirements.

Qualified retirement plans are also subject to regulation under the Employee Retirement Income Security Act of 1974 ("ERISA"), which generally is under the jurisdiction of the Department of Labor ("DOL").[23] The ERISA rules generally relate to the rights of plan participants and beneficiaries, reporting and disclosure, and the obligations of plan fiduciaries. Some of the provisions of the Code and ERISA that apply to qualified retirement plans are identical or very similar.[24] For example, ERISA includes minimum participation and vesting requirements that parallel those under the Code.[25]

Enforcement of qualified retirement plan requirements

Enforcement of a qualified retirement plan requirement depends on the source of the requirement. The qualification requirements under the Code are enforced by the Internal Revenue Service ("IRS"). If a plan fails to meet the qualification requirements, the favorable tax treatment for such plans may be denied; that is, the employer may lose tax deductions and employees may have current income inclusion. As a practical matter, the IRS rarely disqualifies a plan. Instead, the IRS may impose sanctions short of disqualification and require the employer (or other plan sponsor) to correct any violation of the qualification rules.[26]

Certain Code requirements for qualified plans are enforced through an excise tax rather than through disqualification. For example, a violation of the prohibited transaction rules, discussed below, does not result in disqualification of the plan. Instead, in general, an excise tax

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[21] Sec. 401(a)(2). Under this exclusive benefit requirement, prior to satisfaction of all liabilities under the plan with respect to employees and their beneficiaries, assets are not allowed to be used for, or diverted to, purposes other than the exclusive benefit of employees or their beneficiaries.

[22] Sec. 4975.

[23] Pub. L. No. 93-406. As originally enacted in 1974, ERISA consisted of Title I, provisions within the jurisdiction of DOL; Title II, Code provisions; Title III, provisions dealing with jurisdiction and administration (including coordination among the agencies); and Title IV, creating the insurance program for private defined benefit plans, administered by the PBGC. As used herein, "ERISA" generally refers to Title I.

[24] Governmental plans and church plans are generally exempt from ERISA and from the Code requirements that correspond to ERISA requirements.

[25] ERISA secs. 202 and 203.

[26] The Employee Plans Compliance Resolution System is a formal program under which an employer (or other plan sponsor) may correct violations and avoid plan disqualification. Rev. Proc. 2013-12, 2013-04 I.R.B. 313, modified by Rev. Proc. 2015-27, 2015-16 I.R.B. 914, and Rev. Proc. 2015-28, 2015-16 I.R.B. 920.

applies. Employees do not have a right to sue to enforce the qualified retirement plan requirements under the Code.

ERISA's requirements generally may be enforced through administrative actions by DOL or by lawsuits brought by DOL, plan participants or beneficiaries, or plan fiduciaries. Certain violations of ERISA may result in the imposition of a civil penalty.

Types of qualified retirement plans

Qualified retirement plans are broadly classified into two categories, defined contribution plans and defined benefit plans, based on the nature of the benefits provided.[27] Although both types of plans are subject to the qualification requirements, the requirements differ somewhat for the two types of plans.

Under a defined contribution plan, a separate account is maintained for each participant, to which contributions are allocated and investment earnings (and losses) are credited, and a participant's benefits are based solely on the participant's account balance.[28] As discussed below, defined contribution plans commonly allow participants to direct the investment of their accounts. Because the account balance, and thus the participant's benefits, depends on the rate of return on the account, the risk of investment loss (and reward of investment gain) under a defined contribution plan lies with the participant rather than the employer.

Under a defined benefit plan, benefits are determined under a plan formula.[29] Benefits under a defined benefit plan are funded by the general assets of the trust established under the plan, which are invested by plan fiduciaries in accordance with plan terms; individual accounts are not maintained for employees participating in the plan. Employer contributions to a private defined benefit plan are generally subject to minimum funding requirements intended to ensure that plan assets are sufficient to pay the benefits under the plan. Under ERISA, benefits under private defined benefit plans are generally guaranteed (within limits) by the Pension Benefit Guaranty Corporation ("PBGC").

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[27] Under the Code as in effect since before ERISA, retirement plans fall into three general types - pension plans, profit-sharing plans, and stock bonus plans, defined respectively at Treas. Reg. sec. 1.401-1(b)(1)(i), (ii), and (iii). Defined benefit plans and money purchase pension plans (a type of defined contribution plan) are pension plans under the Code; other defined contribution plans are either profit-sharing plans or stock bonus plans. The application of some Code requirements depends on whether the plan is a pension plan, a profit-sharing plan, or a stock bonus plan. Under ERISA, the term "pension plan," defined at ERISA section 3(2)(A), includes both defined benefit plans and defined contribution plans.

[28] Defined contribution plan is defined at section 414(i) and ERISA section 3(34). Under ERISA, a defined contribution plan is also referred to as an individual account plan.

[29] As defined in section 414(j) and ERISA section 3(35), a defined benefit plan is any plan that is not a defined contribution plan. The Code requires benefits under a defined benefit plan to be determined under a formula specified in the plan.

Certain types of qualified retirement plans are referred to as hybrid plans because they have features of both a defined benefit plan and a defined contribution plan. However, legally, the plan is either a defined contribution plan or a defined benefit plan.[30]

Defined contribution plans[31]

Defined contribution plans may provide for nonelective contributions and matching contributions by employers and pretax or after-tax contributions by employees. Total contributions made to an employee's account for a year cannot exceed the lesser of $53,000 (for 2015) or the employee's compensation. A participant must at all times be fully vested in his or her own contributions to a defined contribution plan and must vest in employer contributions under three-year cliff vesting or two-to-six-year graduated vesting.

Defined contribution plans may include special features, such as a qualified cash or deferred arrangement (called a section 401(k) plan) or an employee stock ownership plan ("ESOP").

Under a section 401(k) plan, an employee may elect to have contributions (elective deferrals) made to the plan, rather than receive the same amount in cash.[32] For 2015, elective deferrals of up to $18,000 may be made, plus, for employees aged 50 or older, up to $6,000 in catch-up contributions. Elective deferrals are generally made on a pretax basis. However, a section 401(k) plan may include a qualified Roth contribution program under which elective deferrals are made on an after-tax basis (designated Roth contributions), and certain distributions (qualified distributions) are excluded from income.[33] Many section 401(k) plans provide for matching contributions and may also provide for employer nonelective contributions and after-tax employee contributions.

An ESOP is a stock bonus plan that is designated as an ESOP and is designed to invest primarily in employer stock.[34] An ESOP can be an entire plan or it can be a portion of a defined contribution plan. ESOPs are subject to additional requirements that do not apply to other plans that hold employer stock. In addition, certain benefits are available to ESOPs that are not

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[30] Under section 414(k) and ERISA section 3(35), a defined benefit plan that provides a benefit based partly on the balance of a separate account for a participant is treated as a defined contribution plan for certain purposes.

[31] For a more detailed discussion of defined benefit plans, see Joint Committee on Taxation, *Present Law and Background Relating to Defined Benefit Plans* (JCX-99-14), September 15, 2014. This document is available at www.jct.gov.

[32] Secs. 401(k) and 402(e)(3).

[33] Sec. 402A.

[34] Sec. 4975(e)(7).

available to other types of qualified retirement plans, including an exception to the prohibited transaction rules for certain loans and, in the case of a C corporation, higher deduction limits.[35]

Section 403(b) plans and governmental 457(b) plans

Section 403(b) plans are generally similar to qualified defined contribution plans, but may be maintained only by (1) tax-exempt charitable organizations,[36] and (2) educational institutions of State or local governments (that is, public schools, including colleges and universities). Many of the rules that apply to section 403(b) plans are similar to the rules applicable to qualified retirement plans, including section 401(k) plans. Section 403(b) plans may provide for employees to make elective deferrals (including catch-up contributions), designated Roth contributions, or other after-tax employee contributions, and employers may make nonelective or matching contributions on behalf of employees. Contributions to a section 403(b) plan are generally subject to the same contribution limits applicable to qualified defined contribution plans, including the limits on elective deferrals.[37]

A governmental section 457(b) plan is a plan maintained by a State or local government and is generally similar to a qualified cash-or deferred arrangement under a section 401(k) plan in that it consists of elective deferrals, that is, pretax contributions made at the election of an employee. A governmental section 457(b) plan may also include a qualified Roth contribution program. Deferrals under a governmental section 457(b) plan are generally subject to the same limits as elective deferrals under a section 401(k) plan or a section 403(b) plan.[38]

Some section 403(b) plans of private employers are exempt from ERISA;[39] otherwise, ERISA applies. Like governmental plans generally, section 403(b) plans of State and local governments and governmental section 457(b) plans are not subject to ERISA.

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[35] Secs. 4975(d)(3) and 404(a)(9) and (k).

[36] These are organizations exempt from tax under section 501(c)(3).

[37] If elective deferrals are made to both a qualified defined contribution plan and a section 403(b) plan for the same employee, a single limit applies to the elective deferrals under both plans. Special contribution limits apply to certain employees under a section 403(b) plan maintained by a church. In addition, under a special catch-up rule, an increased elective deferral limit applies under a plan maintained by an educational organization, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches in the case of employees who have completed 15 years of service. Catch-up contributions under this rule may be made in addition to catch-up contributions under the general rule for section 401(k) and section 403(b) plans.

[38] The limit on deferrals under a section 457(b) plan applies separately from the combined limit applicable to section 401(k) and 403(b) plan contributions, so that an employee covered by a governmental section 457(b) plan and a section 401(k) or 403(b) plan can contribute the full amount to each plan. In addition, a special catch-up rule may apply under a section 457(b) plan for an employee's last three years before normal retirement age. If a higher catch-up limit applies under this special rule than under the general catch-up rule, the general catch-up rule does not apply.

[39] 29 C.F.R. sec. 2510.3-2(f).

ERISA fiduciary responsibility and participant-directed investments under account-based plans

ERISA contains general fiduciary duty standards that apply to all fiduciary actions, including investment decisions.[40] ERISA requires that a plan fiduciary generally must discharge its duties solely in the interests of participants and beneficiaries and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. With respect to plan assets, ERISA requires a fiduciary to diversify the investments of the plan so as to minimize the risk of large losses unless under the circumstances it is clearly prudent not to do so.

A plan fiduciary that breaches any of the fiduciary responsibilities, obligations, or duties imposed by ERISA is personally liable to make good to the plan any losses to the plan resulting from such breach and to restore to the plan any profits the fiduciary has made through the use of plan assets.[41] A plan fiduciary may be liable also for a breach of responsibility by another fiduciary (a "co-fiduciary") in certain circumstances, for example, if the fiduciary's failure to fulfill its own fiduciary duties enabled the co-fiduciary to commit the breach.[42]

A defined contribution plan may permit participants or beneficiaries to make investment decisions with respect to their individual accounts. For example, it is common for section 401(k), section 403(b) and governmental section 457(b) plans to provide participants with investment authority with respect to their accounts under the plan.

ERISA provides a special rule in the case of a defined contribution plan that permits participants to exercise control over the assets in their individual accounts (often referred to as "participant-directed investments"). Under the special rule, if a participant exercises control over the assets in his or her account, the participant is not deemed to be a fiduciary by reason of such exercise and no person who is otherwise a fiduciary is liable for any loss, or by reason of any breach, that results from the participant's exercise of control.

Regulations issued by DOL describe the requirements that must be met in order for a participant to be treated as exercising control over the assets in his or her account.[43] With respect to investment options, the regulations provide in part:

- The plan must provide at least three different investment options, each of which is diversified and has materially different risk and return characteristics;

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[40] ERISA sec. 404(a).

[41] ERISA sec. 409. Under ERISA section 502(a)(2), an action for a breach of fiduciary responsibility may be brought by DOL, a plan participant or beneficiary, or another fiduciary.

[42] ERISA sec. 405.

[43] 29 C.F.R. sec. 2550.404c-1. 29 C.F.R. sec. 2550.404c-5 provides rules for default investments if a participant does not select any investment options.

- The plan must allow participants to give investment instructions with respect to each investment option under the plan with a frequency that is appropriate in light of the reasonably expected market volatility of the investment option;
- At a minimum, participants must be allowed to give investment instructions at least every three months with respect to least three of the investment options, and those investment options must constitute a broad range of options;
- Participants must be provided with detailed information about the investment options, information regarding fees, investment instructions and limitations, and copies of financial data and prospectuses; and
- Specific requirements must be satisfied with respect to investments in employer stock to ensure that employees' buying, selling, and voting decisions are confidential and free from employer influence.

If these and the other requirements under the regulations are met, a plan fiduciary may be liable for the investment options made available under the plan, but not for the specific investment decisions made by participants.

Distributions from employer-sponsored retirement plans

Qualified retirement plans are not required to provide for distributions to participants before the later of attainment of normal retirement age under the plan or termination of employment. However, qualified retirement plans and other employer-sponsored plans commonly allow distributions when a participant terminates employment, regardless of the participant's age. Although plans commonly allow distributions on termination of employment at any age, a qualified retirement plan of a private employer generally cannot require a participant who has terminated employment to take a distribution before age 62 unless the value of the participant's vested accrued benefit under the plan is $5,000 or less. Thus, a participant generally decides whether and when to take a distribution.

A distribution from an employer-sponsored plan is generally includible in income except to the extent consisting of basis recovery (as a result of after-tax contributions) or a qualified distribution from a designated Roth account. A distribution from a qualified retirement plan or section 403(b) plan before age 59½ is generally subject to a 10-percent early withdrawal tax to the extent the distribution is includible in income unless an exception applies or the distribution is rolled over to another IRA or employer-sponsored plan as discussed below.

4. Rollovers and transfers between tax-favored retirement savings arrangements

A distribution from a tax-favored employer-sponsored retirement plan or an IRA generally may be rolled over to another such plan or an IRA.[44] The rollover generally can be

[44] Secs. 402(c), 402A(c)(3), 403(b)(8), 408(d)(3), 408A(d)(3), and 457(e)(16). A distribution from a Roth IRA may be rolled over only to another Roth IRA. A distribution from a designated Roth account under an employer-sponsored plan may be rolled over only to another such account or a Roth IRA. If a distribution from a traditional IRA, or a distribution from an employer-sponsored plan other than from a designated Roth account, is

achieved by direct rollover (direct payment from the distributing plan to the recipient plan) or by contributing the distribution to the other plan or IRA within 60 days of receiving the distribution ("60-day rollover"). Amounts that are rolled over are usually not included in gross income.

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rolled over to a Roth IRA or a designated Roth account under an employer-sponsored plan (referred to as a "Roth conversion"), any pretax amount rolled over is includible in income.

B. Other Tax-Favored Accounts

1. Health savings accounts (HSAs) and Archer MSAs

Health savings accounts

An individual with a high deductible health plan (and no other health plan other than a plan that provides certain permitted insurance or permitted coverage) generally may contribute to a health savings account ("HSA"), which is a tax-exempt trust or custodial account. Subject to limits, contributions to an HSA are deductible in determining adjusted gross income if made by an individual and are excludable from gross income and wages for employment tax purposes if made by the employer of an individual.[45] HSA distributions used for qualified medical expenses are not includible in gross income.[46]

For 2015, the maximum aggregate annual contribution that can be made to an HSA is $3,350 in the case of self-only coverage and $6,650 in the case of family coverage. The annual contribution limits are increased by $1,000 for individuals who have attained age 55 by the end of the taxable year (referred to as "catch-up contributions"). The maximum amount that an individual may contribute is reduced by the amount of any contributions to the individual's Archer MSA and any excludable HSA contributions made by the individual's employer. In some cases, an individual may make the maximum HSA contribution, even if the individual is covered by the high deductible health plan for only part of the year. A distribution from an HSA may be rolled over on a nontaxable basis to another HSA and does not count against the contribution limits.

Archer MSAs

An Archer MSA is a tax-exempt trust or custodial account similar to an HSA.[47] An individual is generally eligible for an Archer MSA if the individual is covered by a high deductible health plan and no other health plan other than a plan that provides certain permitted insurance or permitted coverage. In addition, the individual either must be an employee of a small employer (generally an employer with 50 or fewer employees on average) that provides the high deductible health plan or must be self-employed or the spouse of a self-employed individual and the high deductible health plan is not provided by the employer of the individual or spouse.

The rules for Archer MSAs are similar to the rules for HSAs. That is, subject to limits, contributions to an Archer MSA are deductible in determining adjusted gross income if made by an individual and are excludable from gross income and wages for employment tax purposes if made by the employer of an individual. Distributions used for qualified medical expenses are

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[45] Secs. 106(d) and 223.

[46] Distributions not used for medical expenses are includible in income and generally subject to an additional 20-percent tax.

[47] Secs. 106(b) and 220. Archer MSAs were originally called medical savings accounts or MSAs. Section 138 provides rules for Medicare Advantage MSAs.

not includible in gross income.[48] A distribution from an Archer MSA may be rolled over on a nontaxable basis to another Archer MSA or to an HSA and does not count against the contribution limits. However, the rules for Archer MSAs are in some respects less favorable than the rules for HSAs. For example, lower contribution limits apply to Archer MSAs. In addition, after 2007, no new contributions can be made to Archer MSAs except by or on behalf of individuals who previously had made Archer MSA contributions and employees of small employers that previously contributed to Archer MSAs (or at least 20 percent of whose employees who were previously eligible to contribute to Archer MSAs did so).

2. Coverdell education savings accounts (Coverdell ESAs)

A Coverdell education savings account ("Coverdell ESA") is a trust or custodial account created exclusively for the purpose of paying qualified education expenses of a designated beneficiary.[49] Annual contributions to a Coverdell ESA may not exceed $2,000 per designated beneficiary and may not be made after the designated beneficiary reaches age 18 (except in the case of a special needs beneficiary). The ability to contribute is phased out for taxpayers with modified AGI between $95,000 and $110,000 ($190,000 and $220,000 for married taxpayers filing a joint return). The AGI of the contributor, and not that of the beneficiary, controls whether a contribution is permitted by the taxpayer.

Earnings on contributions to a Coverdell ESA generally are includible in income when withdrawn. However, distributions from a Coverdell ESA are excludable from the gross income of the distributee (that is, the student) to the extent that the distribution does not exceed the qualified education expenses incurred by the beneficiary during the year the distribution is made. The earnings portion of a Coverdell ESA distribution not used to pay qualified education expenses is includible in the gross income of the distributee and generally is subject to an additional 10-percent tax.

Tax-free (and free of additional 10-percent tax) transfers or rollovers of account balances from one Coverdell ESA benefiting one beneficiary to another Coverdell ESA benefiting another beneficiary (as well as redesignations of the named beneficiary) are permitted, provided that the new beneficiary is a member of the family of the prior beneficiary and is under age 30 (except in the case of a special needs beneficiary). In general, any balance remaining in a Coverdell ESA is deemed to be distributed within 30 days after the date that the beneficiary reaches age 30 (or, if the beneficiary dies before attaining age 30, within 30 days of the date that the beneficiary dies).

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[48] Distributions not used for medical expenses are includible in income and generally subject to an additional 20-percent tax.

[49] Sec. 530. Tax-favored treatment applies also to qualified tuition programs under section 529 and qualified ABLE programs under section 529A. However, the prohibited transaction rules of the Code do not apply to those programs.

C. Prohibited Transactions

1. In general

The Code and ERISA prohibit certain transactions ("prohibited transaction") between a qualified retirement plan and a disqualified person (referred to as a "party in interest" under ERISA).[50] The prohibited transaction rules under the Code apply also to IRAs, Archer MSAs, HSAs, and Coverdell ESAs.[51]

Disqualified persons include a fiduciary of the plan; a person providing services to the plan; an employer with employees covered by the plan; an employee organization any of whose members are covered by the plan; certain owners, officers, directors, highly compensated employees, family members, and related entities.[52] A fiduciary includes any person who (1) exercises any discretionary authority or discretionary control respecting management of the plan or exercises any authority or control respecting management or disposition of the plan's assets, (2) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of the plan, or has any authority or responsibility to do so, or (3) has any discretionary authority or discretionary responsibility in the administration of the plan.[53]

Prohibited transactions include the following transactions, whether direct or indirect, between a plan and a disqualified person:

1. The sale or exchange or leasing of property,

2. The lending of money or other extension of credit,

3. The furnishing of goods, services or facilities,

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[50] Sec. 4975; ERISA sec. 406. The prohibited transaction rules of the Code and ERISA are very similar, however, some differences exist between the two sets of rules. As mentioned above, ERISA generally does not apply to governmental plans or church plans. The prohibited transaction rules under the Code also generally do not apply to governmental plans or church plans. However, under section 503, the trust holding assets of a governmental or church plan may lose its tax-exempt status in the case of a prohibited transaction listed in section 503(b). Before the enactment of ERISA in 1974, section 503 applied to qualified retirement plans generally. In connection with the enactment of section 4975 by ERISA, section 503 was amended to apply only to governmental and church plans.

[51] These are included in the definition of "plan" under section 4975(e)(1).

[52] Sec. 4975(e)(2). Party in interest is defined similarly under ERISA sec. 3(14) with respect to an employee benefit plan. Under ERISA, employee benefit plans, defined in ERISA section 3(3), consist of two types: pension plans (that is, retirement plans), defined in ERISA section 3(2), and welfare plans, defined in ERISA section 3(1).

[53] Sec. 4975(d)(3); ERISA sec. 3(21)(A). Under ERISA, fiduciary also includes any person designated under ERISA section 405(c)(1)(B) by a named fiduciary (that is, a fiduciary named in the plan document) to carry out fiduciary responsibilities.

4. The transfer to, or use by or for the benefit of, the income or assets of the plan,

5. In the case of a fiduciary, an act dealing with the plan's income or assets in the fiduciary's own interest or for the fiduciary's own account, and

6. The receipt by a fiduciary of any consideration for the fiduciary's own personal account from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.[54]

2. Exemptions from prohibited transaction treatment

Certain transactions are statutorily exempt from prohibited transaction treatment, for example, certain loans to plan participants and arrangements with a disqualified person for legal, accounting or other services necessary for the establishment or operation of a plan if no more than reasonable compensation is paid for the services.[55]

The Code and ERISA also provide for the grant of administrative exemptions, on either an individual or class basis, subject to a finding that the exemption is administratively feasible, in the interests of the plan and of its participants and beneficiaries, and protective of the rights of participants and beneficiaries of the plan. As discussed below, the grant of administrative exemptions with respect to the Code as well as ERISA is within the authority of DOL. Before an administrative exemption is granted, notice must be provided to interested persons, notice must be published in the Federal Register of the pendency of the exemption, and interested persons must be given an opportunity to provide comments.[56]

Administrative exemptions generally apply only in very specific circumstances, for example, specific types of transactions, specific parties, and sometimes specific types of assets or plans. The terms of an exemption also generally include specific conditions, such as the disclosure of particular information. Thus, the grant of an administrative exemption applies only with respect to the transactions and on the conditions specified in the exemption, not all transactions. The grant of an administrative exemption does not affect the availability of statutory exemptions; any otherwise applicable statutory exemptions continue to apply.

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[54] Sec. 4975(c)(1)(A)-(F) and ERISA sec. 406(a)(1)(A)-(D) and (b)(1) and (3). Under ERISA section 406(a)(1), a plan fiduciary is prohibited from causing the plan to engage in a transaction described in paragraphs (A)-(D). ERISA section 406(b)(2) also prohibits a plan fiduciary, in the fiduciary's individual capacity or any other capacity, from acting 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 plan participants or beneficiaries. ERISA section 406(a)(1)(E) and (a)(2) relate to limitations under ERISA section 407 on a plan's acquisition or holding of employer securities and real property.

[55] Sec. 4975(d) and ERISA sec. 408.

[56] As discussed below, the grant of prohibited transaction exemptions is within the jurisdiction of DOL with respect to both ERISA and the Code. DOL may also issue advisory opinion letters with respect to the application of the prohibited transaction rules.

3. Sanctions for violations

Under the Code, if a prohibited transaction occurs, the disqualified person who participated in the transaction is generally subject to a two-tiered excise tax. The first tier tax is 15 percent of the amount involved in the transaction. The second tier tax, imposed if the prohibited transaction is not corrected within a certain period, is 100 percent of the amount involved. In the case of an IRA, HSA, Archer MSA or Coverdell ESA, the sanction for some prohibited transactions is the loss of tax favored status, rather than an excise tax. A private right of action is not available for a Code violation.

Under ERISA, DOL may assess a civil penalty against a person who engages in a prohibited transaction, other than a transaction with a plan covered by the prohibited transaction rules of the Code.[57] The penalty may not exceed five percent of the amount involved in the transaction for each year or part of a year that the prohibited transaction continues. If the prohibited transaction is not corrected within 90 days after notice from DOL, the penalty can be up to 100 percent of the amount involved in the transaction. A prohibited transaction by a fiduciary may also be the basis for an action for a breach of fiduciary responsibility by DOL, a plan participant or beneficiary, or another plan fiduciary (as discussed above).

4. Jurisdiction over the prohibited transaction rules

As enacted in 1974, Title III of ERISA included certain provisions dealing with the coordination between the Department of the Treasury ("Treasury") and DOL of administrative and enforcement action over retirement plans, including procedures in connection with prohibited transactions.[58] Treasury and DOL are directed to consult with each other from time to time with respect to the prohibited transaction rules and exemptions.[59] DOL is required to notify Treasury of information indicating a violation of the prohibited transaction rules. On receiving a written request from DOL, Treasury is to undertake an investigation as to whether an excise tax should be imposed on a person referred to in the request. Treasury is generally required to notify DOL before imposing an excise tax with respect to a prohibited transaction and provide DOL with an opportunity to comment.

After the enactment of ERISA, jurisdiction over the Code provisions governing qualified plans and similar ERISA provisions was divided between Treasury and DOL by Executive Order, referred to as Reorganization Plan No. 4 of 1978 ("Reorganization Plan"). As part of this division, Treasury authority was transferred to DOL with respect to regulations, rulings,

[57] ERISA sec. 502(i).

[58] ERISA secs. 3001-3004. As in the case of tax administration generally, Treasury's authority is delegated to the IRS.

[59] ERISA sec. 3003.

opinions, and exemptions under the prohibited transaction provisions of the Code.[60] However, excepted from the transfer of authority are--

- The imposition of the excise taxes, the exception to the excise tax for an IRA owner or beneficiary, loans to leveraged ESOPs, the definition of "plan" subject to the Code rules, and the definition of ESOP,
- To the extent necessary for the continued enforcement of the excise taxes, joint and several liability, the definition of disqualified person, and rules relating to ownership of stock, partnerships and trusts, and family members, and
- Exemptions with respect to transactions that are exempt from ERISA fiduciary rules by reason of the ERISA safe harbor for participant-directed investments.[61]

As a result, DOL regulations and other guidance relating to prohibited transactions applies for Code purposes, as well as for ERISA purposes, and DOL has the authority to grant individual and class exemptions applicable under the Code, including with respect to IRAs, HSAs, Archer MSAs, and Coverdell ESAs.

The transfer of authority under the Reorganization Plan does not affect the ability of Treasury, subject to the provisions of Title III of ERISA, described above--

- To audit plans and employers, to enforce the excise tax provisions of the Code, or to exercise the authority provided in Title III of ERISA, including the ability to make interpretations necessary to audit, to enforce the taxes, and to exercise the authority provided in Title III of ERISA, and
- Consistent with the coordination requirements under the Reorganization Plan, discussed below, to disqualify a plan subject to the fiduciary requirements of ERISA, including the ability to make the interpretations necessary to make such disqualification.[62]

However, in enforcing the excise taxes and, to the extent applicable, in disqualifying plans, Treasury is bound by the regulations, rulings, opinions, and exemptions issued by DOL pursuant to the authority transferred to DOL under the Reorganization Plan.

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[60] Sec. 102 of the Reorganization Plan. Under section 101 of the Reorganization Plan, authority was generally transferred to Treasury over regulations, rulings, and other administrative guidance under various ERISA provisions, including vesting and related rules and funding.

[61] Authority was transferred to DOL also over regulations, rulings, and opinions under the effective date and transition rules for section 4975 under subsection 2003(c) of ERISA, except with respect to the application of section 503 to qualified retirement plans for periods before ERISA became effective.

[62] Sec. 105 of the Reorganization Plan.

The Reorganization Plan also provides for coordination concerning certain fiduciary actions.[63] In the case of fiduciary actions that are subject to the fiduciary rules under ERISA, Treasury is generally required to notify DOL before commencing any proceeding to determine whether the action violates the exclusive benefit rule under the Code. Further, Treasury is not to issue a determination that a plan or trust does not satisfy the qualification requirements by reason of the exclusive benefit rule unless, within 90 days after the date that Treasury notifies DOL of pending action, DOL certifies that it has no objection to the disqualification or fails to respond.

[63] Sec. 103 of the Reorganization Plan.

D. Fiduciary Status Based on Investment Advice

1. Existing DOL guidance

Current regulations

As described above, a fiduciary includes a person who renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of the plan, or has any authority or responsibility to do so.

Existing DOL regulations, issued in 1975, provide that a person is deemed to be rendering "investment advice" to an employee benefit plan for this purpose only if:

- The person renders advice to the plan as to the value of securities or other property, or makes recommendation as to the advisability of investing in, purchasing, or selling securities or other property; and
- The person either directly or indirectly (for example, through or together with any affiliate) (1) has discretionary authority or control, whether or not pursuant to agreement, arrangement or understanding, with respect to purchasing or selling securities or other property for the plan, or (2) renders any advice as described above on a regular basis to the plan pursuant to a mutual agreement, arrangement or understanding, written or otherwise, between the person and the plan or a fiduciary with respect to the plan, that the person's services will serve as a primary basis for investment decisions with respect to plan assets, and that the person will render individualized investment advice to the plan based on the particular needs of the plan regarding matters such as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.[64]

With respect to a person who does not have discretionary authority or control with respect to plan investments, the standard in the regulations (as described above) is sometimes referred to as a "five part test," with fiduciary status resulting with respect to a particular instance of investment advice only if all five parts are met with respect to the particular advice. That is, a person (1) renders advice as to the value of securities or other property, or makes recommendation 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, (4) that the advice will serve as a primary basis for investment decisions with respect to plan assets, and (5) that the advice will be individualized based on the particular needs of the plan.

The regulations further provide that a person who is a fiduciary with respect to a plan by reason of rendering investment advice (as described above) for a fee or other compensation, direct or indirect, with respect to any moneys or other property of the plan, or having any

[64] 29 C.F.R. sec. 2510.3-21(c). Current DOL regulations also provide that, subject to specified conditions, certain persons are not fiduciaries solely by reason of the execution of securities transactions for a plan in the ordinary course of business. 29 C.F.R. sec. 2510.3-21(c).

authority or responsibility to do so, is not deemed to be a fiduciary regarding any assets of the plan with respect to which the person does not have any discretionary authority, discretionary control or discretionary responsibility, does not exercise any authority or control, does not render investment advice (as described above) for a fee or other compensation, and does not have any authority or responsibility to render such investment advice. However, this rule does not exempt the person from ERISA liability attributable to a breach of responsibility by a co-fiduciary or exclude the person from the definition of the term party in interest (or disqualified person under the Code) based on providing services to the plan with respect to any assets of the plan.

Investment education

In 1996, DOL issued Interpretive Bulletin 96-1 ("IB 96-1"),[65] which provides that the furnishing of mere investment education to a participant or beneficiary in a participant-directed individual account plan does not constitute the rendering of "investment advice." For this purpose, investment education includes the following categories of information and materials (as described below):[66] plan information, general financial and investment information, asset allocation models, and interactive investment materials. However, IB 96-1 also indicates that the information and materials described in the four categories merely represent examples of the type of information and materials that may be furnished to participants and beneficiaries without such information and materials constituting "investment advice." In this regard, the interpretive bulletin indicates that that there may be many other examples of information, materials, and educational services which, if furnished to participants and beneficiaries, would not constitute "investment advice." Accordingly, IB 96-1 provides that no inferences should be drawn from the description of the four categories with respect to whether the furnishing of any information, materials or educational services not described therein may constitute "investment advice."

Plan information

Investment education in the form of plan information (as described in IB 96-1) includes:

- Information and materials that inform a participant or beneficiary about the benefits of plan participation, the benefits of increasing plan contributions, the impact of preretirement withdrawals on retirement income, the terms of the plan, or the operation of the plan; or
- Information such as that described in the rules for participant-directed investments[67] on investment alternatives under the plan (for example, descriptions of investment

[65] 29 C.F.R. sec. 2905.96-1.

[66] IB 96-1 states that this rule applies irrespective of who provides the information (for example, the plan sponsor, fiduciary or service provider), the frequency with which the information is shared, the form in which the information and materials are provided (for example, on an individual or group basis, in writing or orally, or via video or computer software), or whether an identified category of information and materials is furnished alone or in combination with other identified categories of information and materials.

[67] 29 C.F.R. sec. 2550.404c-1(b)(2)(i).

objectives and philosophies, risk and return characteristics, historical return information, or related prospectuses).

General financial and investment information

Investment education in the form of general financial and investment information (as described in IB 96-1) includes information and materials that inform a participant or beneficiary about:

- General financial and investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax-deferred investment;
- Historic differences in rates of return between different asset classes (for example, equities, bonds, or cash) based on standard market indices;
- Effects of inflation;
- Estimating future retirement income needs;
- Determining investment time horizons; and
- Assessing risk tolerance.

Asset allocation models

Investment education in the form of asset allocation models (as described in IB 96-1) includes asset allocation models that are information and materials (for example, pie charts, graphs, or case studies) that provide a participant or beneficiary with models, available to all plan participants and beneficiaries, of asset allocation portfolios of hypothetical individuals with different time horizons and risk profiles, where:

- Such models are based on generally accepted investments theories that take into account the historic returns of different asset classes (for example, equities, bonds, or cash) over defined periods of time;
- All material facts and assumptions on which such models are based (for example, retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, and rates of return) accompany the models;
- To the extent that an asset allocation model identifies any specific investment alternative available under the plan, the model is accompanied by a statement indicating that other investment alternatives having similar risk and return characteristics may be available under the plan and identifying where information on those investment alternatives may be obtained; and
- The asset allocation models are accompanied by a statement indicating that, in applying particular asset allocation models to their individual situations, participants or beneficiaries should consider their other assets, income, and investments (for example, equity in a home, IRA investments, savings accounts, and interests in other qualified and nonqualified plans) in addition to their interests in the plan.

Interactive investment materials

Investment education in the form of interactive investment materials (as described in IB 96-1) includes questionnaires, worksheets, software, and similar materials which provide a participant or beneficiary the means to estimate future retirement income needs and assess the impact of different asset allocations on retirement income, where:

- Such materials are based on generally accepted investment theories that take into account the historic returns of different asset classes (for example, equities, bonds, or cash) over defined periods of time;
- There is an objective correlation between the asset allocations generated by the materials and the information and data supplied by the participant or beneficiary;
- All material facts and assumptions (for example, retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, and rates of return) which may affect a participant's or beneficiary's assessment of the different asset allocations accompany the materials or are specified by the participant or beneficiary;
- To the extent that an asset allocation generated by the materials identifies any specific investment alternative available under the plan, the asset allocation is accompanied by a statement indicating that other investment alternatives having similar risk and return characteristics may be available under the plan and identifying where information on those investment alternatives may be obtained; and
- The materials either take into account or are accompanied by a statement indicating that, in applying particular asset allocations to their individual situations, participants or beneficiaries should consider their other assets, income, and investments (for example, equity in a home, IRA investments, savings accounts, and interests in other qualified and nonqualified plans) in addition to their interests in the plan.

2. Proposed regulations

Overview

On April 20, 2015, DOL issued a notice of proposed rulemaking ("proposed regulations") that would replace the current regulations relating to investment advice with a new standard as to whether a person is a fiduciary based on rendering investment advice.[68] The proposed regulations would generally become applicable eight months after final regulations are published.

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[68] Definition of the Term "Fiduciary"; Conflict of Interest Rule-Retirement Investment Advice, 80 Fed. Reg. 21928, dated April 20, 2015. The proposed regulations apply for purposes of ERISA and the prohibited transaction rules of the Code. The preamble discusses the statutory and regulatory background of the proposed regulations, as well as the reasons for the proposed regulations and the regulatory process. In that regard, DOL previously issued proposed regulations in 2010 (75 Fed. Reg. 65263) on when an individual is a fiduciary based on providing investment advice. The April notice of proposed rulemaking withdrew the 2010 proposed regulations.

Under the proposed regulations, a person is a fiduciary based on rendering investment advice if the person--

- Provides to a plan, a plan fiduciary, an IRA, or an IRA owner[69] certain types of recommendations or statements ("investment advice"), as described below, with respect to any moneys or property of the plan or IRA in exchange for a fee or other compensation, whether direct or indirect, and
- Either directly or indirectly (such as through an affiliate) (a) represents or acknowledges that it is acting as a fiduciary with respect to the investment advice, or (b) renders the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is individualized to, or that the advice is specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA.

Similar to the current regulations, the proposed regulations provide that a person who is a fiduciary with respect to an employee benefit plan or IRA by reason of rendering investment advice, or having authority or responsibility to do so, is not deemed to be a fiduciary with respect to any assets of the plan or IRA with respect to which the person does not have any discretionary authority, discretionary control or discretionary responsibility, does not exercise any authority or control, does not render investment advice for a fee or other compensation, and does not have any authority or responsibility to render such investment advice. However, nothing in this rule may be deemed to exempt the person from ERISA liability attributable to a breach of responsibility by a co-fiduciary or exclude the person from the definition of party in interest under ERISA or disqualified person under the Code.

The proposed regulations significantly change the standard applicable with respect to a person who does not have discretionary authority or control with respect to plan investments by replacing elements of the so-called five-part test under present law. In particular, the proposed regulations eliminate the following three elements of the five-part test under which, to be a fiduciary, a person without such discretionary investment authority must render advice to a plan (1) on a "regular basis," (2) the agreement, arrangement or understanding, or otherwise, between the person and the plan or a fiduciary with respect to the plan to provide the advice must be "mutual," and (3) the person's services must be a "primary basis" for investment decisions for the plan.

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[69] Under the proposed regulations, "IRA" is defined to include HSAs, Archer MSAs, and Coverdell ESAs, as well as IRAs. "IRA owner" means, with respect to one of these accounts, either the owner of the account or the person for whose benefit the account was established. In Part IV.E of the preamble to the proposed regulations, DOL solicits comments as to whether it is appropriate to cover individual accounts other than IRAs and treat them in a manner similar to IRAs. 80 Fed.Reg. at 21947.

The proposed regulations provide various exceptions, as described below, under which a person rendering investment advice is not a fiduciary. However, the exceptions do not apply if the person represents or acknowledges that it is acting as a fiduciary with respect to the advice.[70]

In addition, as described below, in conjunction with the proposed regulations, DOL has proposed a new best interest contract class exemption from prohibited transaction treatment for investment advice provided to retail investors and a principal transaction exemption, as well as proposing changes to various existing class exemptions.

Definitions of investment advice and fee or other compensation

Under the proposed regulations, investment advice includes:

- A recommendation as to the advisability of acquiring, holding, disposing of or exchanging securities or other property, including a recommendation to take a distribution of benefits or a recommendation as to the investment of securities or other property to be rolled over or otherwise distributed from the plan or IRA;[71]
- A recommendation as to the management of securities or other property, including recommendations as to the management of securities or other property to be rolled over or otherwise distributed from the plan or IRA;
- An appraisal, fairness opinion, or similar statement, whether verbal or written, concerning the value of securities or other property if provided in connection with a specific transaction or transactions involving the acquisition, disposition, or exchange, of such securities or other property by the plan or IRA;
- A recommendation of a person who is also going to receive a fee or other compensation for providing any of the types of advice described above.

[70] Similar to current regulations, the proposed regulations also include a rule under which, subject to specified conditions, certain persons are not fiduciaries solely by reason of the execution of securities transactions for a plan in the ordinary course of business.

[71] DOL Advisory Opinion 2005-23A (December 7, 2005) addresses the question of whether a recommendation that a participant in a pension plan roll over his or her account balance to an IRA to take advantage of investment options not available under the plan constitutes investment advice with respect to plan assets. The advisory opinion expresses the view that, with respect to a person who is not otherwise a plan fiduciary, merely advising a plan participant to take an otherwise permissible plan distribution, even when the advice is combined with a recommendation as to how the distribution should be invested, does not constitute investment advice within the meaning of the DOL regulations described above, which defines when a person is a fiduciary by virtue of providing investment advice with respect to employee benefit plan assets. The advisory opinion provides that DOL does not view a recommendation to take a distribution as advice or a recommendation concerning a particular investment (that is, purchasing or selling securities or other property) as contemplated by the regulations and that any investment recommendation regarding the proceeds of a distribution would be advice with respect to funds that are no longer plan assets. Part IV.A(1) of the preamble to the proposed regulations notes that the proposed regulations, if finalized, would supersede Advisory Opinion 2005-23A. 80 Fed.Reg. at 21939.

Further, under the proposed regulations, "fee or other compensation, direct or indirect" means any fee or compensation for the advice received by the person rendering the advice (or by an affiliate) from any source and any fee or compensation incident to the transaction in which the investment advice has been rendered or will be rendered. The proposed regulations further provide that the term fee or other compensation includes, for example, brokerage fees, mutual fund and insurance sales commissions.

Carve-outs from the definition of fiduciary

In general

As indicated above, the proposed regulations provide exceptions (referred to as "carve-outs" in the proposed regulations) from the definition of fiduciary based on rendering investment advice.[72] The carve-outs are for (1) certain counterparties in transactions with an employee benefit plan (referred to as the "seller's carve-out"); (2) swap and security-based swap transactions with an employee benefit plan; (3) employees of an employee benefit plan sponsor; (4) platform providers to employee benefit plans; (5) persons providing selection and monitoring assistance to employee benefit plans; (6) financial reports and valuations (including to an IRA or IRA owner); and (7) investment education (including to an IRA or IRA owner).

Seller's carve-out

The seller's carve-out applies when a counterparty or representative of a counterparty (the "seller") to a transaction with an employee benefit plan, in that capacity, provides advice to an independent plan fiduciary. This carve-out is subject to the following conditions:

First, the seller must provide advice to a plan fiduciary who is independent of the seller and who exercises authority or control respecting the management or disposition of the plan's assets, with respect to an arm's length sale, purchase, loan or bilateral contract between the plan and the counterparty, or with respect to a proposal to enter into such a sale, purchase, loan or bilateral contract. Second, either of two alternative sets of conditions must be met before the seller provides the advice.

Under alternative one, the seller:

- Obtains a written representation from the independent plan fiduciary that the independent fiduciary exercises authority or control with respect to the management or disposition of the plan's assets,[73] that the plan covers 100 or more participants, and that the fiduciary will not rely on the seller to act in the best interests of the plan, to provide impartial investment advice, or to give advice in a fiduciary capacity;

[72] Part I.A of the preamble indicates that the carve-outs deal with relationships that are not appropriately regarded as fiduciary in nature. 80 Fed. Reg. at 21929. As noted above, these carve-outs do not apply to any person who represents or acknowledges that it is acting as a fiduciary within the meaning of ERISA with respect to the advice.

[73] For this purpose, the definition of plan assets in section 3(21)(A)(i) of ERISA applies.

- Fairly informs the independent plan fiduciary of the existence and nature of the seller's financial interests in the transaction;
- Does not receive a fee or other compensation directly from the plan, or plan fiduciary, for the provision of investment advice (as opposed to other services) in connection with the transaction;
- Knows or reasonably believes that the independent plan fiduciary has sufficient expertise to evaluate the transaction and to determine whether the transaction is prudent and in the best interest of the plan participants (the seller may rely on written representations from the plan or the plan fiduciary to satisfy this condition).

Under alternative two, the seller:

- Knows or reasonably believes that the independent plan fiduciary has responsibility for managing at least $100 million in employee benefit plan assets;[74]
- Must also fairly inform the independent plan fiduciary that the seller is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity; and
- Cannot receive a fee or other compensation directly from the plan, or plan fiduciary, for providing the investment advice (as opposed to other services) in connection with the transaction.

Swap and security-based swap transaction ("swap carve-out")

The swap carve-out applies to a swap dealer, security-based swap dealer, major swap participant, or major security-based swap participant that is a counterparty to an employee benefit plan in a swap or security-based swap transaction. Under the swap carve-out, the plan must be represented by a fiduciary independent of the counterparty, and, if the counterparty is a swap dealer or security-based swap dealer, such dealer must not be not be acting as an adviser to the plan under the Commodity Exchange Act or Securities Exchange Act in connection with the transaction. In addition, before providing any recommendations with respect to the transaction, the counterparty must obtain a written representation from the independent plan fiduciary that the fiduciary will not rely on recommendations provided by the counterparty.

Employees of a plan sponsor

Under this carve-out, an employee of an employee benefit plan sponsor is not a fiduciary with respect to advice provided to a fiduciary of the plan as long as the employee receives no fee

[74] For purposes of this condition, when dealing with an individual employee benefit plan, the seller may rely on the information on the most recent Form 5500, Annual Return/Report of Employee Benefit Plan, filed by the plan to determine the value of plan assets, and, in the case of an independent fiduciary acting as an asset manager for multiple employee benefit plans, the seller may rely on representations from the independent plan fiduciary regarding the value of employee benefit plan assets under management.

or other compensation, direct or indirect, for the advice beyond the employee's normal compensation for work performed for the plan sponsor.

Platform Providers/Selection and Monitoring Assistance

The platform provider carve-out applies if a person merely markets and makes available to an employee benefit plan (without regard to the individualized needs of the plan, participants, or beneficiaries) securities or other property through a platform or similar mechanism from which a plan fiduciary may select or monitor investment alternatives, into which plan participants or beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. The person must disclose in writing to the plan fiduciary that the person is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity.

The carve-out for selection and monitoring assistance applies if, in connection with the activities described in the platform provider carve-out with respect to an employee benefit plan, a person (1) merely identifies investment alternatives that meet objective criteria specified by the plan fiduciary (such as stated parameters concerning expense ratios, size of fund, type of asset, credit quality), or (2) merely provides objective financial data and comparisons with independent benchmarks to the plan fiduciary.

Financial reports and valuations

The carve-out for financial reports and valuations applies to a person that provides an appraisal, fairness opinion, or statement of value to:

- An employee stock ownership plan regarding qualifying employer securities;[75]
- An investment fund, such as a collective investment fund or pooled separate account, in which more than one unaffiliated plan has an investment, or which holds plan assets of more than one unaffiliated plan;[76] or
- A plan, a plan fiduciary, a plan participant or beneficiary, an IRA or IRA owner solely for purposes of compliance with the reporting and disclosure provisions under ERISA or the Code (including related regulations, forms and schedules), or any applicable reporting or disclosure requirement under a Federal or State law, rule or regulation or self-regulatory organization rule or regulation.

Investment education

The carve-out for investment education generally partially follows the present-law provisions of IB 96-1 as to when the furnishing of information to participants or beneficiaries is not rendering investment advice. Similar to IB 96-1, the proposed regulations divide investment

[75] Employee stock ownership plan is defined in section 407(d)(6) of ERISA and section 4975(e)(7) of the Code. Employer securities are defined in section 407(d)(5) of ERISA.

[76] 29 C.F.R. sec. 2510.3-101.

education information and materials into four general categories: plan information; general financial, investment and retirement information; asset allocation models; and interactive investment materials. In certain places, the proposed regulations expand the description of the types of information in the category being discussed that qualify for this carve-out for investment education. For example, under general financial, investment, and retirement information, the proposed regulations include information about retirement-related risks, such as longevity risks, market/interest rates, inflation, and health care and other expenses. The proposed regulations also adopt the provision from IB 96-1 that there may be other examples of information, materials and educational services which, if furnished, would not constitute investment advice or recommendations within the meaning of the proposed regulations and that no inference should be drawn regarding materials or information which are not specifically included.

However, the proposed regulations deviate from IB 96-1 in certain ways. The proposed regulations limit this carve-out to information and materials that do not include recommendations as to specific investment products, specific investment managers, or the value of particular securities or other property. Further, relating to asset allocation models and interactive investment materials, the carve-out requires that the information and materials not identify specific investment alternatives available under the plan or IRA.

E. Prohibited Transaction Exemptions Relating to Investment Advice

1. Statutory investment advice exemptions under the Pension Protection Act of 2006

In general

Prohibited transaction exemptions apply under the Code and ERISA in connection with the provision of investment advice by a "fiduciary advisor" through an "eligible investment advice arrangement" to participants and beneficiaries of a defined contribution plan who direct the investment of their accounts under the plan and to beneficiaries of IRAs.[77] If certain requirements are met, the following are exempt from prohibited transaction treatment: (1) the provision of investment advice, (2) an investment transaction (that is, a sale, acquisition, or holding of a security or other property) pursuant to the advice, and (3) the direct or indirect receipt of fees or other compensation in connection with the provision of the advice or an investment transaction pursuant to the advice.

For purposes of the exemptions, an eligible investment advice arrangement is an arrangement that (1) meets the requirements discussed below and (2) either (a) provides that any fees (including any commission or compensation) received by the fiduciary adviser for investment advice or with respect to an investment transaction with respect to plan assets do not vary depending on the basis of any investment option selected (sometimes referred to as "fee-leveling"), or (b) uses a computer model under an investment advice program as described below in connection with the provision of investment advice to a participant or beneficiary. In the case of an eligible investment advice arrangement with respect to a defined contribution plan, the arrangement must be expressly authorized by a plan fiduciary other than (1) the person offering the investment advice program, (2) any person providing investment options under the plan, or (3) any affiliate of (1) or (2).

Subject to certain requirements, an employer or other person who is a plan fiduciary, other than a fiduciary adviser, is not treated as failing to meet the fiduciary requirements of ERISA, solely by reason of the provision of investment advice as permitted under the exemption or of contracting for or otherwise arranging for the provision of the advice. This rule applies if: (1) the advice is provided under an arrangement between the employer or plan fiduciary and the fiduciary adviser for the provision of investment advice by the fiduciary adviser as permitted under the exemption, (2) the terms of the arrangement require compliance by the fiduciary adviser with the requirements of the exemption, and (3) the terms of the arrangement include a written acknowledgement by the fiduciary adviser that the fiduciary adviser is a plan fiduciary with respect to the provision of the advice.[78]

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[77] Sec. 4975(d)(17) and (f)(8) and ERISA sec. 408(b)(14) and (g). These exemptions were established by section 601 of the Pension Protection Act of 2006, Pub. L. No. 109-280.

[78] The exemption does not exempt the employer or a plan fiduciary from fiduciary responsibility under ERISA for the prudent selection and periodic review of a fiduciary adviser with whom the employer or plan fiduciary has arranged for the provision of investment advice. The employer or plan fiduciary does not have the duty to monitor the specific investment advice given by a fiduciary adviser.

Investment advice program using computer model

If an eligible investment advice arrangement provides investment advice pursuant to a computer model, the model must (1) apply generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time, (2) use relevant information about the participant or beneficiary, (3) use prescribed objective criteria to provide asset allocation portfolios comprised of investment options under the plan, (4) operate in a manner that is not biased in favor of any investment options offered by the fiduciary adviser or related person, and (5) take into account all the investment options under the plan in specifying how a participant's or beneficiary's account should be invested without inappropriate weighting of any investment option. An eligible investment expert must certify, before the model is used and in accordance with rules prescribed by the Secretary, that the model meets these requirements. The certification must be renewed if there are material changes to the model as determined under regulations. For this purpose, an eligible investment expert is a person who meets requirements prescribed by the Secretary and who does not bear any material affiliation or contractual relationship with any investment adviser or related person.

In addition, if a computer model is used, the only investment advice that may be provided under the arrangement is the advice generated by the computer model, and any investment transaction pursuant the advice must occur solely at the direction of the participant or beneficiary. This requirement does not preclude the participant or beneficiary from requesting other investment advice, but only if the request has not been solicited by any person connected with carrying out the investment advice arrangement.

Fiduciary adviser

A "fiduciary adviser" is defined as a person who is a fiduciary of the plan by reason of the provision of investment advice to a participant or beneficiary and who is also (1) registered as an investment adviser under the Investment Advisers Act of 1940 or under State laws, (2) a bank, a similar financial institution supervised by the United States or a State, or a savings association (as defined under the Federal Deposit Insurance Act), but only if the advice is provided through a trust department that is subject to periodic examination and review by Federal or State banking authorities, (3) an insurance company qualified to do business under State law, (4) registered as a broker or dealer under the Securities Exchange Act of 1934, (5) an affiliate of any of the preceding, or (6) an employee, agent or registered representative of any of the preceding who satisfies the requirements of applicable insurance, banking and securities laws relating to the provision of advice. A person who develops the computer model or markets the investment advice program or computer model is treated as a person who is a plan fiduciary by reason of the provision of investment advice and is treated as a fiduciary adviser, except that the Secretary may prescribe rules under which only one fiduciary adviser may elect treatment as a plan fiduciary. "Affiliate" means an affiliated person as defined under section 2(a)(3) of the Investment Company Act of 1940. "Registered representative" means a person described in section 3(a)(18) of the Securities Exchange Act of 1934 or a person described in section 202(a)(17) of the Investment Advisers Act of 1940.

Other requirements

Before the initial provision of investment advice, the fiduciary adviser must provide written notice (which may be in electronic form) containing various information to the recipient of the advice, including information relating to: (1) the role of any related party in the development of the investment advice program or the selection of investment options under the plan, (2) past performance and rates of return for each investment option offered under the plan, (3) any fees or other compensation to be received by the fiduciary adviser or affiliate, (4) any material affiliation or contractual relationship of the fiduciary adviser or affiliates in the security or other property involved in the investment transaction, (5) the manner and under what circumstances any participant or beneficiary information will be used or disclosed, (6) the types of services provided by the fiduciary adviser in connection with the provision of investment advice, (7) the adviser's status as a fiduciary of the plan in connection with the provision of the advice, and (8) the ability of the recipient of the advice separately to arrange for the provision of advice by another adviser that could have no material affiliation with and receive no fees or other compensation in connection with the security or other property. This information must be maintained in accurate form and must be provided to the recipient of the investment advice, without charge, on an annual basis, on request, or in the case of any material change.

Any notification must be written in a clear and conspicuous manner, calculated to be understood by the average plan participant, and sufficiently accurate and comprehensive so as reasonably to apprise participants and beneficiaries of the required information. The fiduciary adviser must maintain for at least six years any records necessary for determining whether the requirements for the prohibited transaction exemption were met. A prohibited transaction will not be considered to have occurred solely because records were lost or destroyed before the end of six years due to circumstances beyond the adviser's control.

In order for the exemption to apply, the following additional requirements must be satisfied: (1) the fiduciary adviser must provide disclosures applicable under securities laws, (2) an investment transaction must occur solely at the direction of the recipient of the advice, (3) compensation received by the fiduciary adviser or affiliates in connection with an investment transaction must be reasonable, and (4) the terms of the investment transaction must be at least as favorable to the plan as an arm's length transaction would be.

In the case of an eligible investment advice arrangement with respect to a defined contribution plan, an annual audit of the arrangement for compliance with applicable requirements must be conducted by an independent auditor (that is, unrelated to the person offering the investment advice arrangement or any person providing investment options under the plan) who has appropriate technical training or experience and proficiency and who so represents in writing. The auditor must issue a report of the audit results to the fiduciary that authorized use of the arrangement.

2. New proposed best interest contract ("BIC") class exemption

In general

In conjunction with issuing the April 2015 proposed regulations, DOL issued a new proposed prohibited transaction class exemption that allows financial institutions and related advisers to be compensated for rendering investment advice to retirement investors, subject to a requirement that the advice is in the best interest of the retirement investor and meets certain other requirements (referred to as the "best interest contract (or "BIC") class exemption").[79] This proposed class exemption applies to investment advice provided to "retirement investors," meaning plan participants or beneficiaries who direct the investment of the assets in their accounts, IRA owners who make investment decisions with respect to their IRAs,[80] and a plan sponsor (or employee, officer, or director thereof) of a plan with fewer than 100 participants where the plan does not provided for participant-directed investments and the plan sponsor acts as a fiduciary who has authority to make plan investment decisions.[81]

The proposed BIC class exemption contemplates that an individual (called an "adviser") will provide advice to a retirement investor. An adviser that qualifies for the proposed BIC class exemption is a fiduciary of a plan or IRA solely by reason of the provision of investment advice, who is an employee, independent contractor, agent, or registered representative of a financial institution, and satisfies the applicable Federal and State regulatory and licensing requirements of insurance, banking, and securities laws with respect to the receipt of compensation for services provided in connection with a purchase, sale or holding of an asset as a result of the individual's advice to a retirement investor ("covered transaction"). Advisers may be, for example, registered representatives of broker-dealers registered under the Securities Exchange Act of 1934, or insurance agents or brokers. For purposes of the proposed BIC class exemption, a financial institution is the entity that employs an adviser or otherwise retains the adviser as an independent contractor, agent or registered representative. The financial institution must be a registered investment adviser under the Investment Advisers Act of 1940 or State law, a bank or similar financial institution (but only if the advice is provided through a trust department subject to examination and review by regulators), an insurance company that meets certain requirements, or a registered broker-dealer under the Securities Exchange Act of 1934.

Under the proposed BIC class exemption, investment advice is in the best interest of a retirement investor when the adviser and financial institution providing the advice act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person

[79] Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21960, dated April 20, 2015. This class exemption is proposed to become applicable at the same time as the 2015 proposed fiduciary regulations, eight months after publication of final regulations implementing the proposed regulations.

[80] As in the case of the proposed regulations, the term IRA includes HSAs, Archer MSAs, and Coverdell ESAs.

[81] The proposed BIC exemption at 80 Fed. Reg. 21984 specifies certain situations that are excluded from the exemption. For example, the proposed BIC Exemption does not apply if the advisor, financial institution or any affiliate is the employer of the plan.

would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor, without regard to the financial or other interests of the adviser, financial institution or any affiliate, related entity, or other party.[82]

Assets subject to the proposed BIC class exemption include only the following investment products: bank deposits; certificates of deposit (CDs); shares or interests in registered investment companies (that is, mutual funds); bank collective funds; insurance company separate accounts; exchange-traded REITs (Real Estate Investment Trusts); exchange-traded funds; corporate bonds offered pursuant to a registration statement under the Securities Act of 1933; agency debt securities and U.S. Treasury Securities;[83] insurance and annuity contracts, guaranteed investment contracts, and exchange-traded equity securities.[84] Specifically excluded from this definition is any equity security that is a security future or a put, call, straddle, or other option or privilege of buying an equity security from or selling an equity security to another without being bound to do so.

The proposed BIC class exemption has four categories of requirements that must be satisfied: contract, impartial conduct and other related requirements; range of investment options; cost and fee disclosures to retirement investors; and disclosures to DOL and recordkeeping. There are also supplementary exemptions for the sale of insurance and annuity contracts by insurance companies that are financial institutions under the proposed BIC class exemption and for pre-existing transactions.

Contract and impartial conduct requirements

Contract provisions

The proposed BIC class exemption requires that, before making any recommendations on investment transactions, the adviser and financial institution enter into a written contract with the retirement investor as follows:

- The contract affirmatively states that the adviser and financial institution are fiduciaries under the ERISA or the Code, or both, with respect to any investment recommendation to the retirement investor;
- Under the contract, the adviser and financial institution specifically agree to adhere to certain impartial conduct standards, which include providing investment advice that is

[82] A similar standard applies under the ERISA fiduciary duty requirement in section 404(a)(1)(B) of ERISA. In the preamble to the proposed exemption, DOL notes that fiduciaries of plans subject to ERISA are subject to the ERISA fiduciary standards, but the Code provides no similar fiduciary standard for IRA fiduciaries. 80 Fed. Reg. at 21970. DOL further notes that the best interest standard is defined to effectively mirror the ERISA duties of prudence and loyalty, as applied in the context of fiduciary investment advice.

[83] Agency debt securities and U.S. Treasury securities are defined in FINRA Rules 6710(l) and (p) or their successors.

[84] Equity security is defined in 17 C.F.R. sec. 230.405, and exchange-traded security is defined in 17 C.F.R. sec. 242.600.

in the best interest of the retirement investor, not recommending investment in an asset if they (or affiliates) will receive more than reasonable compensation in relation to the total services they provide to the retirement investor with respect to the investment, and not providing any statements about an asset, fees, material conflict of interest, and any other matter related to the retirement investors investment decision that are misleading; and

- Under the contract, as described below, the adviser and financial institution provide certain warranties; make certain disclosures related to fees and conflicts of interest, and the contract must does not have exculpatory contract provisions.

As described in DOL's background discussion of the proposed exemption, the bilateral contract terms to which advisors and financial institutions must agree in order to qualify for the proposed BIC class exemption potentially create a cause of action that may be used by retirement investors to enforcement these contract terms.[85] For example, an IRA owner could have a contract claim if the adviser recommends an investment product that is not in the IRA owner's best interest, even though neither the Code nor ERISA otherwise create such a cause of action for an IRA owner, solely based on being a retirement investor. DOL also suggests that an action based on breach of the agreement could also be available to plans, participants and beneficiaries, in addition to an action under ERISA to recover any loss in value to the plan (including the loss in value to an individual account), or to obtain disgorgement of any wrongful profits or unjust enrichment.[86]

Warranties required in the contract

To qualify for the exemption, the contract must include certain warranties, but the proposed BIC class exemption is not conditioned on satisfying these warranties. However, failure to satisfy the warranties may create an actionable contract breach. The warranties required in the contract include:

- The advisor and financial institution (and affiliates) will comply with all applicable Federal and State laws regarding the rendering of the investment advice, the purchase, sale or holding of the asset and the payment of compensation related to the purchase, sale and holding;
- The financial institution has adopted written policies and procedures that are reasonably designed to mitigate the impact of material conflicts of interest and ensure that individual advisers adhere to the impartial conduct standards described above. For purposes of the proposed BIC class exemption, a material conflict of interest exists when an adviser or financial institution has a financial interest that could affect the exercise of its best judgment as a fiduciary in rendering advice to a retirement investor regarding an asset;

[85] 80 Fed. Reg. at 21972-21973.

[86] ERISA Sec.502(a)(2) or (3).

- In formulating its policies and procedures, the financial institution has specifically identified material conflicts of interest and adopted measures to prevent them from causing violations of the impartial conduct standards;
- Neither the financial institution nor (to the best of its knowledge) its affiliates or related entities uses quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differentiated compensation or other actions or incentives to the extent they would tend to encourage individual Advisers to make recommendations not in the Best Interest of retirement investors.[87]

Disclosures under the contract

To qualify for the proposed BIC class exemption, the contract must specifically:

- Identify and disclose any material conflict of interest;
- Inform the retirement investor of the right to obtain complete information about all of the fees currently associated with the assets in which it is invested, including all of the fees payable to the adviser, financial institution, and any affiliates;
- Disclose to the retirement investor whether the financial institution offers proprietary products (that is, a product managed by the financial institution or an affiliate) or receives third party payments[88] with respect to the purchase, sale or holding of any asset; and
- Provide the address of a Web page that discloses the compensation arrangements entered into by the adviser and the financial institution.

Exculpatory contract provisions prohibited

The contract cannot include exculpatory provisions disclaiming or otherwise limiting liability of the adviser or financial institution for violating contract terms or provision under which the plan, IRA, or retirement investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the adviser or financial representative.

[87] This warranty does not prevent the financial institution, affiliates and related entities from providing advisers with differential compensation based on investments by plans, participant or beneficiary accounts, or IRAs, to the extent the compensation would not encourage advice counter to the best interest of the retirement investor (for example, differential compensation based on neutral factors).

[88] Third party payments for this purpose are defined as sales charges (when not paid directly by the plan, participant or beneficiary account, or IRA), 12b-1 fees, and other payments paid to the financial institution or any affiliate or related entity by a third party as a result of the purchase, sale or holding of an asset by a plan, participant or beneficiary account, or IRA.

Range of investment options

To qualify for the proposed BIC class exemption, the financial institution must offer, and the adviser must make available to the plan, participant or beneficiary account, or IRA for purchase, sale or holding, a range of assets that is broad enough to enable the adviser to make recommendations with respect to all of the asset classes reasonably necessary to serve the best interests of the retirement investor in light of its investment objectives, risk tolerance, and specific financial circumstances. Nevertheless, a financial institution may limit the assets available for purchase, sale or holding based on whether the assets are proprietary products, generate third party payments, or for other reasons, and still rely on the exemption, provided that:

- The financial institution makes a specific written finding that the limitations it has placed on the assets made available to an adviser for purchase, sale or holding by plans, participant and beneficiary accounts, and IRAs do not prevent the adviser from providing advice that is in the best interest of the retirement investor or otherwise adhering to the impartial conduct standards;
- Any compensation received in connection with a purchase, sale or holding of the asset by a plan, participant or beneficiary account, or an IRA, is reasonable in relation to the value of the specific services provided to the retirement investor in exchange for the payments and not in excess of the services' fair market value;
- Before giving investment recommendations to retirement investors, the adviser or financial institution gives the retirement investor clear written notice of the limitations placed on the assets that the adviser may offer for purchase, sale or holding by a plan, participant or beneficiary account, or an IRA. Notice is insufficient if it merely states that the financial institution or adviser may limit investment recommendations based on whether the assets are proprietary products or generate third party payments, or for other reasons, without specific disclosure of the extent to which recommendations are, in fact, limited on that basis; and
- The adviser notifies the retirement investor if the adviser does not recommend a sufficiently broad range of assets to meet the retirement investor's needs.

Some advisers and financial institutions provide advice to participants in ERISA-covered participant-directed individual account plans in which the menu of investment options is selected by an independent plan fiduciary. In such cases, provided the adviser and financial institution did not provide investment advice to the plan fiduciary regarding the composition of the menu, the adviser and financial institution relying on the proposed BIC class exemption do not have to comply with the requirements described above on range of investments in connection with their advice to individual participants and beneficiaries on the selection of assets from the menu provided. However, this exception is not available for advice with respect to investments within open brokerage windows or otherwise outside the plan's designated investment options.

Cost and fee disclosures to retirement investors

Required fee chart

Prior to the execution of a purchase of any asset, the adviser must furnish the retirement investor a chart showing, with respect to each asset recommended, the total cost to the plan, account, or IRA, of investing in the asset over one-, five-, and 10-year periods.[89] Total cost is the sum of (as applicable) acquisition costs (such as loads, commissions, or markups on assets bought from dealers, and account opening fees), ongoing (such as annual) costs attributable to fees and expenses charged for the operation of a pooled investment fund (such as a mutual fund) must also be included, and disposition costs (such as surrender fees, backend loads, etc., that do not sunset, mark-downs on assets sold to dealers, and account closing fees).

Annual disclosure

The adviser or financial institution must provide the following written information to the retirement investor, annually, within 45 days of the end of the applicable year, in a succinct single disclosure:

- A list identifying each asset purchased or sold during the applicable period and the price at which the asset was purchased or sold;
- A statement of the total dollar amount of all fees and expenses paid by the plan, participant or beneficiary account, or IRA (directly and indirectly) with respect to each asset purchased, held or sold during the applicable period; and
- A statement of the total dollar amount of all compensation received by the adviser and financial Institution, directly or indirectly, from any party, as a result of each asset sold, purchased or held by the plan, participant or beneficiary account, or IRA during the applicable period.

Webpage

The financial institution must maintain a Web page, freely accessible to the public, which shows the following information (in a machine readable format):

- The direct and indirect material compensation (expressed as a monetary amount, formula or percentage of assets) payable to the adviser and financial Institution and any affiliate for services provided in connection with each asset (or, if uniform across a class of assets, the class of assets) available for purchase, holding or sale during the year by the plan or account through the advisor or financial institution, and that a plan, participant or beneficiary account, or IRA has purchased, held or sold within the last 365 days, and

[89] The disclosure chart need not be provided with respect to a subsequent recommendation to purchase the same investment product if the chart was previously provided to the retirement investor within the past twelve months and the total cost has not materially changed.

- The source of the compensation, and how the compensation varies within and among assets.

Disclosure to DOL and recordkeeping

DOL disclosure

Before receiving compensation in reliance on the proposed BIC class exemption, a financial institution must notify DOL of its intention to rely on this BIC class exemption, but does not need to identify any plan or IRA. The notice must remain in effect until revoked in writing by the financial institution.

Recordkeeping

A financial institution must maintain for a period of six years, in a manner that is accessible for examination, the records necessary to enable the persons described below to determine whether the conditions of the BIC class exemption have been met, except that:

- If such records are lost or destroyed, due to circumstances beyond the control of the financial institution, then no prohibited transaction will be considered to have occurred solely on the basis of the unavailability of those records; and
- No party, other than the financial institution responsible for complying with this recordkeeping requirement, will be subject to the civil penalty for prohibited transactions under ERISA or the excise taxes for prohibited transactions under the Code imposed by Code, if the records are not maintained or are not available for examination as required.

Under the proposed BIC class exemption, the records must be unconditionally available at their customary location for examination during normal business hours by DOL or IRS, plan fiduciary involved in the transaction, any contributing employer and any employee organization whose members are covered by a plan covered by the BIC class exemption or any participant or beneficiary of a relevant plan or any relevant IRA owner. However these people are not required to be authorized to examine privileged trade secrets or privileged commercial or financial information, of the financial institution, or information identifying other individuals. If the financial institution refuses to disclose information on this basis, the financial institution must, by the close of the thirtieth day following the request, provide a written notice advising the requestor of the reasons for the refusal and that DOL may request such information.

Data that must be retained and made available for examination by DOL

A financial institution relying on the proposed BIC class exemption for any transaction must maintain data in a manner that is accessible for examination by the DOL for six years from the date of the transaction. However, no party, other than the financial institution responsible for complying with this data retention requirement will be subject to any excise taxes imposed for the prohibited transaction because any data is not maintained or not available for examination as required. The data must be provided to DOL within a reasonable time after a request (but in no event longer than six months) and must provide data for the preceding six years. Records must

be separately kept and be available with respect to assets bought (“inflows”), assets sold (“outflows”), assets held during any quarter (“holding”), and information to determine rates of return (“returns”). The data required to be maintained under the proposed BIC class exemption on inflows, and outflows includes the following (determined separately for inflows, outflows, and holdings), at the financial institution level, for each asset purchased or sold, for each quarter:

- The aggregate number and identity of shares/units bought or sold during, and held at the end;
- The aggregate dollar amount invested (and received for sales) and the cost to the plan, participant or beneficiary account, or IRA associated with the purchase (or sale) or in connection with holding the asset.
- The revenue received by the financial institution and any affiliate in connection with the purchase, sale, or holding of each asset disaggregated by source; and
- The identity of each revenue source (such as, mutual fund, mutual fund adviser) and the reason the compensation was paid.

For returns under the proposed BIC class exemption, information at the retirement investor level includes the identity of the adviser; the beginning-of-quarter value of the retirement investor's portfolio; the end-of-quarter value of the retirement investor's portfolio; and each external cash flow to or from the portfolio during the quarter and the date on which it occurred. For this purpose, “portfolio" means the retirement investor's combined holding of assets held in a plan, account or IRA advised by the adviser. Under the proposed exemption, DOL reserves the right to publicly disclose return information provided by the financial institution. However, if publicly disclosed, the information would be aggregated at the adviser level, and DOL would not disclose any individually identifiable financial information regarding retirement investor accounts.

Supplementary exemption for the purchase of insurance

As described below, in conjunction with the proposed regulations defining fiduciary based on rendering investment advice and providing this proposed BIC class exemption, DOL is proposing to revoke present-law PTE 84-24 to the extent it provides relief for transactions involving the purchase by IRAs of variable annuity contracts and other annuity contracts that are securities under Federal securities law. A supplementary class exemption is being proposed to permit (based on advice from an adviser) the purchase of an insurance or annuity contract from a financial institution that is an insurance company and that is a service provider to the plan or IRA. As in the case of the proposed BIC class exemption, to qualify, the contract must be purchased by a participant-directed (or beneficiary-directed) account, a non-participant-directed plan (covered by ERISA) with less than 100 participants, or an IRA. To qualify for this exemption, the transaction must be effected by the insurance company in the ordinary course of its business as an insurance company, the combined total of all fees and compensation received by the insurance company must not be in excess of reasonable compensation under the circumstances, the purchase must be in cash only, and the terms of the purchase must be at least as favorable to the plan or IRA as the terms generally available in an arm's length transaction with an unrelated party. In order for an advisor, when compensated for the advice to purchase

the insurance or insurance contract, to not be engaged in a prohibited transaction, that advice must satisfy the requirements for the proposed BIC class exemption.

Exemption for pre-existing transactions

In conjunction with proposing the BIC class exemption, DOL also proposes a class exemption for investment professionals that may have provided advice prior to the applicability date of the proposed fiduciary regulations (replacing the five-part test), but did not consider themselves fiduciaries.[90] Their receipt, after that change becomes applicable, of ongoing periodic payments of compensation attributable to a purchase, sale or holding of an asset by a plan, participant or beneficiary account, or IRA prior to the applicability date of the regulation might otherwise raise prohibited transaction concerns. Further, this proposed class exemption applies to advisers and financial institutions who were considered fiduciaries before the applicability date, but who entered into transactions involving plans and IRAs before the applicability date in accordance with the terms of a prohibited transaction exemption that has since been amended.

Possible low-fee investment streamlined class exemption

In the preamble to the BIC exemption, DOL indicates that it is considering proposing an additional class exemption for certain high-quality, low-fee investments (such as mutual funds) that would be subject to fewer conditions than the BIC exemption.[91] DOL indicates that the aim would be to design conditions with sufficient objectivity that advisers and financial institutions could proceed with certainty in their business operations when recommending the investments.[92] DOL indicates that it does not anticipate that the streamlined exemption would require advisers and financial institutions to undertake the contractual commitments or adopt anti-conflict policies and procedures for these high-quality, low-risk investments. However, DOL indicates that some of the required disclosures proposed in the BIC exemption are likely to be required in the streamlined exemption.

3. New proposed class exemption for principal transactions in certain debt securities

In general

Prohibited transactions include the purchase or sale between an employer-sponsored plan or IRA (or other tax-favored individual account) and a fiduciary acting on behalf of its own account (that is, with respect to its own investment holdings), referred to as a "principal transaction." DOL has proposed a new class exemption to permit, subject to certain

[90] The same exclusions apply to this exemption for pre-existing transactions as apply to the proposed BIC class exemption.

[91] 80 Fed. Reg. at 21977-21980.

[92] 80 Fed. Reg. at 21978.

requirements, principal transactions in certain debt securities between a retirement investor and a fiduciary that provides investment advice to the retirement investor.[93]

Subject to the conditions described below, the proposed exemption permits an adviser or financial institution to engage in the purchase or sale of a debt security in a principal transaction with a retirement investor and receive a payment for itself or an affiliate as a result of the adviser's and financial institution's advice. However, the exemption does not apply if (1) the adviser (a) exercises any discretionary authority or discretionary control respecting management of the assets of the plan or IRA involved in the transaction or exercises any discretionary authority or control respecting management or the disposition of the assets, or (b) has any discretionary authority or discretionary responsibility in the administration of the plan or IRA; or (2) the plan is subject to ERISA and (a) the adviser, financial institution or any affiliate is the employer of employees covered by the plan, or (b) the adviser or financial institution is a named fiduciary or plan administrator with respect to the plan, or an affiliate thereof, that was selected to provide investment advice to the plan by a fiduciary who is not independent.[94]

Contract conditions

The exemption is conditioned on a written contract between the adviser and the financial institution and the retirement investor--

- That acknowledges the fiduciary status of the adviser and financial institution,
- Under which the adviser and financial institution agree to comply with specified impartial conduct standards as to providing investment advice that is in the best interest of the retirement investor, the reasonableness of the purchase or sale price of a debt security involved in a principal transaction, and the adviser’s and the financial

[93] Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, 80 Fed. Reg. 21989, dated April 20, 2015. This class exemption is proposed to become applicable eight months after publication of the final exemption. The proposed exemption uses various defined terms, including those listed below, some of which are similar to terms applicable under the proposed BIC class exemption. In addition, some requirements under the proposed exemption are similar to the requirements under the proposed BIC exemption.

[94] The proposed exemption provides relief from prohibited transaction treatment under ERISA section 406(a)(1)(A) and (D) and 406(b)(1) and (2), as well as section 4975(c)(1)(A), (D), and (E). The proposed exemption does not provide relief from prohibited transaction treatment under ERISA section 406(b)(3) and Code section 4975(c)(1)(F), which prohibit a plan fiduciary from receiving any consideration for its own personal account from any party dealing with the plan in connection with a transaction involving the assets of the plan. As a result, the proposed exemption does not include relief for the receipt by a fiduciary of consideration from a trading venue in connection with the execution of purchases and sales in the trading venue. In addition, the proposed exemption does not provide relief from the prohibited transactions under ERISA section 406(a)(1)(C) and section 4975(c)(1)(C), regarding the furnishing of goods, services or facilities between a plan and a disqualified person. The provision of investment advice to a plan under a contract with a fiduciary is a service to the plan and the proposed exemption compliance does not relieve an adviser or financial institution of the need to comply with ERISA the requirements of the statutory exemptions for services under ERISA section 408(b)(2), Code section 4975(d)(2), and related regulations.

institution's statements regarding matters (such as fees) relevant to a retirement investor's investment decision,

- Under which the adviser and financial institution warrant that they and affiliates will comply with Federal and State laws applicable to providing investment advice and the purchase and sale of the debt security, that the financial institution has adopted written policies and procedures reasonably designed to mitigate the impact of material conflicts of interest and to ensure that its individual advisers adhere to the impartial conduct standards, that, in formulating its policies and procedures, the financial institution has specifically identified material conflicts of interest and adopted measures to prevent the material conflicts of interest from causing violations of the impartial conduct standards, and that neither the financial institution nor (to the best of its knowledge) any affiliate uses quotas, performance or personnel actions, bonuses, differentiated compensation or similar actions or incentives to the extent they would tend to encourage individual advisers to make recommendations regarding principal transactions that are not in the best interest of the retirement investor,
- That specifies the circumstances under which the adviser and financial institution may engage in principal transactions with the plan, participant or beneficiary account, or IRA and identifies and discloses the material conflicts of interest associated with principal transactions, documents the retirement investor's affirmative written consent, on a prospective basis, to principal transactions between the adviser or financial institution and the plan, participant or beneficiary account, or IRA, and informs the retirement investor that his or her consent is terminable at will at any time and of the right to obtain complete information about all the fees and other payments currently associated with its investments.

The contract may not contain provisions disclaiming or otherwise limiting liability of the adviser or financial institution for a violation of the contract's terms or a provision under which the plan, IRA or the retirement investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the adviser or financial institution.

<u>Disclosure and recordkeeping requirements</u>

Before engaging in the principal transaction, the adviser or financial institution must provide the retirement investor, orally or in writing, with a statement that the purchase or sale of the debt security will be executed as a principal transaction between the adviser or financial institution and the plan, participant or beneficiary account, or IRA and any available pricing information regarding the debt security, including the prices from the two counterparties as described above.

The financial institution must provide a written confirmation of the principal transaction in accordance with Rule 10b-10 under the Securities Exchange Act of 1934 that also includes disclosure of any payment to the adviser, financial institution or affiliate in connection with the principal transaction. The adviser or financial institution must also provide certain information

in writing to the retirement investor annually, as well as additional information if reasonably requested by the retirement investor.

For six years from the date of each principal transaction, the financial institution must maintain records necessary to the following persons to determine whether the conditions of this exemption have been met: any duly authorized employee or representative of DOL or the IRS, any fiduciary of the plan or IRA (or any duly authorized employee or representative of such fiduciary) that was a party to a principal transaction described in the proposed exemption, any employer of participants and beneficiaries and any employee organization (or any authorized employee or representative of these entities) whose members are covered by the plan, and any participant or beneficiary of the plan, or the beneficial owner of an IRA. Relief from the recordkeeping requirements may apply, such as in the case of the loss or destruction of the records due to circumstances beyond the control of the financial institution.

Other conditions

The debt security being purchased or sold may not be issued by the financial institution or any affiliate, may not be purchased by the plan, participant or beneficiary account, or IRA in an underwriting or underwriting syndicate in which the financial institution or any affiliate is the underwriter or a member, may not possess more than a moderate credit risk, and must be sufficiently liquid that it could be sold at or near its fair market value within a reasonably short period of time.

The purchase or sale of the debt security must be for cash. The purchase or sale of the debt security must be executed at a price that the adviser and financial institution reasonably believe is at least as favorable to the plan, participant or beneficiary account, or IRA than the price available to the plan, participant or beneficiary account, or IRA in a transaction that is not a principal transaction and that is at least as favorable to the plan, participant or beneficiary account, or IRA as the contemporaneous price for the debt security, or a similar security if a price is not available with respect to the same debt security, offered by two ready and willing counterparties that are not affiliates.

In addition, the principal transaction may not be part of an agreement, arrangement, or understanding designed to evade compliance with ERISA or the Code, or to otherwise impact the value of the debt security.

Definitions

Defined terms used in the proposed exemption include the following:

- Adviser means an individual who is a fiduciary of a plan or IRA solely by reason of the provision of investment advice with respect to the assets involved in a transaction, is an employee, independent contractor, agent, or registered representative of a financial Institution, and satisfies the applicable banking, and securities laws with respect to the transaction.
- Financial institution means the entity that employs the adviser (or otherwise retains the individual as an independent contractor, agent or registered representative), that

customarily purchases or sells debt securities for its own account in the ordinary course of its business, and that is registered as an investment adviser under the Investment Advisers Act of 1940[95] or under the laws of the State in which the adviser maintains its principal office and place of business, is a bank or similar financial institution supervised by the United States or State, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1))), but only if the advice resulting in the compensation is provided through a trust department of the bank or similar financial institution or savings association which is subject to periodic examination and review by Federal or State banking authorities, and is a broker or dealer registered under the Securities Exchange Act of 1934.

- Retirement investor means (1) in the case of a plan that does not provide for participant-directed investments, a fiduciary with authority to make investment decisions for the plan, (2) a plan participant or beneficiary with authority to direct the investment of assets in his or her account or to take a distribution, or (3) the owner of a tax-favored individual account acting on behalf of the account.
- Principal transaction means a purchase or sale of a debt security where an adviser or financial institution is purchasing from or selling to a plan, participant or beneficiary account, or IRA on behalf of the financial institution's own account or the account of a person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the financial institution.
- Debt security means a "debt security" as defined in Rule 10b-10(d)(4) of the Exchange Act that is U.S. dollar denominated, issued by a U.S. corporation and offered pursuant to a registration statement under the Securities Act of 1933, an "Agency Debt Security" as defined in FINRA Rule 6710(l) or its successor, or a "U.S. Treasury Security" as defined in FINRA Rule 6710(p) or its successor.
- Best interest of a retirement investor with respect to investment advice means that the adviser and financial institution providing the advice act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor, without regard to the financial or other interests of the adviser, financial institution, any affiliate or other party.

4. Proposed changes to existing class exemptions

In general

Under present law, class exemptions issued by DOL apply to various transactions, subject to conditions applicable under the terms of each exemption. In connection with the issuance of the proposed regulations and new proposed class exemptions, DOL has proposed changes to some existing class exemptions as described below.

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[95] 15 U.S.C. 78a et seq.

Prohibited transaction exemption ("PTE") 75-1[96]

Agency transactions and services under Part I(b) and (c)

These class exemptions apply to the following:

- The effecting of a securities transaction on behalf of an employee benefit plan by a disqualified person (other than a fiduciary) acting in the transaction as an agent for the plan and the performance by the person of clearance, settlement, or custodial functions incidental to the effecting of the transaction, and
- The furnishing to an employee benefit plan by a disqualified person (including an affiliate) of any advice, either directly, or through publications or writings, as to the value of securities or other property, the advisability of investing in, purchasing or selling securities or other property, or the availability of securities or other property or of purchasers or sellers of securities or other property, or of any analyses or reports concerning issuers, industries, securities or other property, economic factors or trends, portfolio strategy, or the performance of accounts, under circumstances that do not make the person a fiduciary with respect to the plan, provided that, in each instance, the transactions are effected on behalf of the plan, or the advice, analyses or reports are furnished to the plan, on terms at least as favorable to the plan as an arm's length transaction with an unrelated party would be and were not, at the time the transactions were effected or the time the advice, analyses or reports were furnished, prohibited transactions under the preERISA provisions of the Code.

DOL proposes to revoke these exemptions, which by their terms do not apply to fiduciaries.[97] Statutory exemptions for transactions described in the exemptions continue to be available as implemented by DOL regulations.[98]

Principal transactions under Part II(2)[99]

This class exemption applies to the purchase or sale by a plan of securities issued by an open-end investment company registered under the Investment Company Act of 1940 (that is, a mutual fund), provided that (1) no fiduciary with respect to the plan who makes the decision on behalf of the plan to enter into the transaction is a principal underwriter for, or affiliated with, the mutual fund, (2) the transaction is at least as favorable to the plan as an arm's length transaction with an unrelated party would be, and (3) the transaction was not, at the time of the transaction, a prohibited transaction under the preERISA provisions of the Code. In addition, the plan generally must maintain or cause to be maintained for a period of six years from the date of the

[96] 40 Fed. Reg. 50845, as amended at 71 Fed. Reg. 5883.

[97] 80 Fed. Reg. 22021.

[98] Sec. 4975(d)(2), ERISA sec. 408(b)(2), and 29 C.F.R. sec. 2550.408b-2.

[99] This exemption was subsequently amended at 71 Fed. Reg. 5883.

transaction records as are necessary to enable the following persons to determine whether the conditions of this exemption have been met: duly authorized employees of DOL or the IRS, plan participants and beneficiaries, any employer of plan participants and beneficiaries, and any employee organization any of whose members are covered by such plan.

DOL proposes to provide relief for these transactions under PTE 86-128, discussed below, and thus proposes to revoke this exemption.[100]

Underwritings under Part III and market-making under Part IV

These class exemptions apply to the following:

- The purchase or other acquisition of securities by an employee benefit plan during the existence of an underwriting or selling syndicate with respect to the securities from a person other than a plan fiduciary in the case in which a plan fiduciary is a member of the syndicate.
- The purchase or sale of securities by an employee benefit plan from or to a market-maker with respect to the securities who is also a plan fiduciary in the case in which a plan fiduciary is a member of the syndicate.

DOL proposes to amend these exemptions to add standards of impartial conduct (similar to the standards applicable under the new proposed class exemptions) as conditions for the underwriting and market-making exemptions to apply.[101]

Extensions of credit under Part V[102]

This class exemption applies to an extension of credit to an employee benefit plan by a party in interest that is a broker or dealer registered under the Securities Exchange Act of 1934 in connection with a purchase or sale of securities. If the party in interest has or exercises any discretionary authority or control (other than as a directed trustee), or renders investment advice with respect to the assets involved in the transaction, no consideration or other interest may be received by the party in interest or an affiliate in connection with the extension of credit.

DOL proposes to amend the exemption so that, in the case of a party in interest that is a plan fiduciary by reason of rendering investment advice, if certain conditions are met, the proposed amendment allows the fiduciary to 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.[103]

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[100] 80 Fed. Reg. 22021.

[101] 80 Fed. Reg. 22035. A similar amendment is proposed to be made to PTEs 77-4, 80-83, and 83-1.

[102] This exemption was subsequently amended. 71 Fed. Reg. 5883.

[103] 80 Fed. Reg. 22004.

PTE 84-24[104]

PTE 84-24 provides class exemptions for the following transactions:

- The receipt, directly or indirectly, by an insurance agent or broker or a pension consultant of a sales commission from an insurance company in connection with the purchase, with plan assets, of an insurance or annuity contract.
- The receipt of a sales commission by a principal underwriter for an investment company registered under the Investment Company Act of 1940 (that is, a mutual fund) in connection with a mutual fund purchase with plan assets.
- The effecting by an insurance agent or broker, pension consultant or investment company principal underwriter of a transaction for the purchase of an insurance or annuity contract, or a mutual fund purchase, with plan assets.
- The purchase, with plan assets, of an insurance or annuity contract from an insurance company.
- The purchase, with plan assets, of an insurance or annuity contract from an insurance company which is a fiduciary or a service provider (or both) with respect to the plan solely by reason of the sponsorship of a master or prototype plan.
- The purchase, with plan assets, of mutual fund shares from, or the sale of mutual fund shares to, the mutual fund or mutual fund principal underwriter, when the mutual fund, principal underwriter, or mutual fund investment adviser is a fiduciary or a service provider (or both) with respect to the plan solely by reason of: (1) the sponsorship of a master or prototype plan; or (2) the provision of nondiscretionary trust services to the plan; or (3) both (1) and (2).

DOL proposes to amend these exemptions to apply impartial conduct standards for fiduciaries similar to those under the new proposed class exemptions.[105] In addition, these exemptions would no longer apply with respect to the purchase by an IRA of a variable annuity contract or other annuity contract that is a security under Federal securities laws or mutual fund shares. Instead, the proposed BIC class exemption could apply to such a transaction, subject to the conditions in the proposed BIC exemption.

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[104] 49 Fed. Reg. 13208, as amended at 71 Fed. Reg. 5887.

[105] 80 Fed. Reg. 22010.

PTE 86-128[106]

PTE 86-128 provides class exemptions for the following transactions, if authorized by a plan fiduciary independent of the plan fiduciary involved in the transaction:

- A plan fiduciary's using its authority to cause a plan to pay a fee for effecting or executing securities transactions to the fiduciary as agent for the plan, but only to the extent that such transactions are not excessive, under the circumstances, in either amount or frequency.
- A plan fiduciary's acting as the agent (that is, broker) for both the plan and one or more other parties to a transaction (referred to as an agency cross transaction).
- The receipt by a plan fiduciary of reasonable compensation for effecting or executing an agency cross transaction to which a plan is a party from one or more other parties to the transaction.

DOL proposes to amend these exemptions to apply the impartial conduct standards applicable under the proposed BIC class exemption.[107] In addition, a new exemption would apply to a plan fiduciary's using its authority to cause a plan to purchase shares of an open-end mutual fund from the fiduciary, acting as principal, and to the receipt of a commission by the person in connection with the transaction, but only if (1) the transactions are not excessive, under the circumstances, in either amount or frequency, and (2) the fiduciary is a broker-dealer registered under the Securities Exchange Act of 1934 and is not a principal underwriter for, or affiliated with, the mutual fund within the meaning of sections 2(a)(29) and 2(a)(3) of the Investment Company Act of 1940. However, the exemptions under PTE 86-128 would not apply with respect to a person that is a fiduciary by reason of rendering investment advice with respect to an IRA involved in a transaction. Instead, the proposed BIC class exemption could apply to such a fiduciary, subject to the conditions in the proposed BIC exemption.

[106] 51 Fed. Reg. 41686, as amended at 67 Fed. Reg. 64137.

[107] 80 Fed. Reg. 22021.

II. DATA RELATING TO CERTAIN TAX-FAVORED SAVINGS ACCOUNTS

The tables in this section provide information on the number of accounts and the fair market value of assets in various relevant tax-favored savings accounts, including individual retirement arrangements (IRAs); private defined contribution plans; and health savings accounts (HSAs), Medicare Advantage MSAs and Archer MSAs.

1. Individual retirement arrangements (IRAs)

In 2012, traditional IRAs held approximately $4.7 trillion of assets across 42 million accounts. Roth IRAs held significantly less, with approximately $410 billion of assets across 17 million accounts. Rollover contributions to IRAs from employer-sponsored plans or other IRAs totaled $313 billion of assets across approximately 4 million accounts. Because some individuals may have multiple accounts, the number of accounts does not accurately indicate the total number of individual savers.

Table 1.─Number of Accounts and Fair Market Value of IRAs, 2012

Type of Account	Number of Accounts (Millions)[1]	Fair Market Value (Billions)
Traditional IRAs	42	$4,707
Roth IRAs	17	$410
SEP	3	$278
SIMPLE	3	$73
Rollover Contributions	4	$313

Note: Based on JCT tabulations of Form 5498 data.
[1] Some individuals may have multiple accounts.

2. Private defined contribution plans

Table 2 presents information on the number of plans, the number of active participants, and the fair market value of assets in private defined contribution. In 2012, according to the Department of Labor's Pension Bulletin for 2012, there were approximately 470,000 plans with some degree of participant-directed investment, accounting for 61.2 million active participants and assets totaling $3.4 trillion.

Table 2.─Number of Accounts and Fair Market Value of Private Employer 401(k) Type Plans, 2012

Type of Account	Number of Plans (Thousands)	Number of Active Participants (Millions)	Fair Market Value (Trillions)
Participant-directed brokerage accounts provided as an investment option under the plan	15.8	4.5	$.5
Total or partial participant-directed account plan[1]	453.3	56.7	$2.9

Source: DOL Pension Bulletin 2012

[1] Plan uses default investment account for participants who fail to direct assets in their account

3. Health savings accounts (HSAs), Medicare Advantage MSAs and Archer MSAs

In 2012, HSAs and MSAs held approximately $14 billion of assets across 7 million accounts. Of these 7 million accounts, approximately 83 percent indicate the taxpayer made some sort of a contribution in 2012, including rollovers.

Table 3.─ Number of Accounts and Fair Market Value of HSAs and MSAs, 2012

Number of Accounts (Millions)[1]	Fair Market Value (Billions)
7	$14

Note: Based on JCT tabulations of Form 5498-SA data.

[1] Some individuals may have multiple accounts.