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DOL Fiduciary Rule Finds New Life in Rule Extension

April 20, 2017

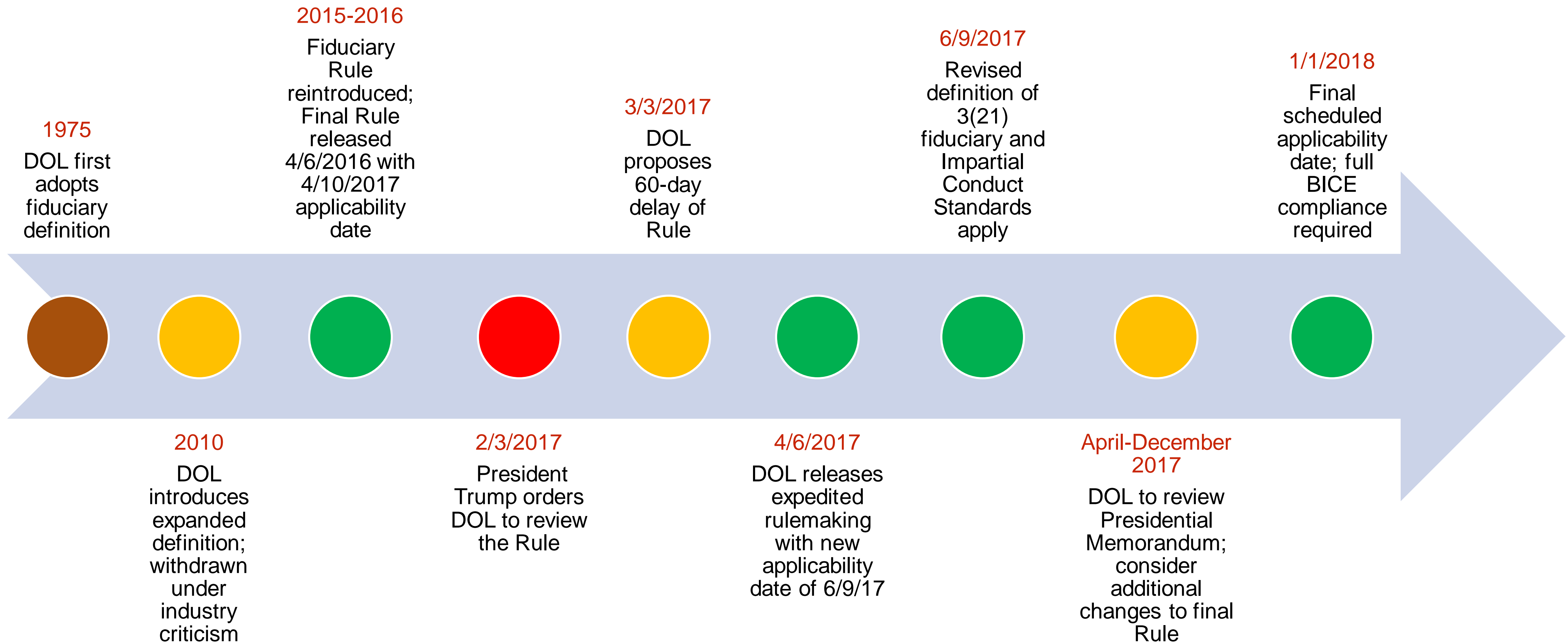
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Agenda

1. Where the Rule stands today
2. How advisors should prepare for June 9 deadline
3. How the marketplace is responding
4. Questions, answers, and discussion

Time and the Fiduciary Rule March On



President Trump's instructions to the DOL

- Determine whether the Rule may adversely affect the ability of Americans to gain access to retirement information and financial advice
- Prepare an economic and legal analysis of the likely impact of the Rule; assess whether the Rule may harm investors by:
 1. Reducing access to retirement savings offerings, product structures, savings information, or financial advice
 2. Dislocate or disrupt the retirement services industry
 3. Increase litigation and prices investors and retirees must pay to gain access to retirement services
- Determine if the Rule is inconsistent with the President's priority to "empower Americans to make their own financial decisions, to facilitate their ability to save for retirement and build the individual wealth necessary to afford typical lifetime expenses"

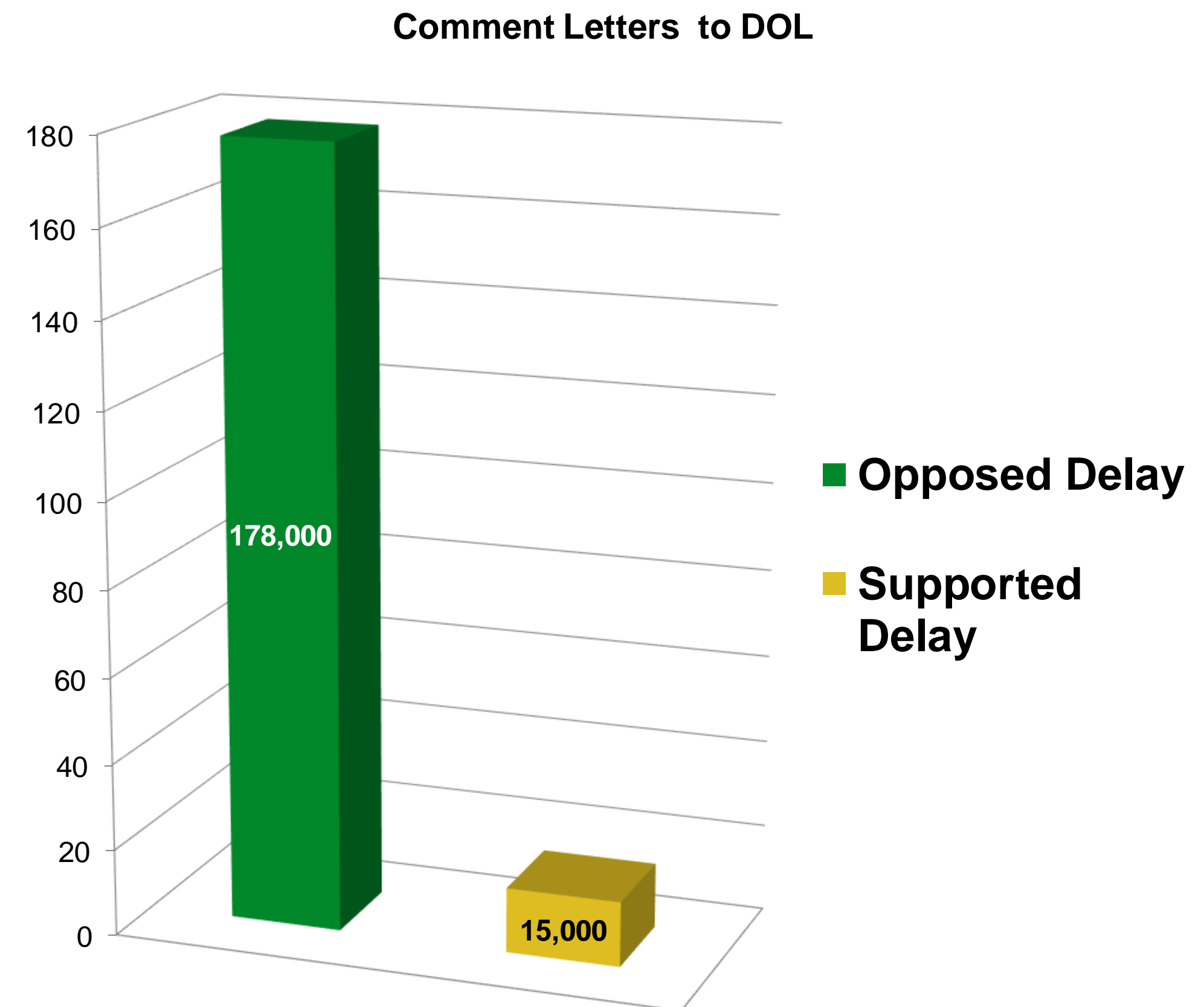
Latest DOL Rulemaking Generates Extensive Comments

For Delay

- Burdensome compliance costs
- Need for additional time to comply
- Rule limits access to advice, products
- Rule hurts small accounts
- Result in inappropriate increase in fee accounts, passive investments
- Reduced competition; harmful exit of advisors
- More time needed to review Presidential Memo

Against Delay

- Investor losses extended due to conflicted advice
- Rule costs already exhaustively studied
- Disagree with lack of compliance preparedness
- Positive changes in marketplace already underway
- Litigation claims exaggerated
- Delay is unfair for firms that prepared
- Create level playing field for all advisers



Surprise Reg Response from DOL: Core Fiduciary Duties Retained

“The Department concludes that it can best protect the interests of retirement investors...provide greater certainty...and minimize the risk of unnecessary disruption by taking a more balanced approach than simply granting a flat delay of fiduciary status and all associated obligations for a protracted period.”

-- *DOL Rule Preamble (Apr. 7, 2017)*

Impact of the April 4, 2017 delay rule

- Moves the first applicability date from April 10, 2017 to June 9, 2017
- Required starting June 9, 2017
 1. Fiduciary definition and all exclusions (non-fiduciary communications)
 2. Impartial conduct standards for all PTEs
- Provides a transition period from June 9, 2017 until January 1, 2018
 1. Not required during the transition period: Designate BICE compliance person, provide written acknowledgment of fiduciary status, disclose material conflicts and offering limitations, document due diligence and maintain certain other records
 2. Indexed and variable annuities remain under PTE 84-24 until 1/1/2018 (instead of BICE)
- The delay “addresses the most controversial elements of the Rule” (i.e. BICE contract and related requirements) while protecting investor interests; Preserves fiduciary principles while making practical concessions

During the transition Period: April-December 2017

“The Department will aim to complete its review pursuant to the President’s Memorandum as soon as possible before [Jan. 1, 2018] and announce its intention on whether to propose changes to the Rule or PTEs, provide additional transitional relief, or to allow all the conditions of the PTEs to become applicable as scheduled on January 1, 2018.”

-- *DOL Rule Preamble* (Apr. 7, 2017)

How ready are you for June 9?



How confident are you that you will be ready to apply the Impartial Conduct Standards by June 9?

Completely confident – 44%

Somewhat confident – 44%

Not at all confident – 4%

N/A – 9%

How big of an impact has the rule and the delay of implementation had on your client conversations?

Big impact, it is always a topic of conversation with clients – 9%

Modest impact, we keep our clients up to date – 62%

No impact, clients aren't monitoring and we don't bring it up – 17%

N/A – 13%

Have you made a decision about how you will proceed regarding acting as a fiduciary?

Yes, business as usual working as a fiduciary – 59%

Yes, tightening definitions and processes as a fiduciary – 21%

Yes, changing to begin acting as a fiduciary – 6%

Yes, decided not to act as a fiduciary – <1%

No – wait and see mode – 5%

N/A – 8%

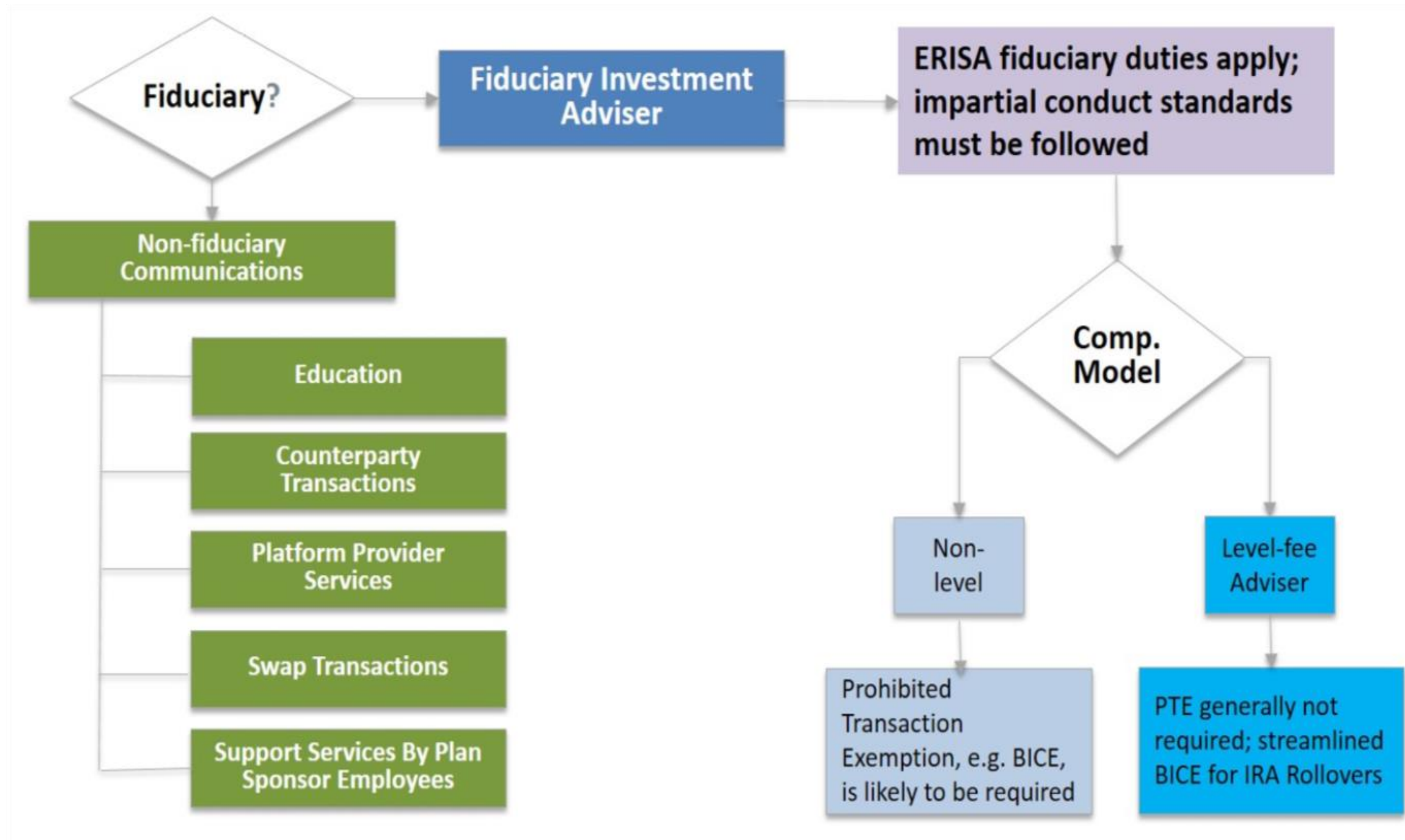
This is no drill! How to prep for June 9 Fiduciary Status

Back to Basics Review

1. Structure of the Fiduciary Rule
2. Fiduciary definition: Who's in, who's not
3. Impartial Conduct Standards
 - a. Rollover advice (Level-fee exemption)
 - b. Variable, 3rd party compensation



Structure of the Fiduciary Rule – What is covered



Who is a fiduciary under the Rule?

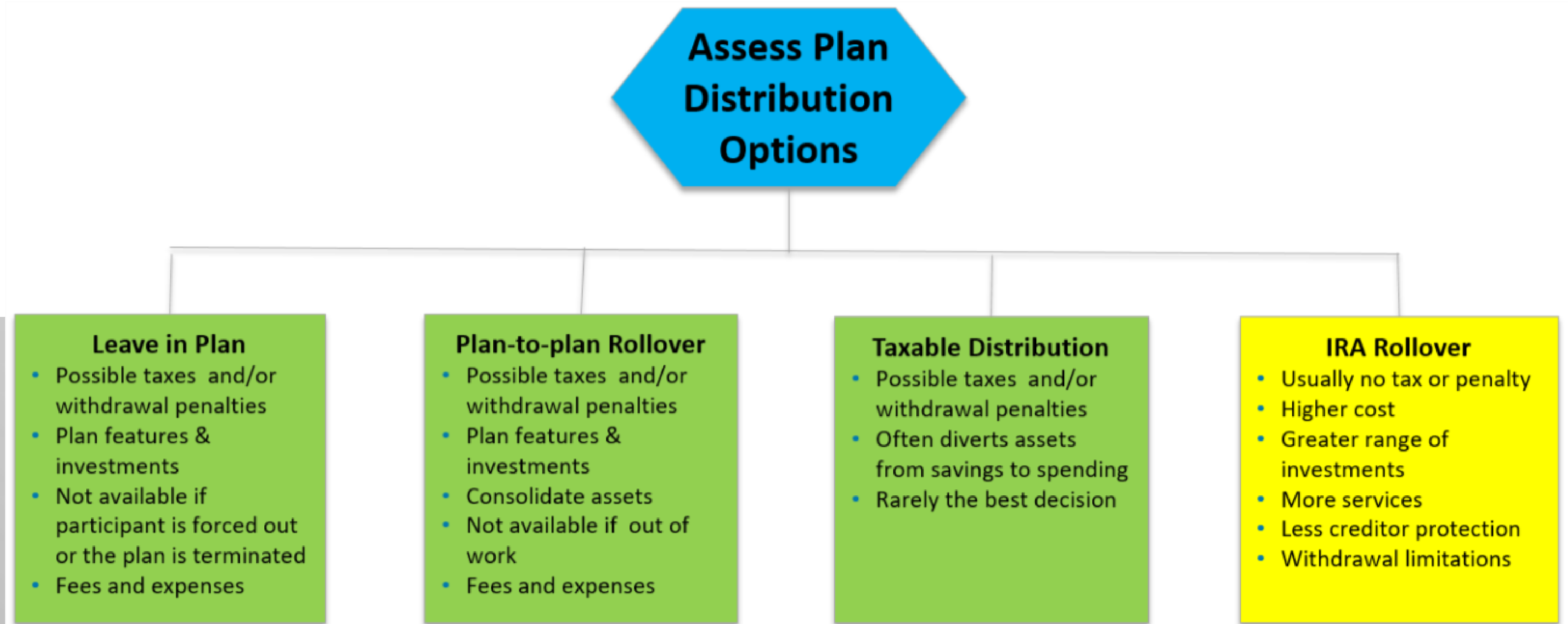
You are a fiduciary under the rule if you render investment advice either directly or indirectly (e.g. through or together with an affiliate) for compensation and do any of the following:

1. Represent or acknowledge that you are acting as a fiduciary; or
2. Render the advice pursuant to a written or verbal agreement, arrangement, or understanding that the advice is based on the particular investment needs of the advice recipient (i.e. it is individualized); or
3. Direct the advice to a specific advice recipient or recipients regarding the advisability of particular investment or management decisions with respect to securities or other investment property of the plan or IRA.

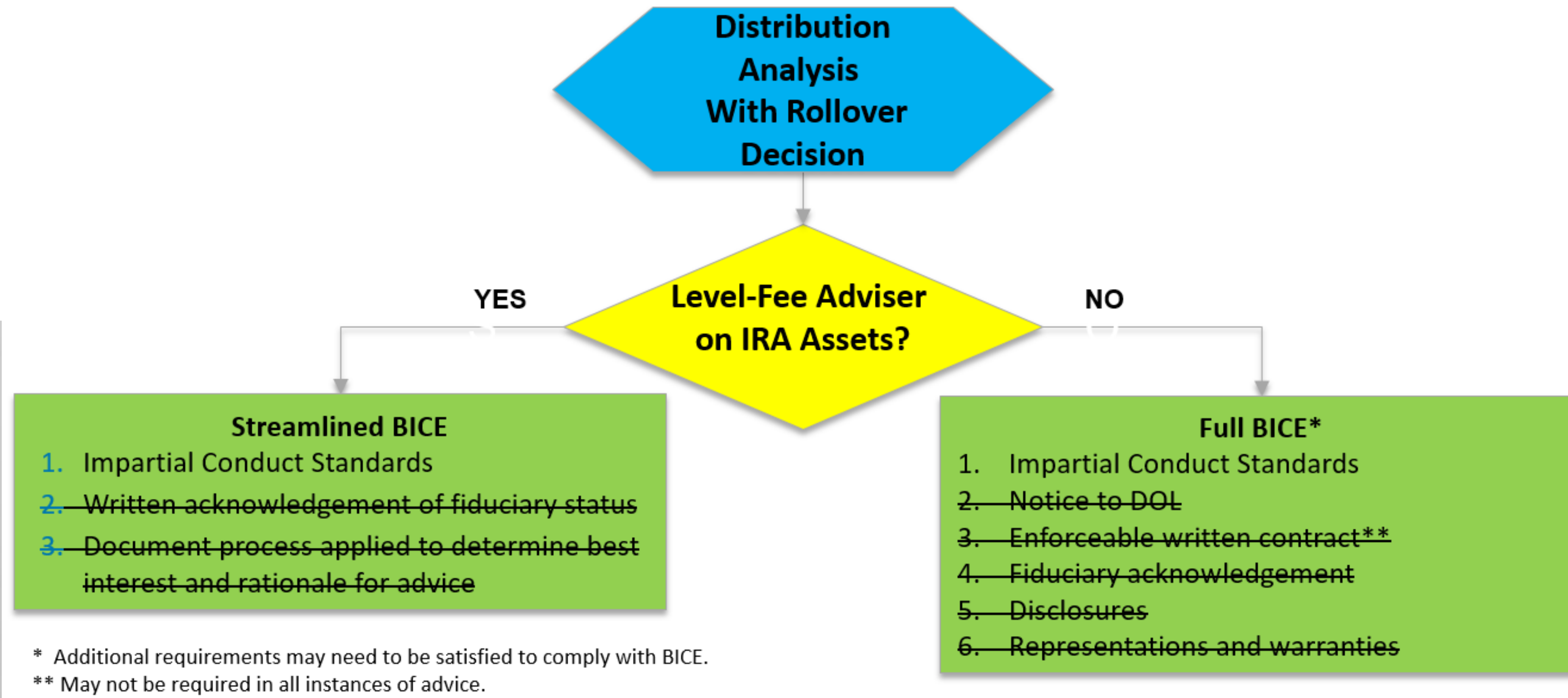
How the Rule works: Rollover advice illustration



Advice on distributions from retirement plans



IRA rollover Decisions



DOL Justification for Retaining Impartial Conduct Standards

“In the absence of the Impartial Conduct Standards, retirement investors are likely to continue incurring new losses from advisory conflicts. Losses from a delay any longer than 60 days would quickly overshadow any additional compliance savings.”

-- *DOL Rule Preamble* (Apr. 7, 2017)

Requirements of the Best Interest Standard

To meet the rule's best interest standard, advice must be:

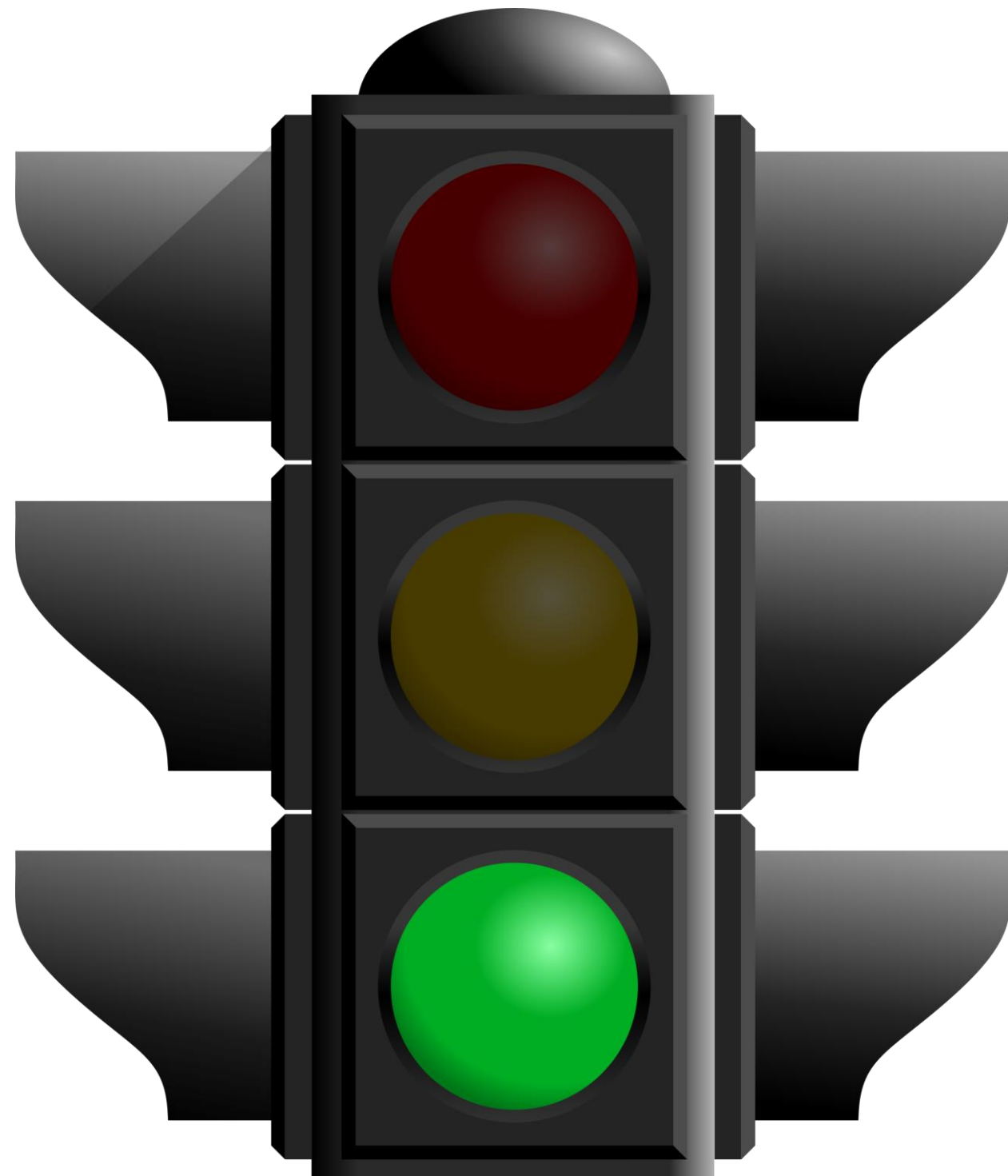
- **Prudent** – “... the fiduciary acts with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims...”
- **Individualized** – “...based on the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor...”
- **Consistent with a duty of loyalty** – “...without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.”

Practices to conform to the best interest standard

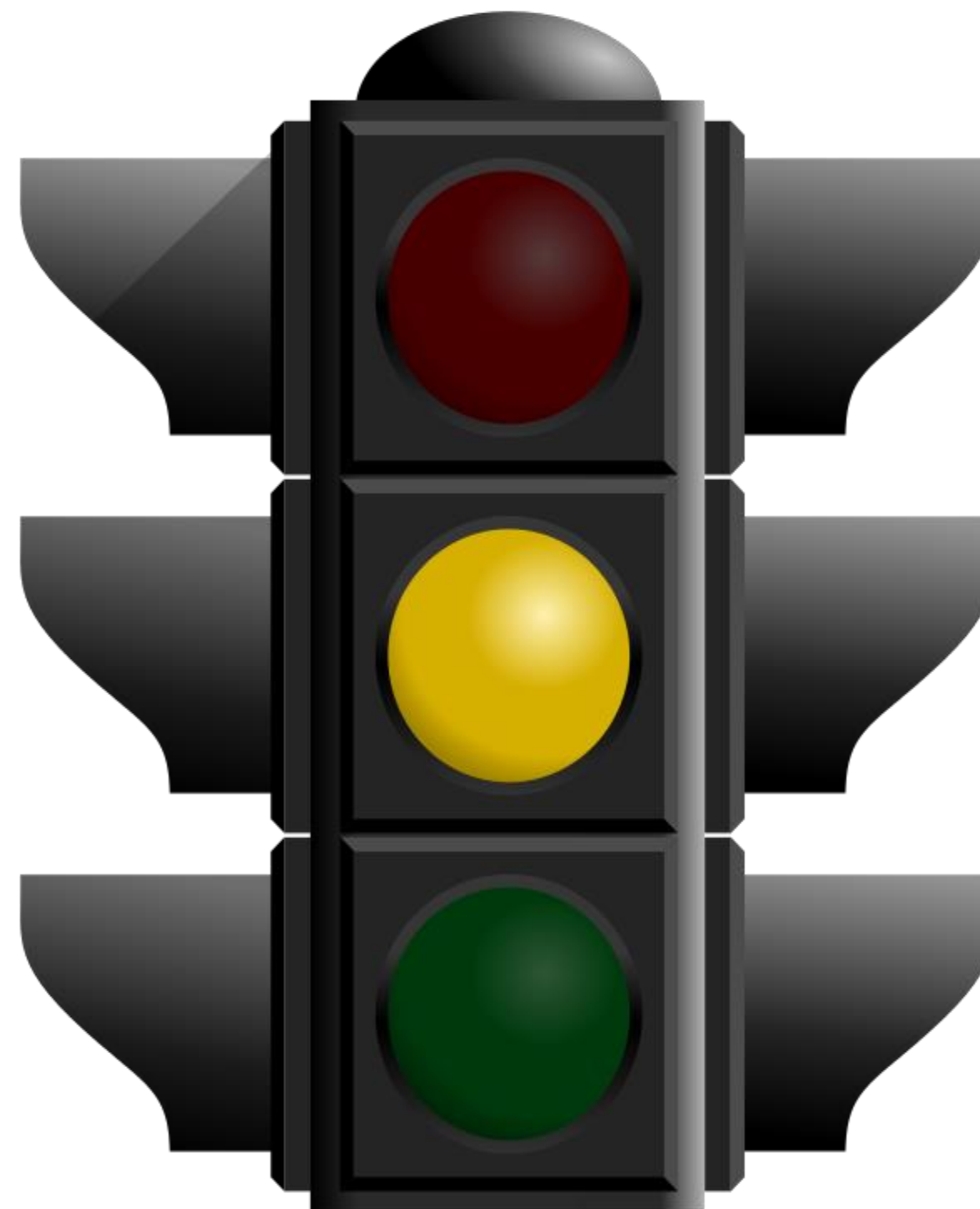
Prudent	Individualized	Adhere to Duty of Loyalty
<ul style="list-style-type: none"> • Apply generally accepted investment theories & principles • Diversify to manage risk of large losses • Apply sound service provider & investment due diligence • Assure reasonable costs & compensation 	<ul style="list-style-type: none"> • Consider client objectives, risk capacity & tolerance, needs in retirement • Consider prevailing circumstances such as plan/account options, market & economic conditions, etc. 	<ul style="list-style-type: none"> • Avoid conflicts when possible; mitigate unavoidable conflicts in client's interest (e.g. BICE) • Disclose costs, conflicts, other material information • Monitor consistent with law and governing documents
<p>Document the above to establish a record of procedural prudence.</p>		

How the marketplace is responding

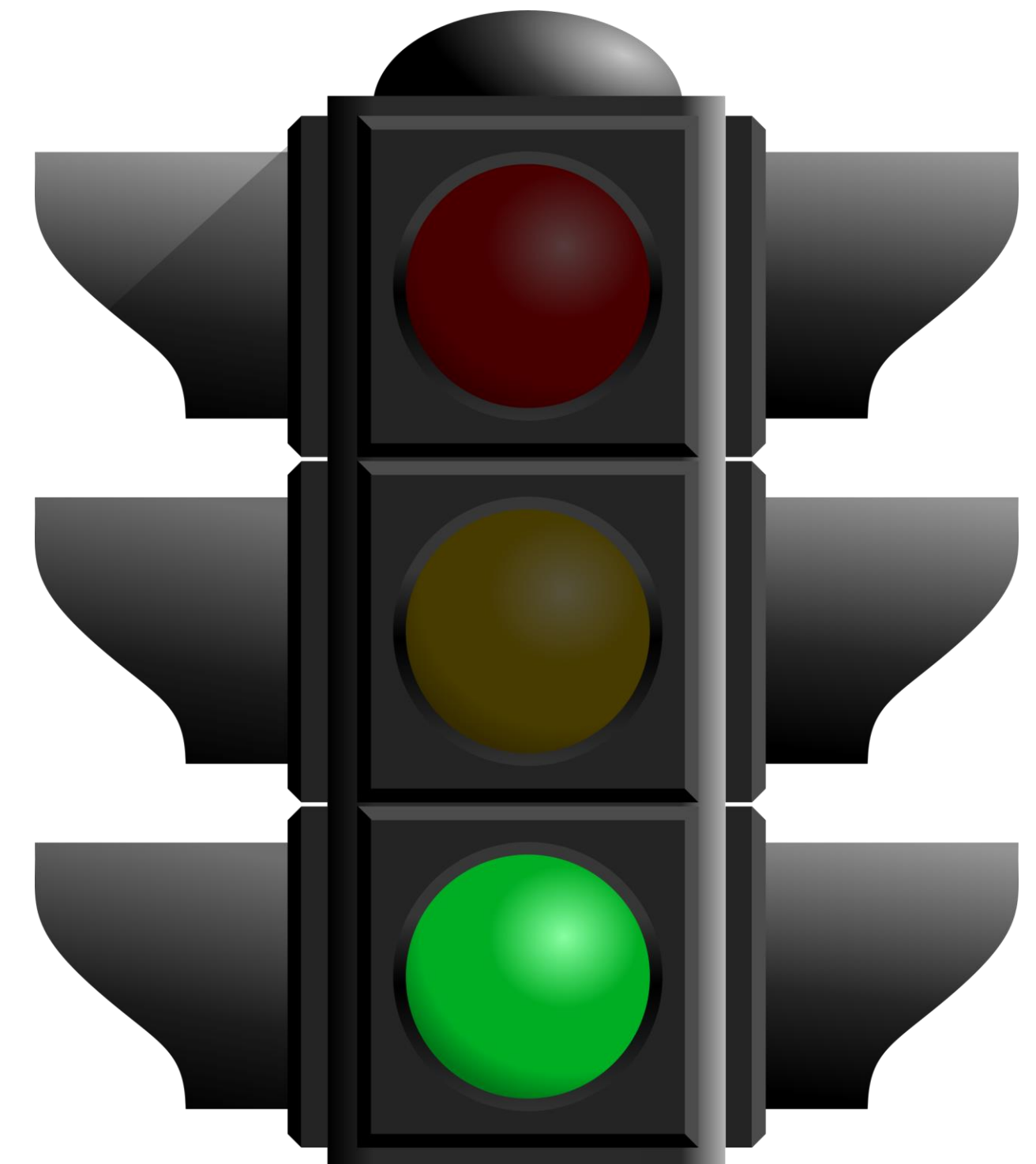
Pre-Election



Nov. 8 – April 4



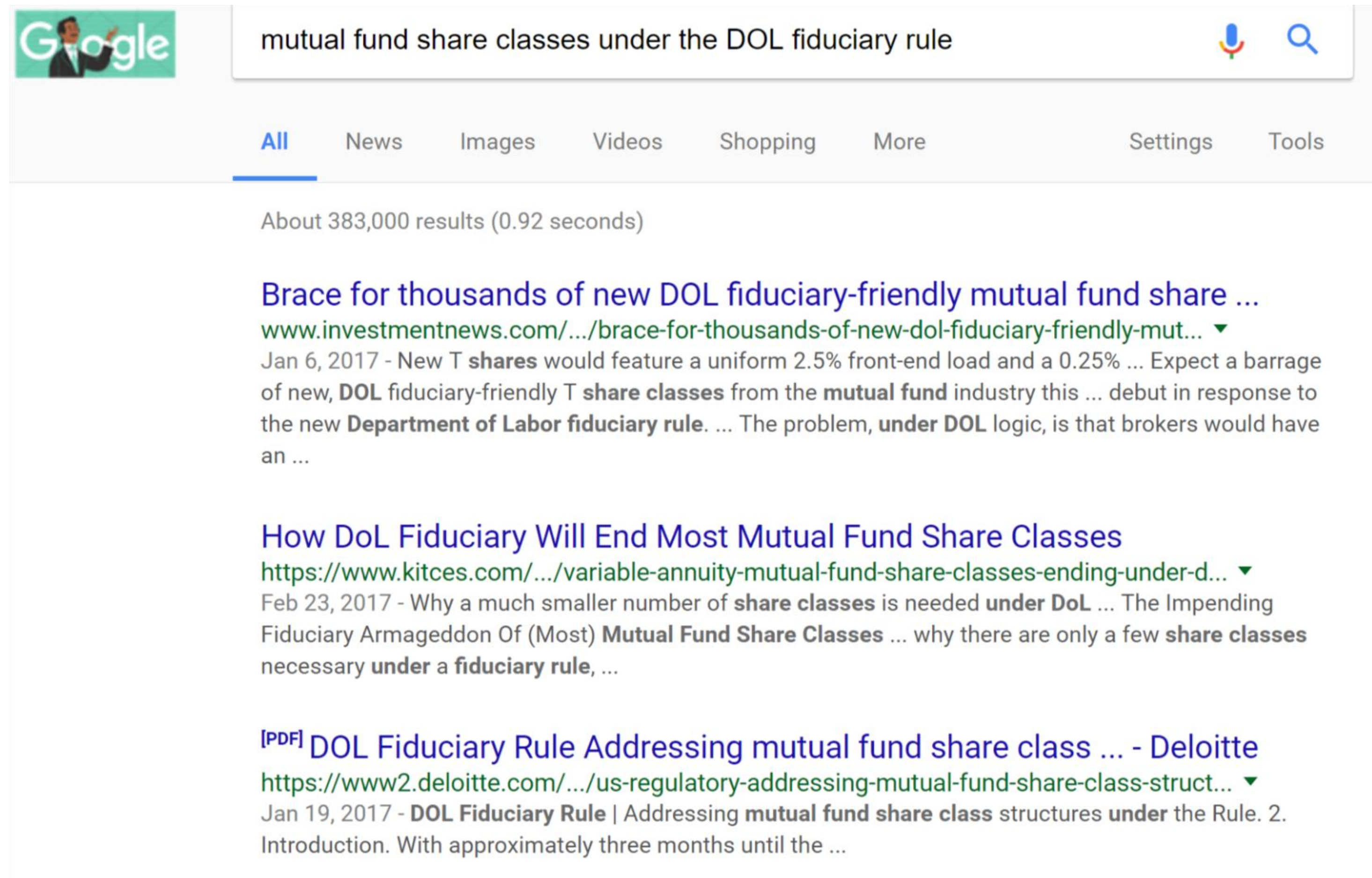
Currently



Three areas of marketplace impact

- Products
- Distribution models
- Professionalization of advice

Product Pricing Changes



Google

mutual fund share classes under the DOL fiduciary rule

All News Images Videos Shopping More Settings Tools

About 383,000 results (0.92 seconds)

Brace for thousands of new DOL fiduciary-friendly mutual fund share ...
www.investmentnews.com/.../brace-for-thousands-of-new-dol-fiduciary-friendly-mut... ▼
Jan 6, 2017 - New T **shares** would feature a uniform 2.5% front-end load and a 0.25% ... Expect a barrage of new, **DOL** fiduciary-friendly T **share classes** from the **mutual fund** industry this ... debut in response to the new **Department of Labor fiduciary rule**. ... The problem, **under DOL** logic, is that brokers would have an ...

How DoL Fiduciary Will End Most Mutual Fund Share Classes
<https://www.kitces.com/.../variable-annuity-mutual-fund-share-classes-ending-under-d...> ▼
Feb 23, 2017 - Why a much smaller number of **share classes** is needed **under DoL** ... The Impending Fiduciary Armageddon Of (Most) **Mutual Fund Share Classes** ... why there are only a few **share classes** necessary **under a fiduciary rule**, ...

[PDF] DOL Fiduciary Rule Addressing mutual fund share class ... - Deloitte
<https://www2.deloitte.com/.../us-regulatory-addressing-mutual-fund-share-class-struct...> ▼
Jan 19, 2017 - **DOL Fiduciary Rule** | Addressing **mutual fund share class** structures **under** the Rule. 2. Introduction. With approximately three months until the ...

Product preference changes

Favored	Disadvantaged
Low cost relative to peers	High cost relative to peers
Passive investments	Actively managed investments
Marketable	Limited marketability; difficult to price
Benchmarked	Difficult to compare
Easy to understand products	Complex products

Some products may buck the trend

Investment and Lifespan Uncertainty

“For the typical investment strategy, investment risk is larger at younger retirement ages, but longevity risk becomes larger with time.”

Source:

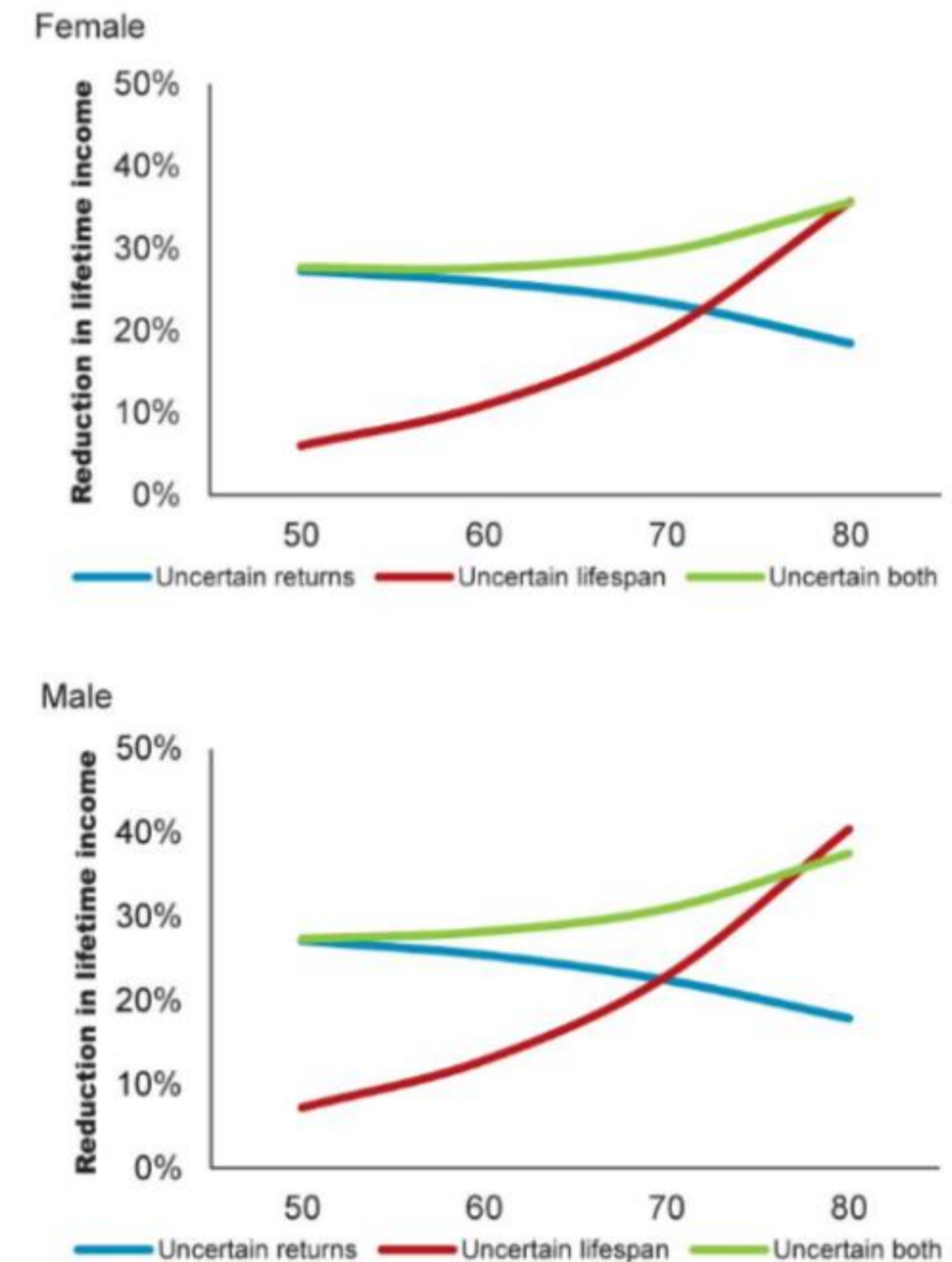
How Big Is Longevity Risk

By Bob Collie, FIA

AAll Journal

October 2015

Figure 5. Impact of Uncertainty on Lifetime Income



Guidance on Guaranteed Income Products as Default Options

- IRS Notice 2014-66 outlines circumstances under which TDFs can restrict participation in designated age-bands to invest in annuities
- October 23, 2014 DOL Information Letter to Mark Iwry, Deputy Assistant Secretary for Retirement and Health Policy at the Department of Treasury, describes circumstances when unallocated deferred annuity contracts can be used in a QDIA
- August 2015 GAO report, 401(K) Plans – Clearer Regulations Could Help Plan Sponsors Choose Investments for Participants, cites a need for greater clarity from the DOL regarding use of lifetime income solutions in QDIAs
- December 22, 2016 DOL Information Letter to TIAA provides greater clarity about the use of annuities as default options even when they don't meet the requirements of a QDIA and expresses support for lifetime income options

Distribution Model Changes

Merrill's actions are worth watching

- Focus on fees, but allow commissions
- Merrill advisers will have to service retirement plans with < \$50 million as 3(21) fiduciary advisers
- Ramping-up financial planning training for advisers

[We're committed to a higher standard for retirement ... - Merrill Lynch](https://www.ml.com/articles/delivering-a-higher-standard-of-care.html)

<https://www.ml.com/articles/delivering-a-higher-standard-of-care.html> ▼

We view the **Department of Labor Fiduciary Rule** as a positive step for the industry and great news for investors. We support it wholeheartedly. Hear from our ...

[Despite new review of DOL fiduciary rule, firms are sticking with higher ...](http://www.investmentnews.com/.../despite-new-review-of-dol-fiduciary-rule-firms-are-stic...)

www.investmentnews.com/.../despite-new-review-of-dol-fiduciary-rule-firms-are-stic... ▼

Feb 6, 2017 - Many broker-dealers – including **Merrill Lynch**, Morgan Stanley and Wells Fargo – are preparing for the changes in operations the **rule** would ...

[Merrill Lynch eliminates commission IRA business in response to DOL ...](http://www.investmentnews.com/.../merrill-lynch-eliminates-commission-ira-business-in-res...)

www.investmentnews.com/.../merrill-lynch-eliminates-commission-ira-business-in-res... ▼

Oct 6, 2016 - In a signal of the radical change the brokerage industry is set to undergo because of the Labor Department's **fiduciary rule**, **Merrill Lynch** has ...

[Bank of America Merrill Lynch tells advisers to stop selling mutual ...](http://www.investmentnews.com/.../bank-of-america-merrill-lynch-tells-advisers-to-stop-sell...)

www.investmentnews.com/.../bank-of-america-merrill-lynch-tells-advisers-to-stop-sell... ▼

Nov 1, 2016 - The firm is eliminating potential conflicts of interest before the **DOL fiduciary rule** take effect next year.

[Merrill Lynch may 'adjust timeline' to comply with fiduciary rule ...](http://www.financial-planning.com/.../merrill-lynch-once-a-fiduciary-rule-leader-may-adjus...)

www.financial-planning.com/.../merrill-lynch-once-a-fiduciary-rule-leader-may-adjus... ▼

Feb 3, 2017 - **Merrill Lynch** may 'adjust timeline' to comply with **fiduciary rule** ... to comply with the **Department of Labor's** fiduciary or conflicts-of-interest rule.

[Using DOL as cover, Bank of America cuts the Merrill Lynch bull as it ...](http://riabiz.com/.../using-dol-as-cover-bank-of-america-cuts-the-merrill-lynch-bull-as-it-ad...)

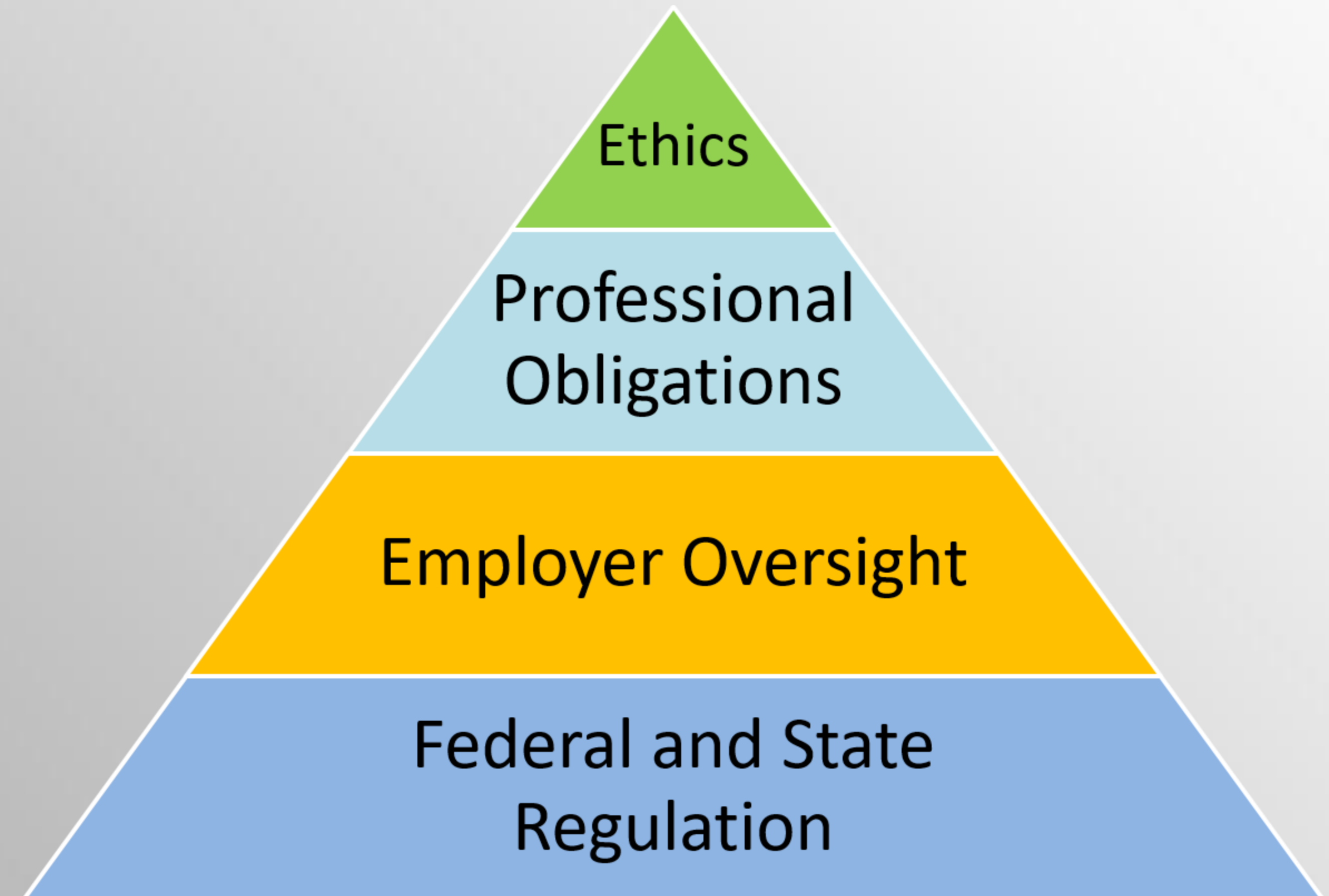
riabiz.com/.../using-dol-as-cover-bank-of-america-cuts-the-merrill-lynch-bull-as-it-ad... ▼

Oct 18, 2016 - Bank of America seems to see its opening – using the **DOL** cudgel, it'll force new **fiduciary rules** on a suitability rule-based **Merrill Lynch**.

Professionalization of advice

Financial advice is a profession

- Service orientation
- Body of knowledge
- Code of conduct that places client interests first (fiduciary standard)
- Sanctioning authority
- Pathway to the profession (academic and experience)



The future we foresee and what it would mean for advisers

- More clear differentiation between the financial products industry and the financial advice profession – Pick your career path
- Higher conduct standards; professionalization of advice with practitioners being more highly educated/prepared for holistic advice – Invest in professional development, specialize, and refine business practices
- Fewer advisers; compensation stable to rising – Commit to building the profession
- Greater use of technology by advisers and to directly deliver advice to the “middle class” – Invest in technology and cybersecurity
- Active management will persist and rebound as additional sources of market inefficiencies are explored and exploited – Look for trends such as guaranteed income and ESG investing
- Regulatory redirection and roll-backs in the near term; watch for title regulation and efforts to “enforce the laws that are on the books” – Recognize that fiduciary accountability is here to stay

Questions, Answers, and Discussion

Additional information on fiduciary trends can be found at fi360 Fiduciary Talk Podcast

www.fi360.com/fiduciarytalk (also available on iTunes)

and the Fi360 Blog www.fi360.com/blog