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The Final DOL Fiduciary Rule

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Topics



- Overview
 - Why is the Rule necessary?
 - Definition of an investment fiduciary adviser
 - Chronology
- Non-fiduciary communications
- Prohibited Transaction Exemptions
- Marketplace Impacts

Why is The Rule Necessary?



“Instead of ensuring that trusted advisers give prudent and unbiased advice in accordance with fiduciary norms, the current regulation erects a multi-part series of technical impediments to fiduciary responsibility.”

[DOL Notice of Rulemaking, April 2015]

Fundamental premise: Investment advice rendered without fiduciary accountability is not consistent with legislative intent and harms investors.

Original Fiduciary Adviser Definition



1. Renders investment advice
2. Receives compensation, direct or indirect
3. Advice is individualized
4. Provided on a regular basis
5. Serves as primary basis for decision-making

This 5-part test narrowed the statutory definition.

Two Clarifying Questions



- What is investment advice?
- Who is a fiduciary investment adviser?

What is Investment Advice?



- Two types of recommendations that are advice:
 - Advisability of acquiring, holding, disposing of, or exchanging, securities or other investment property or how to invest after a rollover, transfer or distribution from a plan or IRA
 - Recommendation as to management of securities or other investment property
- Advice involves a call to action specific to the recipient; giving rise to fiduciary accountability
- Content, context, and presentation are important

More About “Management” Advice



- Investment policies and strategies
- Portfolio composition
- Selection of other investment advisers or managers
- Selection of account arrangements (broker/adviser)
- Plan or IRA rollovers, transfers, or distributions
 - Whether to do so
 - In what amount
 - In what form
 - To what destination

Fiduciary Investment Adviser



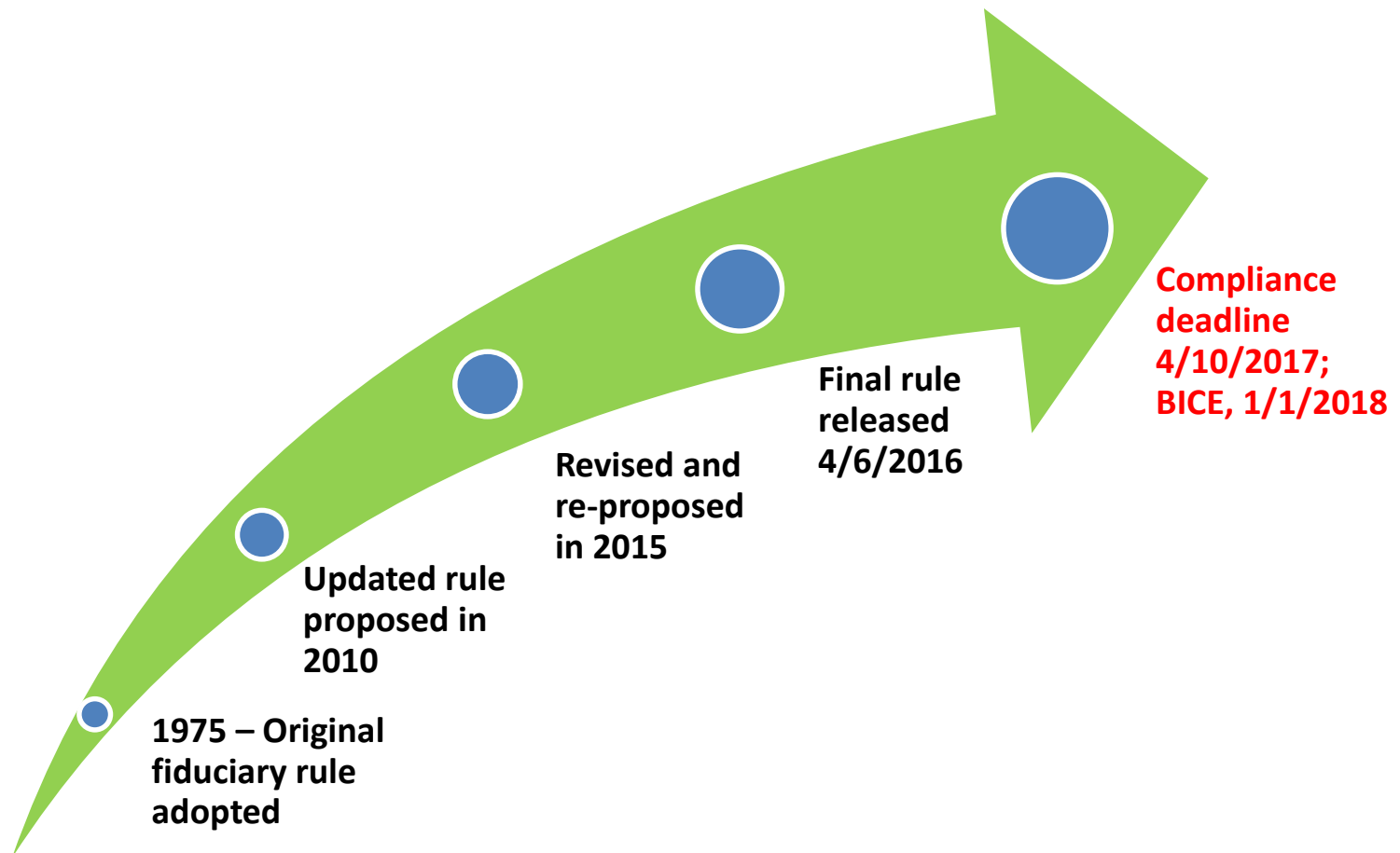
- Paid person(s) who provide, directly or indirectly, investment advice that:
 1. Represents/acknowledges acting as fiduciary; or
 2. Is pursuant to an agreement, arrangement, or understanding that is individualized; or
 3. Pertains to the advisability of particular investment or management decisions regarding plan or IRA investment property.

Important Big Picture Concepts



- The rule is not just about conflicts
 - Duty of Loyalty (conflicts)
 - Duty of Care (prudence)
- DOL keys in on the term ‘recommendation’
 - Advice is a communication that a person would reasonably view as a suggestion to take a particular course of action; advice = fiduciary
 - Education and other communications without a call to action are non-fiduciary; formerly known as carve-outs
- Appraisals may be subject to fiduciary rulemaking later
- Duty to monitor may be limited, if appropriate

Fiduciary Rule Chronology



Non-fiduciary Communications

Non-fiduciary Communications



1. Swaps
2. Internal staff advice
3. Platform providers
4. Investment education
5. Counterparty transactions (Sellers)

Platform Providers



- Recordkeepers, TPAs, and the like that make available platforms of investment vehicles
- Must be independent of the plan fiduciary
- State intention to not be a fiduciary, and do not become a functional fiduciary under the rule
- Not limited by plan size
- Not available for plan participants or beneficiaries or IRA accountholders

Investment Education



- Involves providing specific types of information
 - Descriptions of investments or plan alternatives without specific recommendations
 - General financial, investment, or retirement information
 - Asset allocation models
 - Interactive investment materials
- May come from sponsor, fiduciary, or others
- Frequency, form, and account types are not limited
- Selection and monitoring of education providers are fiduciary obligations

Investment Education Limitations



Asset allocation models and interactive materials may not identify specific investments, unless:

- The alternative is a Designated Investment Alternative (DIA) of a plan
- The alternative is subject to oversight by a plan fiduciary independent of the person who developed or markets the investment alternative or distribution option
- Models/materials identify all comparable alternatives
- Models/materials are accompanied by directions to find more information about the alternatives

Counterparty Transactions (Sellers)



- Sales to independent fiduciaries with financial expertise (bank, insurance company, federal or state registered investment adviser, broker-dealer, or other person with at least \$50 million under management or control)
- Inform fiduciary of no intent to provide impartial advice
- Have reason to believe fiduciary is capable of expert evaluation
- Not available for sales directly to IRA accountholders

Prohibited Transaction Exemptions

Prohibited Transaction Exemptions



- Best interest contract exemption (BICE or BIC Exemption)
- Principal transactions exemption
- Existing PTEs

BICE – Key Features



- BIC exemption permits
 - Variable and indirect compensation for brokers, firms
 - Binding arbitration for IRA and non-ERISA plan disputes
 - Class action suits available for systemic abuse
- Also covers investment, rollover advice to
 - Participants
 - IRAs
 - Small plans (under \$50 m. in assets)
- New – indexed annuities included (fixed annuities still covered in PTE 84-24)

BICE – Requirements



- Acknowledge fiduciary status
- Adhere to impartial conduct standards
 - Prudent investment advice
 - Charge only reasonable compensation
 - Avoid misleading statements
 - Contract for IRAs and non-ERISA plans
- Implement policies and procedures reasonably and prudently designed to prevent violations
- Refrain from sales incentives
- Disclose fees, comp and conflicts of interest
- Notify DOL

BICE Limitations



- Proprietary products subject to ‘finding’
 - Firm makes written finding that products are OK
 - Subject to impartial conduct standards
 - Disclose conflicts
 - Product compensation is reasonable
- Ban on complex, illiquid products removed
 - All product recommendations subject to prudence std.
- Not available to advisors with discretion

Level-Fee Exemption



- Available to advisors charging flat fees, AUM
- No BICE required for Level-to-Level rollovers; statutory protection for investors
- Conditions of safe harbor under BICE
 - Acknowledge fiduciary status
 - Subject to impartial conduct standards
 - Document reasons why recommendation in best interest of client

Marketplace Impacts

Likely Impacts on Financial Companies

- Revenues, profitability, and valuations suffer at BDs
- Continued high M&A activity for advisory firms
- Regulatory, litigation, and reputational risks rise; fiduciary practices must be embedded in firms
- Rollover analysis becomes a specialty
- Training, technology, and business intelligence will be needed to transition quickly
- Third party verification of conformity to fiduciary practices and objective due diligence help meet regulatory requirements

Likely Product Impacts



- Price and cost compression
- Variable and indexed annuity sales slow
- ETFs, index funds, top tier products will gain flows
- Due diligence drives up product quality
- Compensation comes out of products to avoid BICE
- Product wholesaling requires fiduciary expertise
- Illiquid, hard-to-price products require exceptional due diligence support; sales will slow
- Seller's Exemption supports active management and sophisticated investments

Likely Impacts on Brokers and Advisors



- Retail brokerage commoditized/automated
- Institutional brokerage thrives under the Seller's Exemption; requires top, fiduciary-savvy talent
- Total number of advisors continues to fall
- Competition is based upon professional excellence; credentials, specialization, professional recognition, and professional practice business model necessary
- Fiduciary policies and procedures must be embedded in business models
- Management and technology excellence required

Questions

Additional information on fiduciary trends can be found at

fi360 Fiduciary Talk Podcast
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Questions about CE can be directed to support@fi360.com