

Structured Thoughts

News for the financial services community.



Implications of the DOL Fiduciary Rule for Structured Products

On April 6, 2016, the Department of Labor (“DOL”) issued its final conflict of interest regulations, which significantly expand who is considered a fiduciary when dealing with a retirement account. The new regulations, together with a number of amended and final prohibited transaction exemptions that were concurrently released, exceed 1,000 pages (the “Regulations”),¹ and apply to IRAs and to pension and 401(k) plans that are covered by ERISA.²

The new Regulations sweep within the concept of “fiduciary” broker-dealers and other financial advisors who provide any investment recommendation to a retirement plan or an IRA. As a fiduciary, a broker-dealer would be required to act in the best interest of its customers and would generally be prohibited from receiving commissions or other variable compensation. In order to receive transaction-based compensation when dealing with a retirement account, a broker-dealer would need to fit the transaction within one of the exceptions or exemptions set forth in the Regulations. As discussed in this article, sponsors and distributors of structured products should review their structured product programs as well as related distribution and compensation arrangements in order to comply with the new Regulations. The Regulations will begin to become effective on April 10, 2017.

Background and New Rule

Under the current rules, which have been in place for more than 40 years, a party is considered a fiduciary only if it provides investment advice on a regular basis under a mutual agreement, arrangement or understanding. The advice

¹ <http://www.dol.gov/ebsa/regs/conflictsofinterest.html>. Prior to the issuance of the final regulation, the DOL had issued proposed regulations on October 21, 2010, which were withdrawn on September 19, 2011, and then revised substantially and re-proposed on April 20, 2015.

² The Employee Retirement Income Security Act of 1974.

must serve as the primary basis for investment decisions and must be individualized for the particular needs of the retirement investor.

The new Regulations remove the requirements that (a) the advice be given on a regular basis, (b) it be given under a mutual agreement or understanding or (c) it serve as a primary basis for the investment decision.

In addition, the new Regulations expand the scope of what is considered an investment “recommendation” and what is considered advice that is “individualized” to the needs of a plan or IRA. The Regulations revise the definition of “investment advice” to include:

- recommendations to purchase or sell securities or other investment products (including rollover decisions),
- recommendations regarding investment strategy,
- appraisals of investments and
- recommendation of other persons to provide investment advice.

The Regulations look to FINRA guidance as to what constitutes an investment recommendation. FINRA has stated that a communication that could reasonably be viewed as a “suggestion” that the client take certain action or refrain from taking certain action in relation to a security or investment strategy constitutes a “recommendation.” See FINRA Notice to Members 11-02. Importantly, this broad definition could cover virtually all dealings between a broker-dealer and its customer, other than processing unsolicited orders.

The new Regulations provide that persons who provide such “investment advice” fall within the general definition of a fiduciary if they either (i) represent that they are acting as a fiduciary under ERISA or the Code or (ii) provide the advice under an agreement, arrangement or understanding that the advice is individualized or specifically directed to the recipient for consideration in making investment or investment management decisions regarding plan assets. These criteria for determining who is a fiduciary would generally cover most client account agreements.

A person’s status as a fiduciary is critical. For a broker-dealer who has been categorized for the first time as a fiduciary, his or her duties have dramatically increased. Determining that an investment is “suitable” for a client would no longer be sufficient. Rather, the broker-dealer will need to act in a manner which it believes is in the best interests of its customers. In addition, the broker-dealer is required under ERISA to discharge his or her duties to the plan or IRA with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use.

Furthermore, as a fiduciary, the broker-dealer has for the first time become subject to ERISA’s self-dealing rules, which provide generally that a fiduciary acting in its fiduciary capacity (e.g., as the giver of advice) cannot cause itself or any of its affiliates to receive additional compensation. “Variable” compensation (e.g., commissions and similar transaction-based fees) are expressly prohibited unless there is an available exception or exemption. In the final Regulations, the Department of Labor provides three principal avenues for avoiding a self-dealing prohibited transaction from occurring: the seller’s exception, the Best Interest Contract Exemption and the Principal Exemption. We discuss these provisions in more detail below.

Seller’s Exception to Fiduciary Status

The seller’s exception carves out from the new Regulations advice rendered to certain sophisticated clients or professionally managed plans. Under the final Regulations, a seller will not be deemed a fiduciary if, prior to the transaction, the seller provides advice to a person who is independent of the seller, and:

- (A) the seller knows or reasonably believes that the person with whom it is negotiating is (i) a bank as defined in section 202 of the Investment Advisers Act of 1940 (“Advisers Act”) or similar institution under state or federal law, (ii) an insurance carrier qualified in more than one state to perform the services of managing, acquiring or disposing of assets of a plan, (iii) an investment adviser registered under the Advisers Act or in some cases under state law, (iv) a broker-dealer registered under the Securities Exchange Act of 1934 or (v) an independent

- fiduciary that holds, or has under management or control, assets of at least \$50 million (the seller may rely on written representations from the plan or independent fiduciary as to (v));
- (B) the seller knows or reasonably believes that the independent fiduciary of the plan or IRA is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies (the person may rely on written representations from the plan or independent fiduciary to satisfy this paragraph (B));
 - (C) the seller fairly informs the independent fiduciary that the person is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction and fairly informs the independent fiduciary of the existence and nature of the person's financial interests in the transaction;
 - (D) the seller knows or reasonably believes that the independent fiduciary of the plan or IRA is a fiduciary under ERISA or the Code, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction (the person may rely on written representations from the plan or independent fiduciary to satisfy this paragraph (D)); and
 - (E) the seller does not receive a fee or other compensation directly from the plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner for the provision of investment advice (as opposed to other services) in connection with the transaction. In other words, the seller can still receive a fee or compensation from an entity or person other than the plan or IRA, such as an underwriting commission that is reduced from an issuer's net proceeds.

The Best Interest Contract Exemption (BICE)

The Best Interest Contract Exemption (BICE) creates an avenue for undertaking transactions on a commission basis with retail retirement clients who would not qualify for the seller's exception. BICE is available for transactions in all classes of securities; however, it only covers transactions effected on an agency or riskless principal basis. Principal transactions, which are defined to include purchases or sales on behalf of a broker-dealer's own account or the account of an affiliate, may not be effected under BICE.

The final Regulations expressly contemplate that proprietary products may be sold under BICE. Proprietary products are defined as products which are managed, issued or sponsored by the broker-dealer or an affiliate. The application of this definition to many types of structured products is not clear. In addition, given the potential inconsistency between the definition of prohibited "principal transactions" and "proprietary products," it is not clear if certain categories of proprietary products may not be sold under BICE because they would be deemed principal transactions. Market participants are expected to request the DOL to clarify these issues before the effective date.

What Are the Requirements to Comply with BICE?

The exemption requires that the IRAs enter into a written contract under which the financial institution acknowledges its and its individual advisers' fiduciary status. For plans covered by ERISA (e.g., an employer-sponsored 401(k) plan) there is no contract required, but the financial institution must still provide a written statement to the plan that acknowledges its fiduciary status. In addition, the contract or statement must warrant that:

- (i) the adviser, financial institution and affiliates will adhere to basic standards of impartial conduct (including advice that is in the "best interest" of the advisee (see below));
- (ii) 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 (see below);
- (iii) 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 and designated a person or persons, identified by name, title or function, responsible

- for addressing material conflicts of interest and monitoring their advisers' adherence to the impartial conduct standards;
- (iv) neither the financial institution nor (to the best of its knowledge) any affiliate 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 that are not in the best interest of the plan or IRA. The exemption provides that this requirement does not prevent the financial institution or its affiliates from providing advisers with differential compensation (including commissions) to the extent that the financial institution's policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of advisers with the interests of the plan or IRA. Differential compensation received by an adviser based on what product the adviser sells appears under the exemption to be limited to cases where objective neutral factors affect the amount of services the adviser has to give with respect to the different types of investments. For example, it is possible that the sale of a structured note that requires an adviser to provide greater explanations or guidance to the plan or IRA might justify a greater commission; however, no concrete examples were given by the DOL.
 - (v) the contract is prohibited from having (a) exculpatory provisions disclaiming or otherwise limiting the liability of the adviser or financial institution; (b) a provision under which the plan or IRA 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; provided that, the parties may knowingly agree to waive the plan's or IRA's right to obtain punitive damages or rescission as a remedy to the extent such a waiver is permissible under applicable state or federal law; or (c) agreements to arbitrate or mediate individual claims in venues that are distant or that otherwise unreasonably limit the ability of the retirement investors to assert the claims safeguarded by this exemption. So, the contract cannot waive the plan or IRA's right to participate in a class action lawsuit, but can require arbitration of individual claims; provided that the forum for arbitration does not unreasonably limit the ability of the plan or IRA to assert its claim.³
 - (vi) the contract or statement must state the best interest standard of care owed by the adviser and financial institution to the plan or IRA; inform the retirement investor of the services provided by the financial institution and the adviser; and describe how the plan or IRA will pay for services, directly or through third-party payments, such as revenue sharing or 12b-1 fees. Investment advice is considered in the "best interest" of the plan or IRA 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 acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances and needs of the plan or IRA, without regard to the financial or other interests of the adviser, financial institution or their respective affiliates.
 - (vii) the contract or statement must describe "material conflicts of interest" in connection with the fees received by the adviser or financial institution.⁴ A "material conflict of interest" exists when "an adviser or financial institution has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a retirement investor.
 - (viii) the contract or statement must inform the plan or IRA that the investor has the right to obtain copies of the financial institution's written description of its policies and procedures, as well as the specific disclosure of costs, fees and compensation, including third-party payments, regarding recommended transactions, described in dollar amounts, percentages, formulas or other means reasonably designed to present materially accurate disclosure of their scope, magnitude and nature in sufficient detail to permit the plan

³ One liberalization of the final exemption over the proposed exemption is that for existing clients, the written contract requirement is met if the financial institution delivers the proposed contract amendment complying with BICE, and does not hear back from the IRA investor within 30 days; provided that the contract amendment does not impose any new contractual obligations, restrictions or liabilities on the IRA.

⁴ Although not clearly stated in the Regulations, we believe disclosure of material conflicts of interest in offering documents timely delivered to the retirement investor should suffice for this purpose.

or IRA to make an informed judgment about the costs of the transaction and about the significance and severity of the material conflicts of interest, and describes how the plan or IRA can obtain the information, free of charge, within 30 business days following the request, but always before the transaction occurs if the request was made before the transaction occurs.

- (ix) the contract or statement must include a link to the financial institution's website, and must inform the plan or IRA that: (a) model contract disclosures updated as necessary on a quarterly basis are maintained on the website, and (b) the financial institution's written description of its policies and procedures adopted in accordance with the exemption are available free of charge on the website.
- (x) the contract or statement must disclose to the plan or IRA whether the financial institution offers proprietary products or receives third-party payments with respect to any recommended investments, and to the extent the financial institution or adviser limits investment recommendations, in whole or part, to proprietary products or investments that generate third-party payments, notify the plan or IRA of the limitations placed on the universe of investments that the adviser may offer for purchase, sale, exchange or holding by the retirement investor.
- (xi) the contract or statement must provide contact information (telephone and email) for a representative of the financial institution that the plan or IRA can use to contact the financial institution with any concerns about the advice or service they have received, and, if applicable, a statement explaining that the plan or IRA can research the financial institution and its advisers using FINRA's BrokerCheck database or the Investment Adviser Registration Depository (IARD), or another database maintained by a governmental agency or instrumentality, or self-regulatory organization.
- (xii) the contract or statement must describe whether or not the adviser and financial institution will monitor the plan or IRA's investments and alert the plan or IRA to any recommended change to those investments, and, if so monitoring, the frequency with which the monitoring will occur and the reasons for which the plan or IRA will be alerted.

What Are the Impartial Conduct Standards?

The impartial conduct standards that the financial institution and its representatives must adhere to, are the following:

- (i) when providing investment advice to plan or IRA, the financial institution and the adviser(s) provide investment advice that is, at the time of the recommendation, in the best interest of the retirement investor. As noted above, this advice must reflect the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances and needs of the plan or IRA, without regard to the financial or other interests of the adviser, financial institution or any affiliate or other party.
- (ii) the recommended transaction will not cause the financial institution, adviser or their affiliates to receive, directly or indirectly, compensation for their services that is in excess of reasonable compensation within the meaning of ERISA's service provider exemption.
- (iii) statements by the financial institution and its advisers to the plan or IRA about the recommended transaction, fees and compensation, material conflicts of interest and any other matters relevant to the plan or IRA will not be materially misleading at the time they are made.

Additional Requirements for Proprietary Products and Third-Party Payments

If a financial institution restricts advisers' investment recommendations, in whole or part, to proprietary products or to investments that generate third-party payments, to rely on BICE it must:

- (i) prominently notify the plan or IRA in writing of such fact, as well as the existence of any material conflicts of interest prior to or at the time of execution of the recommended transaction;
- (ii) document in writing:
 - (a) its limitations on the universe of recommended investments and the material conflicts of interest associated with any contract, agreement or arrangement providing for its receipt of third-party payments or associated with the sale or promotion of proprietary products;
 - (b) any services that it will provide to plans or IRAs in exchange for third-party payments, as well as any services or consideration it will furnish to any other party, in exchange for the third-party payments;
 - (c) that it will reasonably conclude that the limitations on the universe of recommended investments and material conflicts of interest will not cause the financial institution or its advisers to receive compensation in excess of a reasonable amount and
 - (d) that it will reasonably determine that these limitations and material conflicts of interest will not cause the financial institution or its advisers to recommend imprudent investments, and the bases for its conclusions,
- (iii) adopt, monitor, implement and adhere to policies and procedures and incentive practices that meet the terms of the exemption.

Additional Requirements Under BICE

- (i) The financial institution must make certain disclosures to the plan or IRA prior to or at the time of the transaction, such as (a) the best interest standard of care owed by the adviser and financial institution to the plan or IRA, and any material conflicts of interest, (b) that the plan or IRA has the right to obtain copies of the financial institution's written description of its policies and procedures adopted in accordance with BICE, as well as specific disclosure of costs, fees and other compensation, including third-party payments with respect to recommended transactions and (c) a link to the financial institution's website, which itself must meet a number of requirements under BICE.
- (ii) The financial institution must maintain a website that is freely accessible to the public and updated at least quarterly that has:
 - (a) a discussion of the financial institution's business model and the material conflicts of interest associated with that business model;
 - (b) a schedule of typical account or contract fees and service charges;
 - (c) a model contract or other model notice of the contractual terms (if applicable) and certain disclosures required under BICE, which are reviewed for accuracy no less frequently than quarterly and updated within 30 days if necessary;
 - (d) a written description of the financial institution's policies and procedures that accurately describes or summarizes key components of the policies and procedures relating to conflict-mitigation and incentive practices in a manner that permits plans or IRAs to make an informed judgment about the stringency of the financial institution's protections against conflicts of interest;
 - (e) to the extent applicable, a list of all product manufacturers and other parties with whom the financial institution maintains arrangements that provide third-party payments to either the adviser or the financial institution with respect to specific investment products or classes of investments recommended to plans or IRAs;

- (f) a description of the arrangements, including a statement on whether and how these arrangements impact adviser compensation, and a statement on any benefits the financial institution provides to the product manufacturers or other parties in exchange for the third-party payments; and
- (g) disclosure of the financial institution's compensation and incentive arrangements with advisers including, if applicable, any incentives (including both cash and non-cash compensation or awards) to advisers for recommending particular product manufacturers, investments or categories of investments to plans or IRAs, or for advisers to move to the financial institution from another firm or to stay at the financial institution, and a full and fair description of any payout or compensation grids, but not including information that is specific to any individual adviser's compensation or compensation arrangement.

Disclosure to DOL and Recordkeeping

- (i) A financial institution, before receiving compensation in reliance on BICE, must notify the DOL of its intention to rely on the BICE. The notice will remain in effect until revoked in writing by the financial institution. The notice need not identify any plan or IRA. The notice must be provided by email to BICE@dol.gov.⁵
- (ii) The financial institution must maintain for a period of six years, in a manner that is reasonably accessible for examination, the records necessary to determine whether the conditions of this exemption have been met with respect to a transaction, except that (a) 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 (b) no party, other than the financial institution responsible for complying with this requirement, will be subject to the excise tax that may be assessed under ERISA or the Internal Revenue Code as the result of a prohibited transaction, if the records are not maintained or are not available for examination as required by BICE.

The Principal Exemption

The Principal Exemption is an avenue for the sale or purchase of a limited group of investment products on a principal basis. The exemption is only available for (i) "Debt Securities," which is defined to include U.S. Treasury and agency securities and U.S. dollar denominated debt issued by a U.S. corporation in an offering registered under the Securities Act of 1933,⁶ (ii) certificates of deposit,⁷ (iii) unit investment trusts and (iv) such other securities as the DOL may determine.

The Principal Exemption does not cover sales of Debt Securities issued by the broker-dealer or any of its affiliates. In addition, it is not available for Debt Securities being sold through an underwriting if the broker-dealer or any of its affiliates are members of the underwriting syndicate. Moreover, in order to qualify under the Principal Exemption, a Debt Security (but not a certificate of deposit) must have no greater than "moderate credit risk" and must be "sufficiently liquid" so that it could be sold at or "near" its "carrying value" within a "reasonably short period of time." None of the referenced terms are defined in the Principal Exemption.

Thus, the Principal Exemption is a relatively narrow exemption. The relative illiquidity of many structured notes may render them outside the scope of this exemption.

For those securities and transactions which might qualify, the impartial conduct, contract and disclosure requirements discussed under BICE will apply to transactions effected under the Principal Exemption.

⁵ To some extent, this notification will aid the DOL in determining how the new rules are being applied in practice. That is, the DOL will know which entities are the ones that might need the most oversight or review.

⁶ Accordingly, structured products such as Regulation D notes, unregistered bank notes and registered notes issued by non-U.S. issuers will not qualify for this exemption.

⁷ This provision appears to include (and permit) structured certificates of deposit, such as those linked to an equity index.

Implications for Structured Products

The new Regulations pose challenges for the sale of structured products to retail retirement accounts. Sales to larger, institutional plans and professionally managed plans should qualify for the seller's exception and therefore will be largely unaffected by the new Regulations.

Sale of Proprietary Structured Products

Broker-dealers may not be able to sell on a commission basis proprietary structured products which have been "issued" by an issuer affiliated with the broker-dealer. The Principal Exemption expressly states that it is not available for these sales. Moreover, BICE is not available for the sale of products for "the account of" the broker-dealer or an affiliate. This raises the question of what degree of involvement by a broker-dealer or its affiliates might cause the resulting structured product to be deemed "issued by" or sold for "the account of" the broker-dealer or its affiliates. DOL guidance on this topic would be helpful. Our view is that a broker-dealer and its affiliates may enter into hedging transactions in connection with a structured product and still be eligible to sell it under the Principal Exemption or BICE.⁸ Co-branding presents a closer question, but co-branded products should still be eligible if the notes are not issued by the broker-dealer's affiliates. However, if an affiliate of the broker-dealer is the issuer or guarantor of the structured note, then it seems clear that the Principal Exemption is not available and BICE may not be available.

If this is the case, proprietary products consisting of structured notes issued by an affiliate of the broker-dealer could not be sold by that broker-dealer on a commission basis under BICE or the Principal Exemption. In order to distribute such products on a commission basis, distribution would likely need to be limited to (i) institutional retirement accounts eligible for the seller's exception and (ii) sales (including on a principal basis) to unaffiliated broker-dealers and distributors who would then sell to retail retirement accounts.⁹

Proprietary structured notes which have not been issued by the broker-dealer's affiliates would be eligible for sale under the Principal Exemption or BICE. However, in order to qualify under the Principal Exemption, the notes could not be sold through an offering in which the broker-dealer is participating as a member of the underwriting syndicate. Moreover, the notes would have to meet the credit risk and liquidity standards described in the section above entitled "The Principal Exemption." These provisions would not apply to the sale of such structured notes on an agency basis under BICE. As a result, broker-dealers may determine that it is better to sell such products on an agency basis, rather than try to comply with the restrictive provisions of the Principal Exemption. This conclusion might also lead product manufacturers to distribute such notes through best-efforts offerings, where the participating brokers may act on an agency basis.

The foregoing concerns would not apply to the sale of proprietary, structured CDs, as they are not subject to the same limitations as Debt Securities. Accordingly, proprietary structured CDs could generally be sold under the Principal Exemption or under BICE.

As discussed below under *General Fiduciary Concerns*, the sale of any proprietary products to a retail retirement account will raise additional concerns as to whether the sale is in the best interests of the customer.

Sale of Non-proprietary Structured Products

Generally speaking, non-proprietary structured products would be eligible for sale under the Principal Exemption or under BICE. However, under the Principal Exemption, a broker-dealer would still be subject to a number of constraints discussed above, including the prohibition on sales of Debt Securities through underwritings in which the broker is participating, as well as the credit risk and liquidity standards. As a result, broker-dealers might find it better to sell non-proprietary structured products that are Debt Securities on an agency basis under BICE.

⁸ The potential revenue stream from the hedging transactions will need to be disclosed. As the amount of such revenues may not be known, we believe it should suffice if the broker-dealer provides a description of the hedging arrangements.

⁹ Sales to these accounts could also be made on a non-commission basis, as is presently done for the sale of some structured products to advised accounts.

General Fiduciary Concerns

In order to sell any products under BICE or the Principal Exemption, broker-dealers will need to comply with the requirement to act in the best interest of their customers without regard to the interests of the broker. In addition, all material conflicts of interest must be disclosed.

As a result, the proposed sale of any structured products to a retail retirement account under BICE or the Principal Exemption will require careful consideration of the questions listed below.¹⁰ These questions are likely to be raised by any broker-dealer in the distribution chain who will be selling to a retail retirement account. As a result, both product manufacturers and distributors should consider the following:

Why is the structured product in the best interest of the customer?

Are there any features of the product, including risk to principal and liquidity, which might detract from its being in the best interests of the customer?

Are there comparable products available at a lower cost?

Does the broker-dealer or any of its affiliates receive any third-party payments in connection with the product which must be disclosed?

If so, are there comparable products which are not subject to these third-party payments?

If the structured product is a proprietary product, does the broker-dealer or any of its affiliates receive payments for management, hedging or other services which might create a material conflict of interest?

If the structured product is a proprietary product, does the broker-dealer firm place any limitations on the availability of similar products?

If so, have these limitations been adequately disclosed to the customer?

If so, has the broker-dealer adequately documented that the limitations will not cause the broker-dealer to recommend imprudent investments?

The analysis based on these questions should be properly documented and retained to demonstrate compliance with the requirements of the Regulation. While many of these questions will relate to products generally, it would appear that some of them must be examined and documented as to specific sales, such as whether the sale is in the “best interest of the customer.”

Next Steps

Product manufacturers and distributors of structured products should review their product offerings and their distribution arrangements in order to prepare for the application of the new Regulations. Steps to consider include:

- Limiting the sale of higher-cost products and products that bear a greater risk of loss to institutional retirement accounts eligible for the seller’s exception.
- Revising structured products sold to retail retirement accounts to eliminate or modify risks or costs which might impair the ability to sell such products under the best interest standard.
- Reducing or eliminating certain third-party payments to distributors, such as “shelf space” and similar fee arrangements, in order to mitigate potential conflict of interest issues for distributors.

¹⁰ This list is intended only as an example. It is likely to vary in practice, depending upon the nature of the targeted investors, the nature of the instrument and other factors.

- Reviewing all proprietary structured products sold through affiliated distributors to determine if their products may be sold to retail retirement accounts notwithstanding any inherent conflicts of interest and notwithstanding any limitations on the availability of competing products.
- Revising distribution arrangements so that structured products may be sold on an agency basis through best efforts offerings under BICE. Product manufacturers and other broker-dealers will likely seek to revise their distribution agreements to add representations and covenants that demonstrate that the relevant broker-dealer is properly selling to accounts affected by the new regulations. Through their “know your dealer” processes, they will also seek to understand their distributors’ familiarity with, and potential ability to comply with, these rules.
- Revising distribution arrangements so that structured products consisting of notes issued by an affiliate are distributed initially solely to (i) institutional retirement accounts and (ii) unaffiliated broker-dealers and distributors who then sell the products to retail retirement accounts.

Conclusion

The new Regulations will have an impact on how structured products are packaged and sold to retail retirement accounts. Although initial implementation is nearly a year away, the scope and complexity of likely program changes require immediate attention from both manufacturers and distributors of structured products. Many financial institutions are currently organizing designated teams or committees to address these issues across their institution. In light of the particular application of these rules to structured products, it will likely be very useful to ensure that team members that are familiar with the institution’s structured products business and offerings have a seat at that table for these discussions.

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