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John Hancock Investment Management
It’s Been a Hot Summer for the Regulation of Advice and There’s No Sign of a Cooldown

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Topics

• Covid-19 Impact

• Standards of Conduct

• Investment Selection

• Continuing Education for Advisors

• What to expect in the months ahead and how to prepare
Covid-19 Impact on Investors*

• Big drop in DC plan, IRA assets – February peak to March bottom
• Looming retirement crisis: More than half of unemployed older Americans may be forced into early retirement
• 71% of Americans expect pandemic to affect their retirement plans
  o 15% have delayed retirement; 24% considering delay
• Plans delayed switching plan service providers in 2Q; picked up in 3Q
• 2Q annuity sales down 24%
• Consumers go on spending boom instead of saving
• Half of Gen Z, Millennials say risk tolerance has increased since outbreak

* Sources (in order of presentation): Center for Retirement Research, Boston College, June 2020; New School Retirement Equity Lab brief (8/5/20); TD Ameritrade survey, June 2020; LIMRA/Secure Retirement Institute (7/14/20); LIMRA, 2Q 2020 compared to 2Q 2019; Bloomberg News (8/19/20); E*Trade survey (8/19/20).
SEC Continues [Some] ‘Business as Usual’

**SEC Relief**
- Staff continue to work remotely
- Extended spring filing deadlines for Form ADV up to 45 days
- Additional relief on filing financial statements -- publicly traded and crowdfunding companies (small business issuers)
- Exemptive relief for muni advisors thru 12/31/20

**SEC Regulation**
- Staff continues to examine firms remotely, enforce 12b-1 disclosures
- Requires disclosure of PPP loans by IA firms
- Regulatory alert related to Covid-19 compliance risks (8/12/20)
- Implemented Reg BI, Form CRS rules on time
  - Adds new FAQs on dual registrant status, account changes, titles
Standards of Conduct

- SEC’s Regulation Best Interest, Form CRS
- DOL’s proposed new Prohibited Transaction Exemption for conflicted advice
- State initiatives:
  - Fiduciary rules
  - NAIC’s model rule for annuity transactions; and
  - NASAA’s proposed “policies and procedures” model rule for state-registered investment advisers
SEC’s Regulation Best Interest - Framework

- Form CRS
- Duty of Care
- Compliance
- Conflict of Interest
- Disclosure
SEC Staff Offers Mixed Reviews on Form CRS

Special SEC review committee* observed:

• Some content lacks “certain disclosures or could be clearer or otherwise improved.” Committee
  o Did not provide # of firms reviewed or examples
  o Will “engage with firms to share best practices and provide feedback” and
  o Host fall roundtable to share additional thoughts

• In interim, SEC staff recommends reviewing
  o Form CRS instructions
  o Form CRS adopting release
  o FAQs on Form CRS

• OCIE issued 4/7/20 risk alert that it may review Form CRS content, delivery and timing process

* Statement by Staff Standards of Conduct Implementation Committee, 7/27/20
Few clients mention Form CRS to me 16%

I have heard nothing from clients or prospects about Form CRS 54%

I am proactively using Form CRS to engage clients and prospects 30%

POLLING QUESTION 1: HOW ARE CLIENTS REACTING TO FORM CRS?
## SEC’s Regulation Best Interest – Firm Readiness*

### GOVERNANCE
- Governance structures to lead and manage Reg BI and Form CRS compliance requirements

### SUPERVISION
- Inventory of changes
- Updates to Written Supervisory Procedures and Systems (WSPS)
- Identification of technology tools to monitor compliance

### DISCLOSURE – FORM CRS
- Creation
- Use of technology and vendors
- Delivery preferences and methods
- Supervision and audit of delivery

### CONFLICTS OF INTEREST
- Conflict inventories
- Limitations on products
- Eliminating sales contests
- Reviewing and updating disclosures
- Restricting use of the terms “Adviser” and “Advisor”

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* Based upon FINRA Preparedness Review results
## SEC’s Regulation Best Interest – Standard of Care

<table>
<thead>
<tr>
<th>REG BI OBLIGATIONS</th>
<th>FI360’S FIDUCIARY PRECEPTS</th>
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<tbody>
<tr>
<td>Disclosure</td>
<td>Account for costs</td>
</tr>
<tr>
<td></td>
<td>Manage conflicts of interest</td>
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<tr>
<td>Duty of Care</td>
<td>Diversify to manage risk and return</td>
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<tr>
<td></td>
<td>Prudently select fiduciary and non-fiduciary service providers</td>
</tr>
<tr>
<td></td>
<td>Control and account for costs</td>
</tr>
<tr>
<td>Conflict of Interest</td>
<td>Avoid or manage conflicts of interest</td>
</tr>
<tr>
<td>Compliance</td>
<td>Follow laws and governing documents</td>
</tr>
<tr>
<td>Additional fiduciary best practices</td>
<td>Prepare and follow an investment policy statement</td>
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<tr>
<td></td>
<td>Monitor service providers</td>
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<td></td>
<td>Monitor and assure conformity to fiduciary obligations</td>
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- Fiduciary advisors can and should showcase fiduciary best practices
- Dually registered advisors must clearly delineate fiduciary and non-fiduciary services in each client relationship
- Non-fiduciary brokers should adhere to the fiduciary principles embedded in Reg BI but must steer clear of practices that require registration under the Advisers Act
# DOL’s Proposed New PTE for Conflicted Advice

<table>
<thead>
<tr>
<th>Provisions</th>
<th>Implications</th>
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| Formally reinstates DOL’s five-part test to establish fiduciary accountability | • This effectively happened in 2018 when the Fifth Circuit vacated the 2016 Fiduciary Rule  
|                                                                           | • Handicaps enforcement of fiduciary status                                   |
| Creates a PTE that provides greater latitude for “investment advice fiduciaries” to receive compensation conflicts | • Requires acknowledgment of fiduciary status  
|                                                                           | • Mirrors the requirements of the BIC Exemption  
|                                                                           | • Applies to rollovers and certain principal transactions                   |
| Relies upon Impartial Conduct Standards (ICS) to protect investors        | • Adhere to best interest standard  
|                                                                           | • Must not subordinate investor interests  
|                                                                           | • Receive only reasonable compensation  
|                                                                           | • Make no materially misleading statements  
|                                                                           | • Establish, maintain, and follow policies and procedures                     |
| Includes a “retrospective review” requirement to detect/prevent violations of ICS and PTE | • Written review, conducted at least annually  
|                                                                           | • Certified by financial institution’s CEO or equivalent                      |
DOL’s Proposed New “ICS” PTE – Current Status

• 30-day comment period closed August 6, 2020, despite requests from consumer, union, and other groups requesting more time
• A public hearing has been scheduled Sept. 3rd on the proposal.
• Rollover provision reversing Advisory Opinion 2005-23A (“Deseret letter”) under fire from financial institutions; consumer groups argue that the 5-part test renders investor protections ineffective
• Would become effective 60 days after publication in Federal Register
• Guesstimates of timing
  o Final rule release anywhere from late this September to January
  o Compliance deadline one year after the rule is final
# NAIC Model Rule for Annuity Transactions

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<thead>
<tr>
<th>NAIC Rule</th>
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<tr>
<td>Adopted 2/13/20 by NAIC; state-by-state approval required. YTD adopted by Iowa, Arizona.</td>
</tr>
<tr>
<td>Covers annuity transactions by insurance cos. and agents; partial overlap with Reg BI covering variable annuities.</td>
</tr>
<tr>
<td>Exempts transactions used to fund ERISA and other federal, state, or church retirement plans; settlements from personal injury litigation; or prepaid funeral contracts.</td>
</tr>
<tr>
<td>Additional suitability factors: insurance needs, existing annuity/insurance holdings; risk tolerance to accept non-guaranteed elements of annuity</td>
</tr>
<tr>
<td>Compliance with Reg BI or Advisers Act, or comparable state laws, may satisfy NAIC rule.</td>
</tr>
<tr>
<td>Stipulates in Rule text that it does not create a fiduciary obligation.</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Regulation Best Interest</th>
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<tr>
<td>Effective 6/30/20</td>
</tr>
<tr>
<td>Covers advice on participant rollovers/distributions, investment strategies and securities transactions by brokerage firms and agents</td>
</tr>
<tr>
<td>Exempts advice to nearly all retirement plans except SEP and SIMPLE IRAs; covers advice to individual participant accounts in addition to HSAs, MSAs, 529 plan accounts.</td>
</tr>
<tr>
<td>In addition to Reg BI obligations, suitability factors include age, other investments, financial situation and needs, tax status, investment objectives, experience, time horizon, liquidity needs, and risk tolerance.</td>
</tr>
<tr>
<td>No equivalent safe harbor under other laws.</td>
</tr>
<tr>
<td>Adopting release states, “We have declined to subject broker-dealers to a wholesale and complete application of the existing fiduciary standard under the Advisers Act.” However, the Rule text does not disclaim fiduciary status of a broker.</td>
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Other State Initiatives

• Fiduciary rules for brokers pending:
  o NJ, NV

• Massachusetts fiduciary rule enforcement begins 9/1/2020; covers
  o BD firms and agents (RIAs already subject to fiduciary duty)
  o Only transactions, unless broker holds discretion or monitors
    ▪ Also non-brokerage financial advice
    ▪ Infers compensation must be reasonable

• NASAA’s proposed “policies and procedures” model rule
  o Proposed 7/2/20; will require state-by-state adoption
  o Mirrors SEC Rule 206(4)-7, or “CCO Rule”
  o Obligations are “inherent to an investment adviser’s fiduciary duty”
Investment Selection

- ESG Investing
- Private Equity in Defined Contribution Plans
ESG Investments – DOL’s Two-pronged Attack

• Proposed Rule “Financial Factors in Selecting Plan Investments”
  • To confirm that investment decisions must be based solely on financial considerations
  • Sets more stringent selection standards for ESG factor investing and adds documentation to “all things being equal” decision
  • Disqualifies use of ESG mandate in QDIAs

• Letter from EBSA to plan sponsors with ESG options in the plan menu asking for detailed information in a very short time period (e.g. 2 weeks)

• 30-day comment period
ESG Investments – Current status of DOL Actions

• 30-day comment period ended July 31

• Comments have been overwhelmingly negative; many faulting a flawed premise that investing using ESG factors detracts from results

• Morningstar comments cited internal research that ESG-focused funds generally have outperformed over the past 1-, 3-, and 5-year periods and noted that the question should be why wouldn’t a plan sponsor consider using ESG factors (other than added regulatory burdens)

• DOL has stated that the proposed rule and EBSA letter are unrelated
I feel that incorporating ESG is too risky 13%

I plan to do research before I decide. 2%

I will recommend to retail portfolios, but not to plan sponsor clients 24%

I will use ESG factors and potentially recommend ESG options to plan sponsor clients 46%

What ESG rule? 15%

POLLING QUESTION 2: IF DOL’S ESG RULE IS ENACTED, WILL YOU BE LESS LIKELY TO CONSIDER ESG FACTORS IN PLAN INVESTMENTS?
Private Equity in Defined Contribution Plans

• DOL Information Letter issued June 3, 2020 responds to Pantheon Ventures and Partners Group (developers of private equity investments in collective trust form) about using private equity as a designated investment alternative in an ERISA individual account plan

• Concludes that offering a professionally managed asset allocation fund would not be a fiduciary breach if used in a manner consistent with applicable ERISA standards

• Provides guidance about appropriate selection and monitoring capabilities and practices
WHAT ARE YOUR THOUGHTS ABOUT USING PRIVATE EQUITY AS A DESIGNATED INVESTMENT ALTERNATIVE IN 401(K) PLANS?

- I am not interested in considering them for my clients' retirement plans (58%)
- I expect to recommend private equity for my clients' plans and plan participants (23%)
- I plan to do research before I decide (10%)
- What private equity guidance? (9%)
Continuing Education

• NASAA’s model rule proposal to establish a CE program for IARs
  o Pending adoption; would need state-by-state approval
  o 12 hours annual CE
    ▪ 6 hours investments
    ▪ 6 hours ethics or “professional responsibility”
  o Existing FINRA firm element CE, professional designation programs would count (subject to 3rd party review)
  o Exempt from CE rule some designations (CFA, CFP, PFS, etc.)
  o Job task survey by NASAA to determine appropriate topics

• CFP Board’s Ethics CE requirement focusing on its new Code and Standards
## What to expect after November elections

<table>
<thead>
<tr>
<th>Regulation</th>
<th>Republican Administration</th>
<th>Democrat Administration</th>
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<tbody>
<tr>
<td>SEC Reg BI</td>
<td>Rule retained; enforcement focus</td>
<td>Rule reinterpreted or replaced to require fiduciary accountability</td>
</tr>
<tr>
<td>DOL “ICS” PTE Rule</td>
<td>Rule finalized; possible loosening of rollover provisions</td>
<td>Five-part test replaced; “regular” and “primary basis” deleted</td>
</tr>
<tr>
<td>Qualified Plans</td>
<td>Support industry initiatives that include tax breaks for new plans, encourage annuities as DIAs</td>
<td>Automatic 401(k) on federal level; tax credit for lower, middle-income worker contributions</td>
</tr>
<tr>
<td>State Initiative</td>
<td>More fiduciary and other investor protection rulemakings, legislation</td>
<td>Potentially less state activity if federal protections increase</td>
</tr>
<tr>
<td>Proposed DOL ESG Rule</td>
<td>Withdrawn, revert to existing guidance</td>
<td>Revert to pre-2018, more encouraging, stance on ESG</td>
</tr>
<tr>
<td>DOL Private Equity Interpretation Letter</td>
<td>Retained</td>
<td>Reined in by replacement of the five-part test and stronger protections</td>
</tr>
<tr>
<td>State Model Laws: CE and Policies &amp; Procedures</td>
<td>Widely adopted</td>
<td>Widely adopted</td>
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Make Impartial Conduct Standards Your Focus

• Establishing Prudence – Methods and Merits

  • Procedural prudence – the extent to which the fiduciary assembled, evaluated, and acted upon pertinent information in a professional manner; i.e., applying sound decision-making methodology

  • Substantive prudence – whether the fiduciary reached objectively sound decisions; i.e., the merits of the decision made
Demonstrating Prudence: Why? How? What?

• Why? Purpose; decision to be made, for example …
  • Account type to choose
  • Investment selection
  • Whether to roll a plan distribution to an IRA

• How? Process; choices and the decision-making methodology
  • Alternatives
  • Factors, their relative weights, and the formula to “score” alternatives

• What? Decision; objectively, what should be done

“Why” and “How” demonstrate procedural prudence, using a sound process. “What” demonstrates substantive prudence, coming to the right conclusion.
Attributes of a Profession – The Path We Are On

• Service orientation (recognized obligation to the public)
• Standard of conduct that places clients interests first (fiduciary standard)
• Body of knowledge (sophisticated academic foundation)
• Sanctioning authority (government and/or professional organizations)
• Pathway to the profession (recognized curriculum to become a practitioner)
Questions
THANK YOU