

# Disclosure of Noncash Compensation and Third-Party Payments in Response to the DOL Fiduciary Rule

JANUARY 2017

The content contained in this document is proprietary property of ICI and should not be reproduced or disseminated without ICI's prior consent. The illustrations and considerations set forth in this document are not intended to be, and should not be construed as, legal advice or a recommendation as to how mutual funds or other interested market participants should evaluate their options for adopting or modifying policies and practices to facilitate compliance with the Department of Labor (DOL) fiduciary rule. All market participants must make their own independent and unilateral decisions about any such matters.

# Disclosure of Noncash Compensation and Third-Party Payments in Response to the DOL Fiduciary Rule

## Contents

<b>Introduction</b> .....	3
<b>Identifying Types of Compensation</b> .....	4
Noncash Compensation .....	4
Third-Party Payments .....	5
<b>Conclusion</b> .....	5



## Introduction

On April 6, 2016, the Department of Labor (DOL) issued a final rule defining who is a “fiduciary” under Section 3(21) of the Employee Retirement Income Security Act of 1974 and Section 4975(e)(3) of the Internal Revenue Code as a result of giving investment advice to an employee benefit plan, plan fiduciary, plan participant or beneficiary, individual retirement account (IRA), or IRA owner (collectively referred to in this paper as *retirement investors*). As the DOL notes, the final rule treats persons who provide investment advice or recommendations for a fee or other compensation with respect to assets of a plan or IRA as fiduciaries in a wider array of advice relationships.

Intermediaries operating as fiduciaries under the Best Interest Contract exemption (BICE)<sup>1</sup> are required to disclose all fees, compensation, and material conflicts of interest<sup>2</sup> to retirement investors. The goal of the disclosure is to ensure investors are fully informed about all types of compensation the adviser or financial institution may receive as a result of a recommendation so they are aware of potential conflicts of interest. Use of the BICE requires certain disclosures to occur either before or concurrent with a recommended investment transaction,<sup>3</sup> certain information to be provided upon request, and additional disclosures to be included on a publicly available website that is reviewed and updated as needed each quarter.<sup>4</sup> The transaction and website disclosure provisions have an applicability date of January 1, 2018.

An Investment Company Institute (ICI) industry working group of fund companies, intermediaries, and service providers drafted this paper to explore the disclosure of noncash compensation and third-party payments in response to the DOL fiduciary rule. The paper identifies potential data sources that intermediaries can use to help fulfill their disclosure requirements. It also highlights various types of information that fund companies and intermediaries may need to share to support disclosure.

This document is not intended to provide any legal advice and should not be relied on for that purpose; it serves solely as a tool to help funds and intermediaries identify and analyze potential approaches and data sources to assist fiduciaries in meeting disclosure requirements under the final rule.

---

<sup>1</sup> 81 Fed. Reg. p. 21002 (April 8, 2016). Along with the final rule, the DOL issued a number of prohibited transaction exemptions, including the BICE. The Best Interest Contract is an agreement between the retirement investor and the financial institution that, if the specific terms outlined within the exemption are met (e.g., written acknowledgment of the adviser’s and financial institution’s fiduciary duty to the investor, disclosure of compensation and other fee information), allows “reasonable” compensation otherwise prohibited under the final rule to be paid.

<sup>2</sup> 81 Fed. Reg. p. 21084. 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.

<sup>3</sup> 81 Fed. Reg. pp. 21078–21079. Requests from the retirement investor received before the transaction must be fulfilled before the transaction; requests after the transaction must be fulfilled within 30 business days after the transaction.

<sup>4</sup> The final rule does not stipulate whether the quarterly reporting by a fiduciary must be calendar or off-calendar.

## Identifying Types of Compensation

The BICE compensation disclosure requirements cover two categories of compensation: direct and indirect. Direct compensation or fees are paid from the investor to the intermediary. These amounts are typically deducted from a retirement investor's account balance or from the amount of a specific transaction and paid to the recipient. Examples include:

- » New account setup fees
- » Commission dollars paid by the investor
- » Transaction-related fees (e.g., switch/exchange fees, liquidation fees, wire payment fees)
- » IRA custodian annual maintenance fees

Indirect compensation or fees are paid from a third party (e.g., from the fund) to the intermediary or the intermediary's affiliates. Two categories of indirect compensation are noncash compensation and third-party payments.<sup>5</sup> Funds currently disclose to retirement investors that they may pay indirect compensation to intermediaries; the BICE seeks to make the disclosure from the intermediary more straightforward and transparent.

## Noncash Compensation

The BICE requires noncash compensation received by an intermediary to be disclosed on a publicly available website. Noncash compensation may include, but is not limited to, meals, entertainment, travel, and tangible gifts, prizes, and awards. There is no de minimis amount noted for noncash compensation under the BICE.

It is the intermediary's responsibility to update the website regarding noncash compensation no less than quarterly. The intermediary may require the fund company's assistance to complete the update. Consequently, the intermediary may request that the fund company report the following:

- » Name(s) of noncash compensation recipients
- » Date the noncash compensation was paid
- » Amount paid
- » Description of the basis for any reported cash value<sup>6</sup>

In preparation for noncash compensation<sup>7</sup> reporting under the BICE, intermediaries may consider reviewing and amending policies and procedures regarding employee receipt of and reporting on noncash compensation. Intermediaries also should discuss with fund companies what information the funds will be expected to report, including:

- » Types of information

---

<sup>5</sup> 81 Fed. Reg. p. 21084. Third-party payments include sales charges when not paid directly by the plan, participant or beneficiary account, or IRA; gross dealer concessions; revenue sharing payments; 12b-1 fees; distribution, solicitation, or referral fees; volume-based fees; fees for seminars and educational programs; and any other compensation, consideration, or financial benefit provided to the financial institution or an affiliate or related entity by a third party as a result of a transaction involving a plan, participant or beneficiary account, or IRA.

<sup>6</sup> For example, the actual cost of a meal or the per-person calculated cost of an activity.

<sup>7</sup> A financial institution's review of policies and procedures regarding all compensation is necessary in order to comply with the policies and procedures requirements of the BICE.

- » A reporting schedule (including when there is no information to report)
- » The intermediary recipient(s) of the fund company's reporting

Funds should consider identifying all areas where noncash compensation might occur and whether specific policies, procedures, and staff education should be created or updated with regard to tracking and reporting such compensation to intermediaries.

## Third-Party Payments

To receive relief under the BICE from restrictions on the receipt of reasonable third-party payments for transactions involving a plan, participant or beneficiary account, or IRA, investment advice fiduciaries (e.g., advisers, financial institutions, their affiliates, and related entities) must disclose *all* third-party payments.<sup>8</sup>

The working group identified the following sources that should provide sufficient details to support third-party payment disclosure:

- » Fund documents: The fund's prospectus and/or statement of additional information describe both direct and indirect compensation that the intermediary could receive, including sales commissions, 12b-1 payments, and the potential for revenue sharing payments.
- » Contracts/agreements: Contracts and/or service agreements outline the specific commercial arrangements between the fund company and intermediary, including related fee schedules for services the intermediary provides the fund company or its shareholders, or any revenue sharing that may be received.
- » Fee and commission payment invoices: Intermediaries can use fee and commission payment invoices to reconcile actual amounts received and ensure all third-party payments are incorporated into the quarterly disclosure updates made in response to the final rule. These invoices may be received either through DTCC Payment aXis<sup>9</sup> or by paper/electronic means.

Unlike noncash compensation, third-party payments are already known and communicated to intermediaries on a preestablished frequency. Intermediaries will need to ensure that all information is consolidated within the organization and available in a timely manner to support the disclosure requirements of the final rule.

## Conclusion

Intermediaries operating under the BICE must ensure they disclose all potential sources of compensation to retirement investors to whom they render investment advice. Noncash compensation disclosure will require the coordinated effort of financial advisers and fund companies when reporting information, while financial institutions will need to monitor third-party payment arrangements for potential changes to disclosures. It is important for intermediaries acting as fiduciaries to establish robust policies and procedures to identify, accumulate, and disclose all direct and indirect compensation details in accordance with the final rule.

---

<sup>8</sup> Note that if the adviser limits recommendations to funds that generate third-party payments, then additional conditions apply under the BICE.

<sup>9</sup> DTCC Payment aXis<sup>®</sup> automates and streamlines the processing of commissions (both direct and trailing, such as 12b-1) and various types of mutual fund fees. Firms that are active in retirement plan processing can service firm-to-firm commissions in the same manner as fund-to-broker commissions. [www.dtcc.com/wealth-management-services/mutual-fund-services/dtcc-payment-axis](http://www.dtcc.com/wealth-management-services/mutual-fund-services/dtcc-payment-axis).



1401 H Street, NW  
Washington, DC 20005  
202-326-5800  
[www.ici.org](http://www.ici.org)