

The logo for Fi360, featuring the text 'Fi360' in a white, sans-serif font. The 'i' has a dot, and the '360' is slightly larger than the 'Fi'. The logo is centered within a white square frame.

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A Broadridge® Company

# State of the Fiduciary Standard

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Ready for Next

# Overview

## EVOLVING CONTOURS OF THE FIDUCIARY STANDARD

- A look at agents of change through core duties of loyalty and care, including
  - Recent policy initiatives
    - ESG investing
    - Regulation Best Interest
    - Impartial Conduct Standards
  - The courts



## APPLYING BEST PRACTICES

# Fiduciary Duty of Loyalty\*

“LOYALTY CAN BE DEFINED AS A STATE OF MIND AND A MANNER OF BEHAVIOR IN WHICH ONE PERSON IDENTIFIES WITH THE OTHER PERSONS’ INTERESTS.”

- TWO PARTIES OPERATING IN A RELATIONSHIP OF TRUST AND FAITH
  - Trustee
  - Entrustor
- TWO KEY ASPECTS OF LOYALTY
  - Act for the sole benefit of the entrustor
  - Prohibition from acting in conflict of interests with the entrustor

Source: Fiduciary Law, Tamar Frankel, Oxford University Press, 2011, pages 106 - 109

## Fiduciary Duty of Care\*

“IN CONTRAST TO THE DUTY OF LOYALTY, WHICH IS LINKED TO MISAPPROPRIATION OF ENTRUSTMENT, A VIOLATION OF THE DUTY OF CARE IS LINKED TO LACK OF EXPERTISE, INATTENTION, AND NEGLIGENCE.”

- Qualifications: possess and apply professional skills
- Evaluation of performance: based upon the process applied
- Boundaries may be variable: reasonable expectations of parties, discretionary powers of the fiduciary, applicable laws

Source: Fiduciary Law, Tamar Frankel, Oxford University Press, 2011, pages 171 - 174

# SEC – Expect the Reg BI Package to Evolve



## REGULATION BEST INTEREST

Disclosure Obligation  
Conflicts Obligation  
Care Obligation  
Compliance Obligation

Little changed but new emphasis on Conflicts and Care Obligations

## FORM CRS

Both brokers and advisors must describe client relationship in common terms

Fiduciary advice versus transactional relationships clarified

## IA GUIDANCE: FIDUCIARY DUTY

Client interests must not be subordinated to adviser’s interests

Client interests interpreted to be paramount

## IA GUIDANCE: BD EXEMPTION

“Solely Incidental” broadly interpreted with focus on method of compensation

“Solely Incidental” interpretation narrowed to focus more on nature of relationship

# What Standards Apply in the Digital World?



SEC REQUEST FOR INFORMATION AND COMMENTS ON BROKER-DEALER AND INVESTMENT ADVISER DIGITAL ENGAGEMENT PRACTICES (DEPS) – 8/27/21\*

DEPS INCLUDE PREDICTIVE DATA ANALYTICS, DIFFERENTIAL MARKETING, AND BEHAVIORAL PROMPTS (GAMIFICATION) USED IN WEALTH MANAGEMENT AND BROKERAGE PLATFORMS AND ROBO-ADVISING

## KEY QUESTIONS:

- If DEPs change client behavior, are they making recommendations or giving advice?
- How, from a regulatory policy perspective, should investors be protected?

## LIKELY ANSWERS:

- Reg BI or IA fiduciary standard applies
- Decision architecture of DEPs must be transparent, appropriate to the customer or client relationship, and closely monitored internally and by regulators

\* <https://www.sec.gov/rules/other/2021/34-92766.pdf>

# SEC – Major Developments in the ESG Realm



NEW WEBPAGE: “SEC RESPONSE TO CLIMATE AND ESG RISKS AND OPPORTUNITIES”

FIRST SENIOR POLICY ADVISOR FOR CLIMATE AND ESG APPOINTED (CHAIR’S OFFICE)

NEW CLIMATE AND ESG TASK FORCE ESTABLISHED (DIVISION OF ENFORCEMENT)

POTENTIAL RULEMAKING IS FOCUSED ON DISCLOSURES BY PUBLIC COMPANIES – PUBLIC COMMENT PERIOD ENDED IN JUNE

“ THE CHALLENGE FOR THE COMMISSION IS HOW TO FACILITATE ACCESS FOR THE AVERAGE INVESTOR TO RELIABLE, ISSUER-SPECIFIC, FINANCIALLY MATERIAL INFORMATION THAT IS GENERATED IN A COST-EFFICIENT WAY AND PROVIDED IN A USEFUL FORMAT.”

[Harvard Law School Forum on Corporate Governance, 2021]



# DOL's New ESG and Proxy Voting Rule (10-13-21): Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights



## FOCUS ON FIDUCIARY PRINCIPLES

- Prudence: Consider relevant facts and circumstances and act on them
- Loyalty: Must not subordinate retirement income or financial benefits to other objectives
- Exercise Shareholder Rights: Carry out these duties subject to prudence and loyalty

## PRUDENCE EXPLICITLY RECOGNIZES THAT CONSIDERATION OF ESG FACTORS MAY BE REQUIRED

- Climate change-related factors: exposure to physical, transitional, legal or regulatory risks
- Governance factors: board composition, executive compensation, transparency, and accountability
- Workforce practices: diversity and inclusion; hiring, promotion, and retention; training; labor relations

## LOYALTY MAY ALSO REQUIRE CONSIDERATION OF ESG FACTORS

- Replaces “pecuniary” basis for decision-making with broader evaluation of “risk and return factors”
- Special documentation of collateral benefits is no longer required in “tie-breaker” situations
- Designated Investment Alternatives (including QDIAs) may use ESG factors, subject to ERISA fiduciary duties

## IMPEDIMENTS TO CONSIDERING “NON-PECUNIARY” BENEFITS REMOVED FOR PROXY VOTING AND OTHER SHAREHOLDER RIGHTS, SUBJECT TO PRUDENCE AND LOYALTY OBLIGATIONS

# Fiduciary Obligations of ESG Investing are Contextual

**Spectrum of Capital (based upon OECD and other sources capturing the range of ESG investing)**

Philanthropy	Impact Investing	Social Investing	Sustainable Investing	Responsible Investing	Traditional Financial Only Investing
Address specific societal challenges that do not generate financial returns	Address specific societal challenges that require below market returns	Seek investments with both social and financial returns	Pursue ESG opportunities to enhance risk-adjusted returns	Incorporate ESG factors to traditional investing to mitigate ESG-related risks	Focus on delivering competitive financial returns
Social return only	Expectation of below market returns	Willingness to accept below market returns	Apply ESG factors to enhance value and returns	Mitigate ESG risks to protect value and achieve competitive returns	Limited or no regard for ESG practices
Focus on Client Directives and Objectives			Focus on Financial Objectives and Regulatory Limitations		

# SEC – Examination Priorities



## REG BI – HEAVILY FOCUSED ON *POLICIES AND PROCEDURES* FOR COMPLIANCE\*

- How have firms considered costs in making a recommendation
- Alterations to product offerings
- Recommendations to new customers (especially rollovers)
- Recommendations of complex products and consideration of reasonably available alternatives
- How conflicts have been Identified and addressed
- Have app-based broker-dealers implemented effective policies and procedures

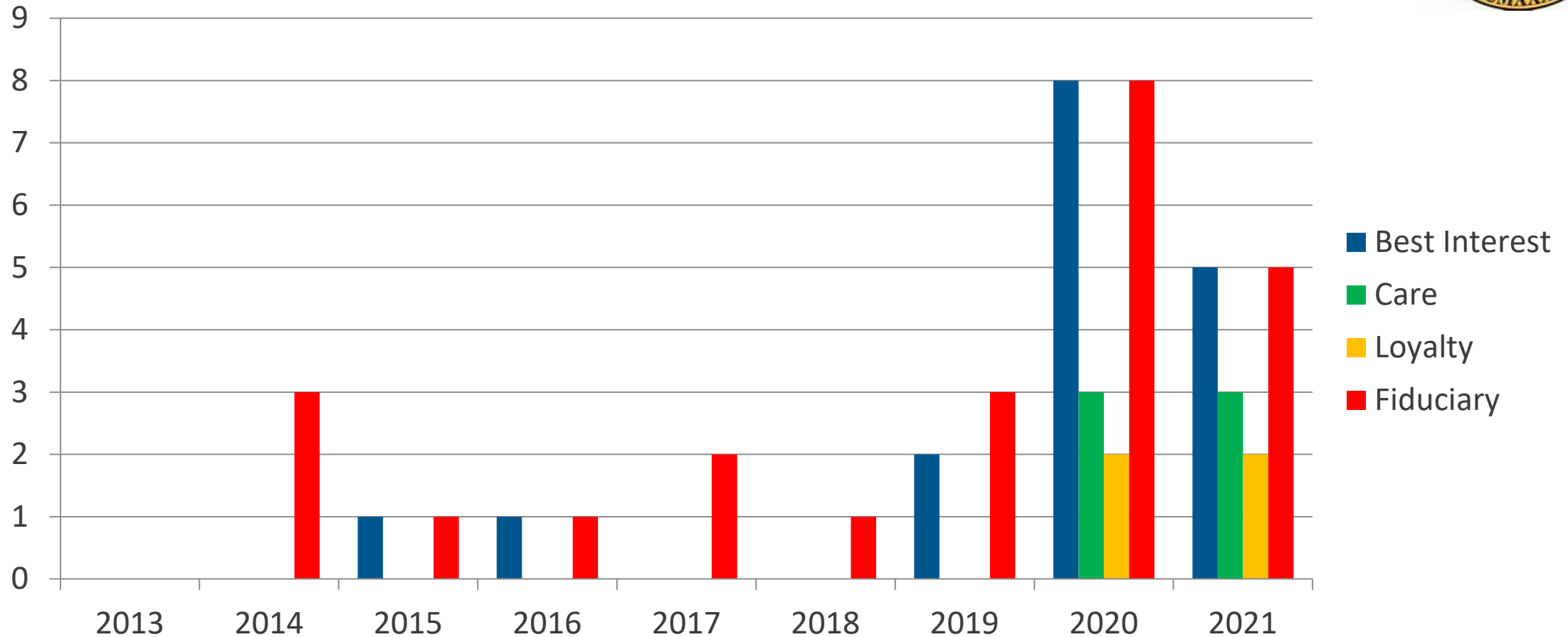
CLIMATE AND ESG-RELATED RISKS: “[S]TAFF WILL ... ASSESS COMPLIANCE WITH DISCLOSURE OBLIGATIONS UNDER FEDERAL SECURITIES LAWS” (FEB. 24, 2021 STATEMENT BY ACTING CHAIR ALLISON HERREN LEE)

\* Based upon Dec. 21, 2020 “Statement on Recent and Upcoming Regulation Best Interest Examinations from the SEC Division of Examinations”

# Fiduciary Terminology



Word Count: Annual SEC Exam Priority Releases: 2013-2021\*



\*'Best Interest' and 'Care' word counts excluded when used in connection with 'Regulation Best Interest,' 'Care Obligation'

# Fiduciary Duty of Loyalty

## DOL

- Impartial Conduct Standards
  - No misleading statements or omissions
  - Never place own interests ahead of investor
  - Compliance with best execution requirements under securities laws
- Rollover advice
  - No longer ‘non-fiduciary conduct’ (under previous guidance)
  - ...a ‘primary concern’ due to its ‘extraordinary importance’ to retail investors\*



\* DOL FAQ on PTE 2020-02, April 2021

# Fiduciary Duty of Care

## DOL

- Impartial Conduct Standards
  - Must meet professional standard of care
- Rollover advice (PTE 2020-02)
  - Document and disclose in writing specific reasons advice in best interest of participant
  - Among factors to consider:
    - Alternatives to rollover (including leaving in plan)
    - Services available under new arrangement
    - Long-term impact of increased costs
    - Why rollover appropriate despite increased costs

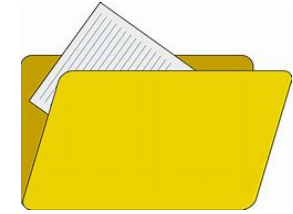


# New PTEs: Core fiduciary components likely to remain

## Impartial Conduct Standards

<b>Duty of Loyalty</b>	<b>Duty of Prudence</b>
Not place adviser's own interest ahead of investor's	Meet a professional standard of care
Charge no more than reasonable compensation	Have and apply policies and procedures
Comply with federal securities laws regarding 'best execution'	
Make no misleading statements	

# The Importance of Documentation



“Financial Institutions must **document** the reasons that a rollover recommendation is in the best interest of the Retirement Investor....”

— PTE 2020-02

“**Recordkeeping** violations may not grab the headlines, but the underlying obligations are essential to market integrity and enforcement.” — Gurbir Grewal, Director  
SEC Division of Enforcement  
*Remarks at industry conference, Oct. 6, 2021*

“Defendants present **extensive evidence** that they acted prudently in monitoring the Plan’s recordkeeping expenses. The **facts** show that [Defendant] periodically reviewed 408(b)(2) disclosures and invoices...to ensure the compensation for recordkeeping was reasonable.”

— U.S. District Judge Virginia A. Phillips  
*Order dismissing all claims, Alas v. AT&T Services, Inc.*  
Sept. 28, 2021



# Fiduciary Duty of Loyalty

## ERISA CLASS ACTIONS

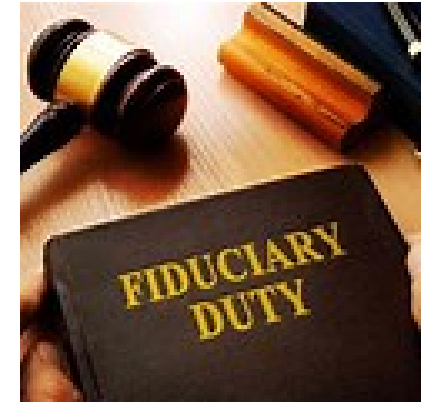
- Disloyalty claims
  - Proprietary investments
    - Using plans to ‘seed’ new funds
    - Higher-cost share classes
  - RK/admin services of plan sponsor
  - Float interest charged by RK
  - Cross-marketing by RK
  - Revenue-sharing (involving excessive fees)
  - Knowing participation in a fiduciary breach
  - Other self-dealing activities



# Fiduciary Duty of Prudence

## ERISA CLASS ACTIONS

- Breaches of Duty of Prudence most common claim
- Common Prudence violation claims:
  - Active versus passive investments (including TDFs)
  - Failure of fiduciaries to monitor
    - Investment options
    - RK costs
    - Other fiduciaries
  - Revenue sharing vs. per head RK fee
  - Underperformance, including MMFs, SVFs, TDFs, VAs

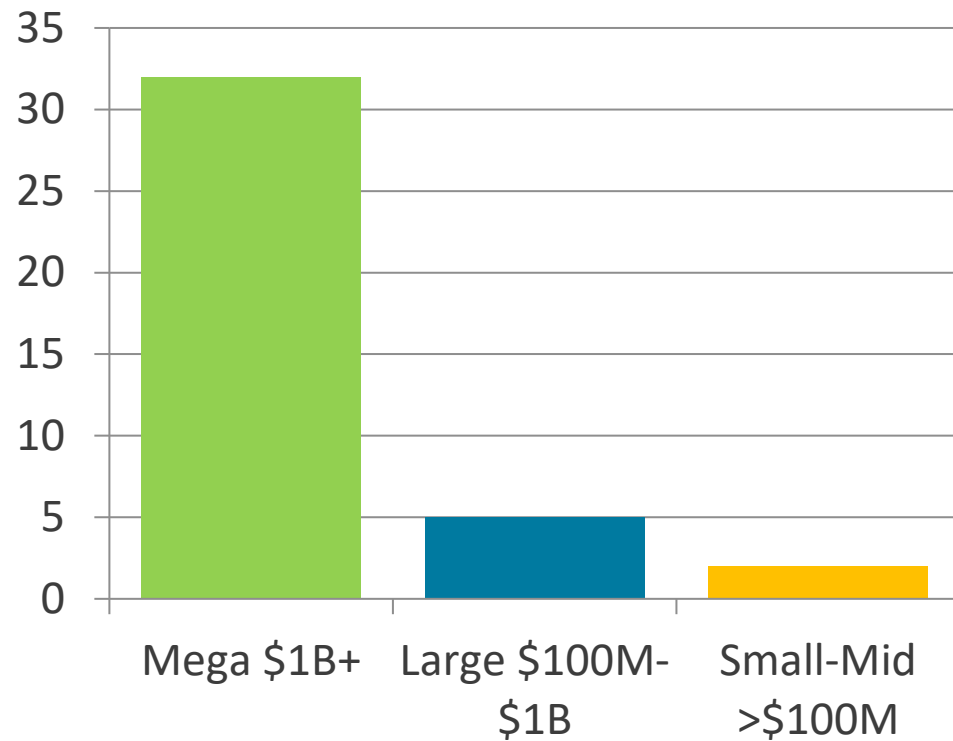


# ERISA Litigation Trends –2021

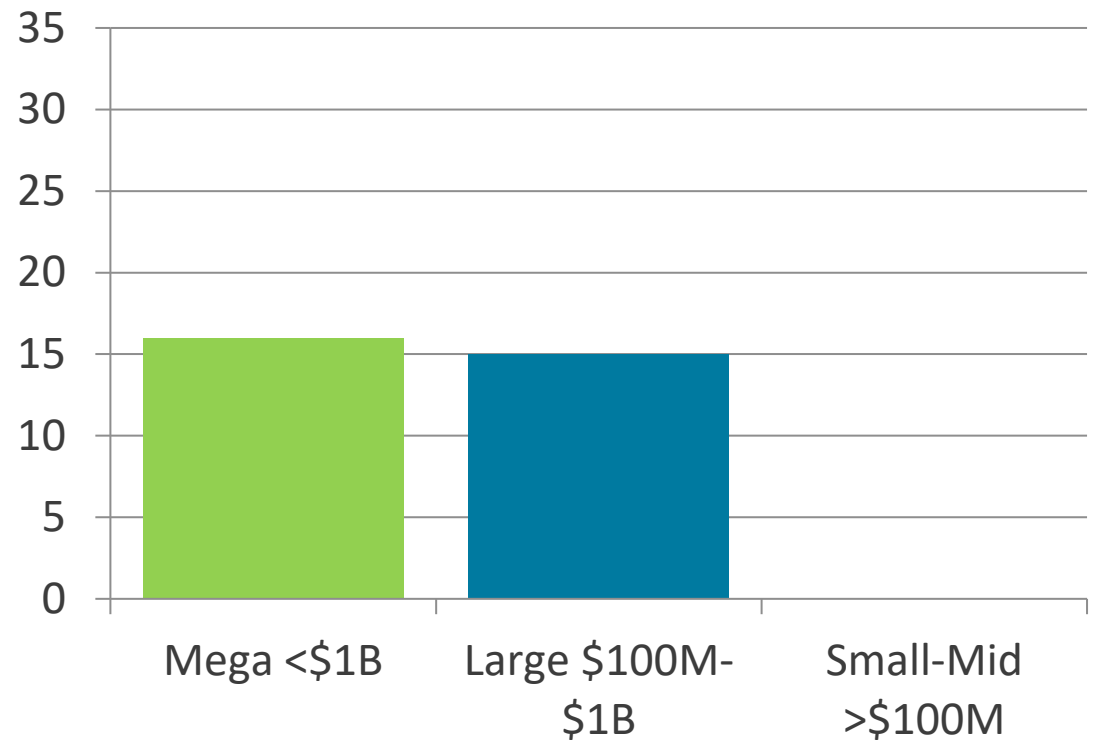


## Plan Defendants By Assets: 2016 & 2021\*

2016 Plans



2021 Plans YTD



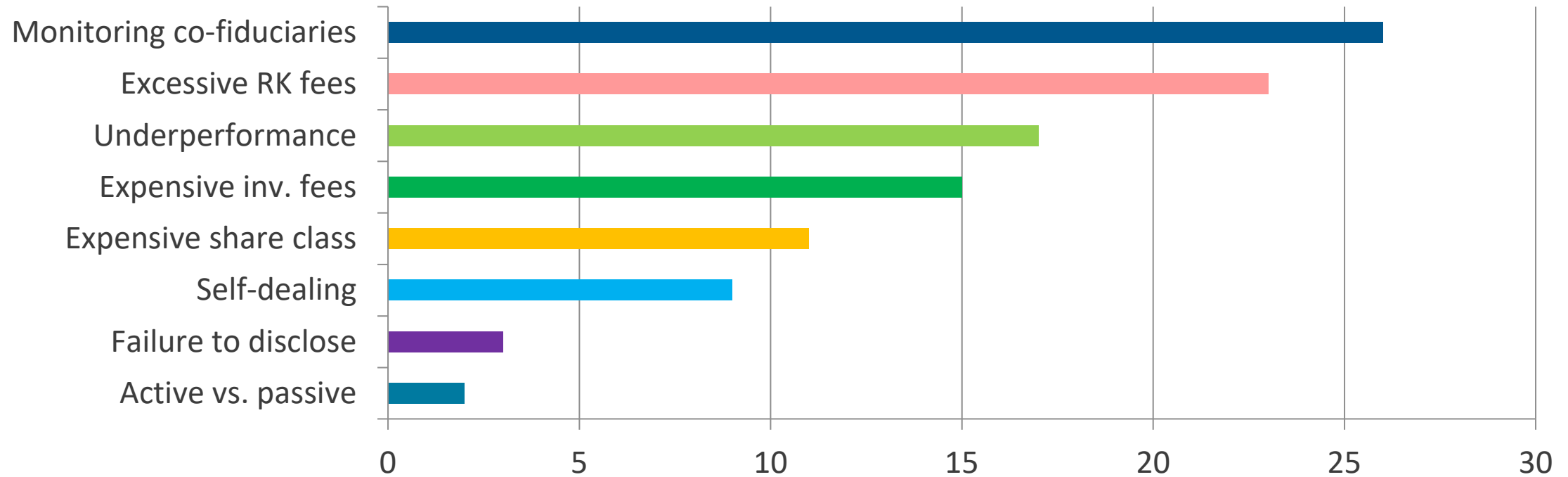
\*Excludes ERISA stock drop and church plan complaints; also excessive-fee suits in which the plan was not the defendant.

# ERISA Litigation Trends –2021



- 33 Excessive Fee Cases Filed by End of 3Q, 2021 (.8 cases per week)  
– Compares to 1.8 cases filed per week, 2020

## Most Common Claims in 2021\*



\*As of 9/30/21. Note: Some claims overlap.

# Monitoring the Contours of the Fiduciary Standard



*Advisors should look to*

## REGULATORS FIRST

- SEC, DOL interpret legislative mandates; refine contours
- 2 state agencies, 1 state assembly, have adopted a fiduciary std. for brokers

## COURTS SECOND

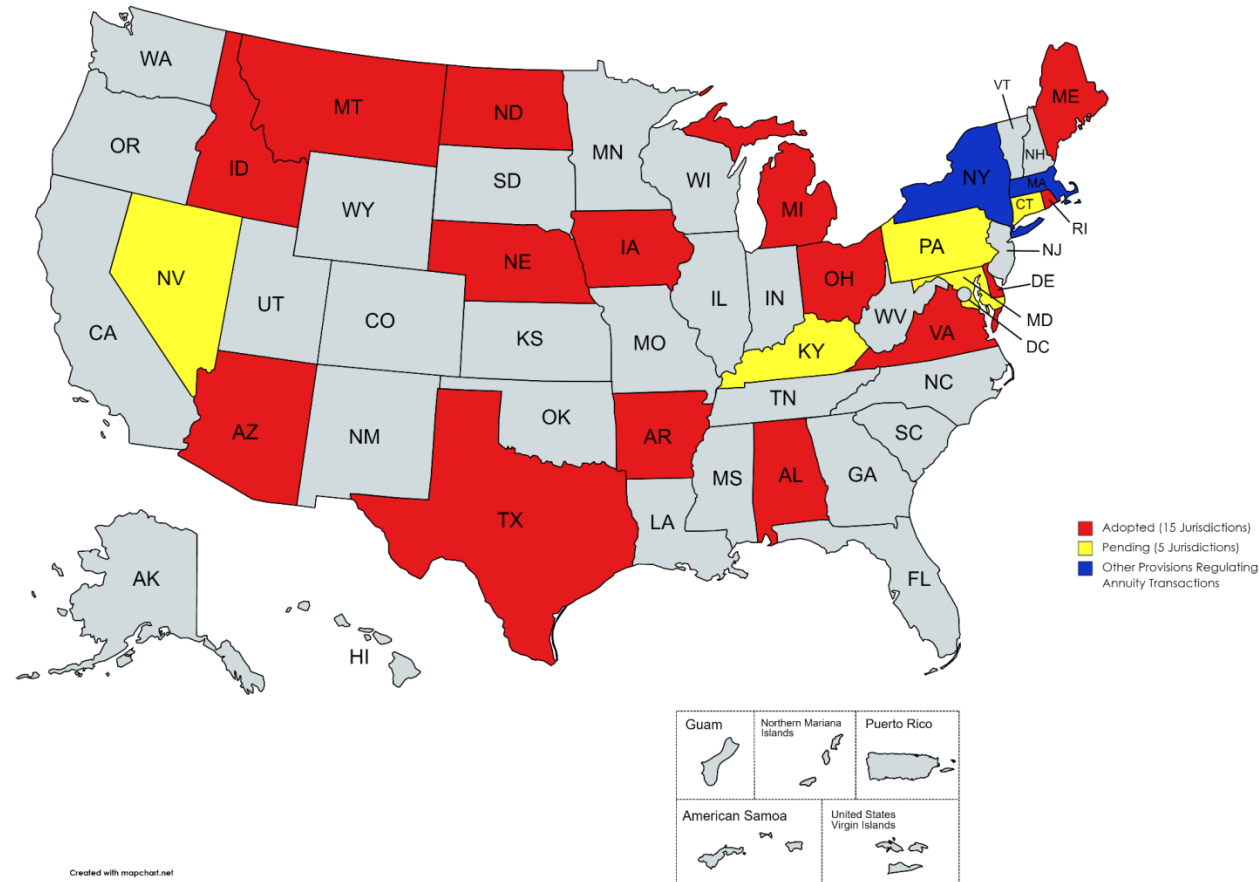
- ERISA dispute resolution guided by common law of trusts;
- Circuit splits make it difficult for larger firms to comply

## LEGISLATORS LAST

- Partisan divide reduces chances of statutory changes

# Key Takeaway – States Have Best-Interest Rules, Too

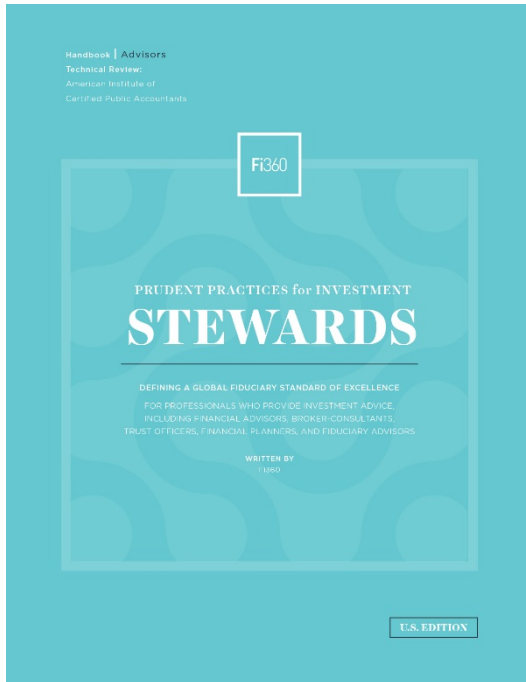
## NAIC States With ‘Suitability in Annuity Transactions’ Rule\*



\*As of 8/3/21

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# Applying Best Practices



Investment Stewards  
(U.S. Edition)



Investment Advisors  
(U.S. Edition)



Investment Managers  
(U.S. Edition)



## Q & A

PLEASE SUBMIT ANY QUESTIONS USING THE ON24  
INTERFACE

ADDITIONAL QUESTIONS CAN ALSO BE SENT TO  
[SUPPORT@FI360.COM](mailto:SUPPORT@FI360.COM)



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THANK  
YOU

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