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Compensation, Conflicts & Best Practices under DOL's Fiduciary Rule

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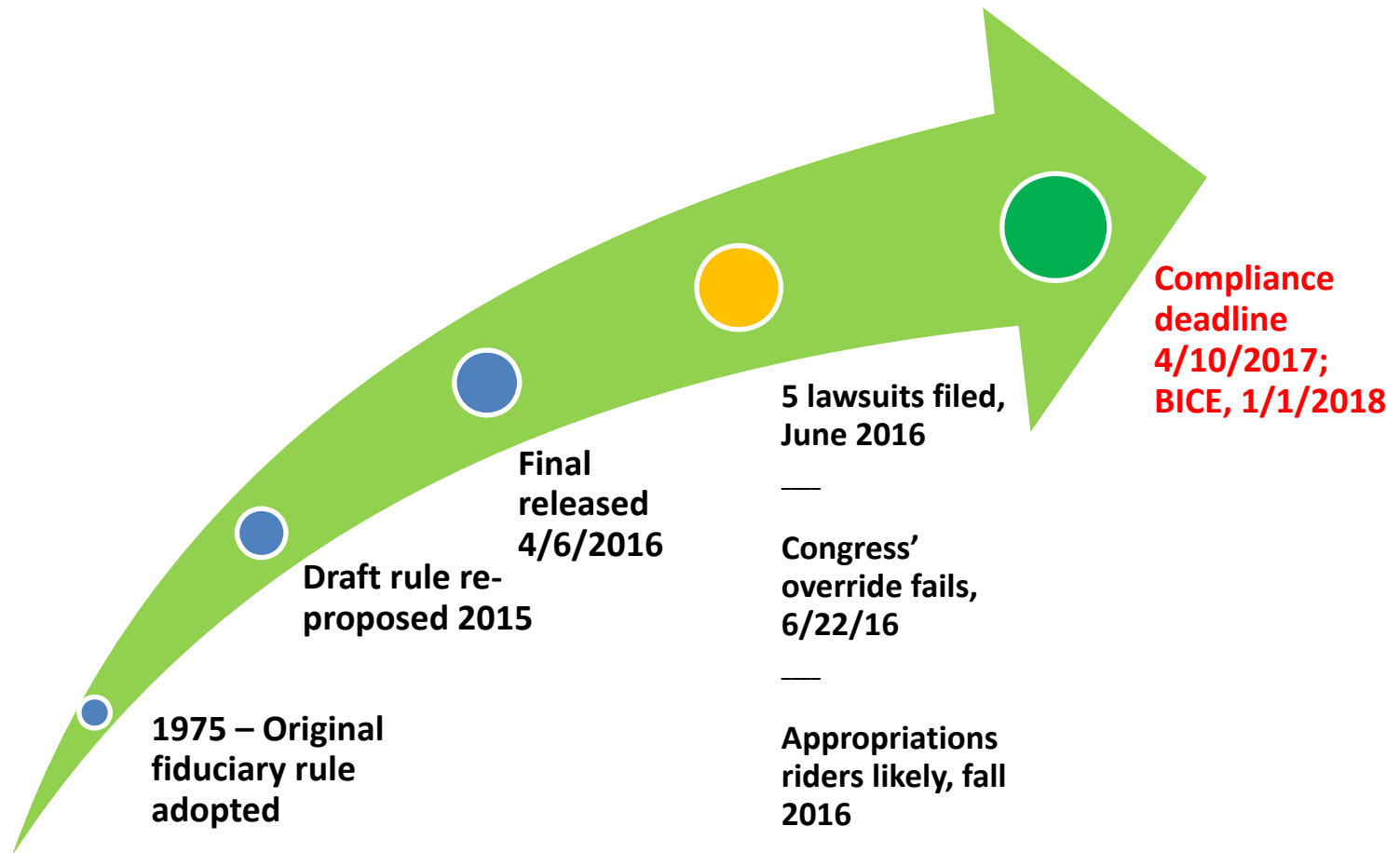
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Topics



- DOL Rule overview
 - Chronology
 - Expansion of fiduciary coverage
 - Compensation conflicts as the DOL's focal point
- The new competitive landscape: who is and isn't a fiduciary
- Advice on annuities
- Advice on rollovers
- How to achieve compliance and succeed competitively

Fiduciary Rule Chronology



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.

New Fiduciary Investment Adviser

Person(s) who provide, directly or indirectly, investment advice and any of the following apply:

1. Represent or acknowledge fiduciary status
2. Pursuant to an agreement, arrangement, or understanding that is individualized
3. Pertaining to the advisability of particular investment or management decisions regarding plan or IRA investment property
 - a. Investment policies and strategies
 - b. Portfolio composition
 - c. Selection of other investment advisers or managers
 - d. Selection of account arrangements (brokerage/wrap)
 - e. IRA Rollover decisions

Compensation Issues



- DOL rule focuses principally on managing compensation conflicts
- 3rd party, variable compensation prohibited except under PTEs
- Variable compensation includes commissions, split-commission arrangements, 12b-1 fees, indirect fees, including finder fees, trails
- Excessive compensation prohibited
- Sales quotas, bonuses, contests, special awards generally prohibited
 - However, incentive compensation permitted “when...reasonably designed to avoid a misalignment” of interests
- ‘Reasonable’ compensation a facts and circumstance issue
 - Must reflect fair market value for services provides
- ‘Level fees’ include AUM, retainer, hourly, salary
 - Cannot vary based on investment recommended
- DOL has not defined when commission compensation may be excessive compared to a level fee alternative under the rule

The New Competitive Landscape



- The dwindling realm of non-fiduciary business models
 - Seller to financially sophisticated counterparties (the only option for “full service brokerage”)
 - Self-directed brokerage
 - Other providers of non-fiduciary communications and services
- Fiduciary business models encompassing all advice providers
 - Level fee fiduciary adviser
 - Fiduciary adviser with variable compensation (requires BICE)

Non-Fiduciary Activities



- Non-fiduciary communications specified in the rule
 - Counterparty transactions (sellers to financially sophisticated fiduciaries)
 - Swaps
 - Platform providers
 - Investment education
 - Internal staff support from sponsor's employees
- Self-directed brokerage
- 3(21) advisers are not fiduciaries all the time for everything
 - Only within scope of agreement; not all fiduciary activities of a plan
 - Public speaking or cocktail conversation (no 'call to action')
 - Marketing or negotiating prior to the time the BICE contract is executed (but conditions apply)

Few Changes for Level-fee Advisers



- Change in the competitive landscape: fewer financial services representatives, virtually all fiduciaries
- Be aware that the new wave of class-actions is increasingly focused on imprudent selection of investment options, including
 - Newly issued TDFs
 - Stable value vs. money market funds
 - Share classes
- Some impactful changes in IRA Rollovers

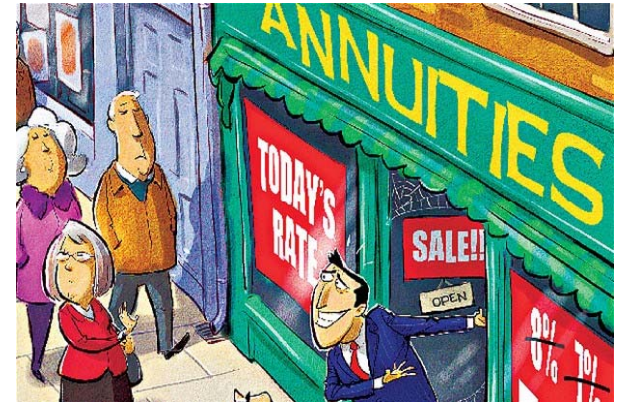
Advisers With Variable Compensation:

Best Interest Contract Exemption

- BICE permits variable and indirect compensation
- Increased regulatory and litigation risks
 - Binding arbitration for IRA and non-ERISA plan disputes
 - Class action suits available for systemic abuse
- Covers investment, rollover advice to participant, IRAs, and small plans (under \$50 million in assets)
- Proprietary products subject to ‘finding’
 - Firm makes written finding that products are OK
 - Subject to impartial conduct standards
 - Disclose conflicts
 - Product compensation is reasonable
- Applies to variable and indexed annuities (fixed under PTE 84-24)

Equity-Indexed and Variable Annuities

- Subject to BICE
- Impartial Conduct Standards
 - Requires DOL-specific suitability analysis
 - Prudent Man rule
 - 4 suitability factors
 - Prohibits excessive compensation
 - Disclosures must not be misleading
- Numerous other due diligence factors (in Preamble)
- NAIC suitability rule – state specific
 - Model rule has 12 suitability factors
 - State rules vary

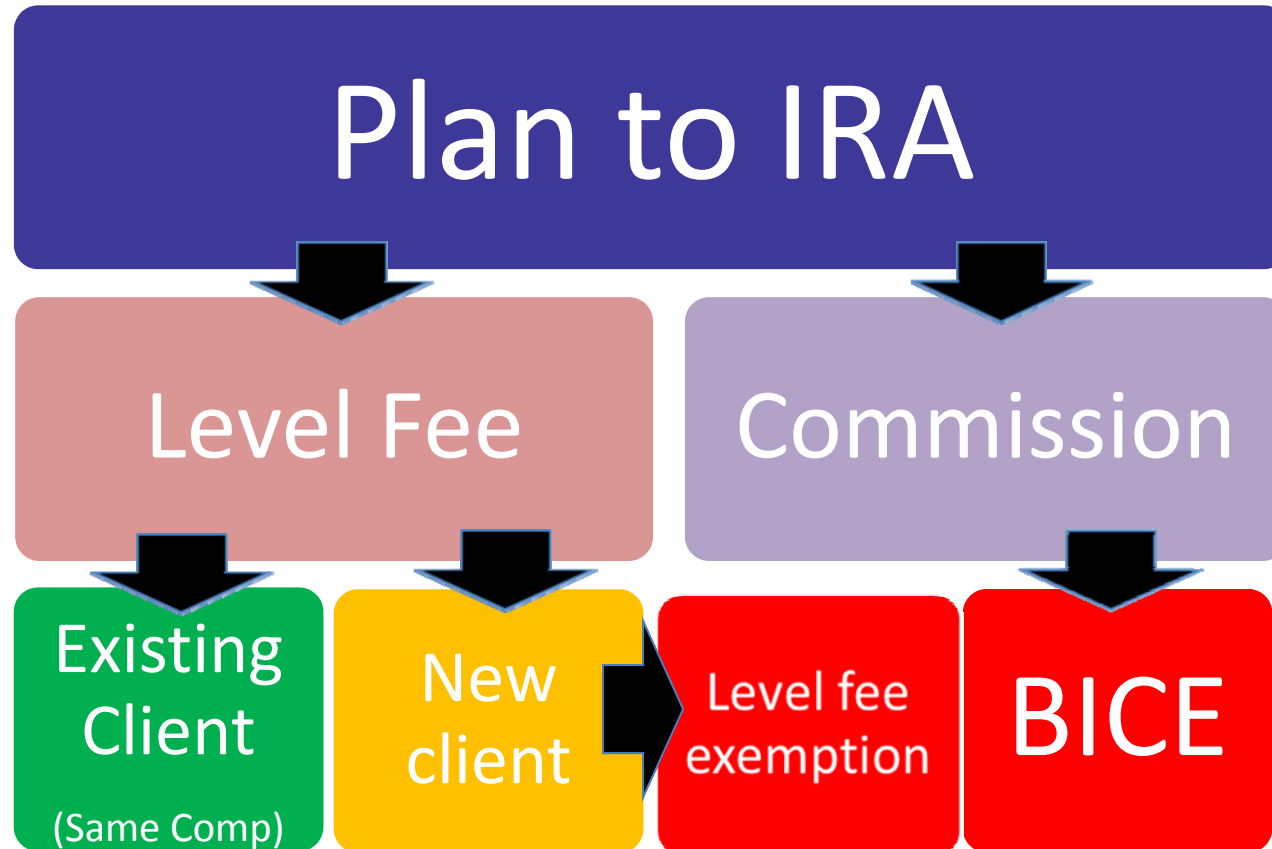


Rollover Advice Is A Fiduciary Act



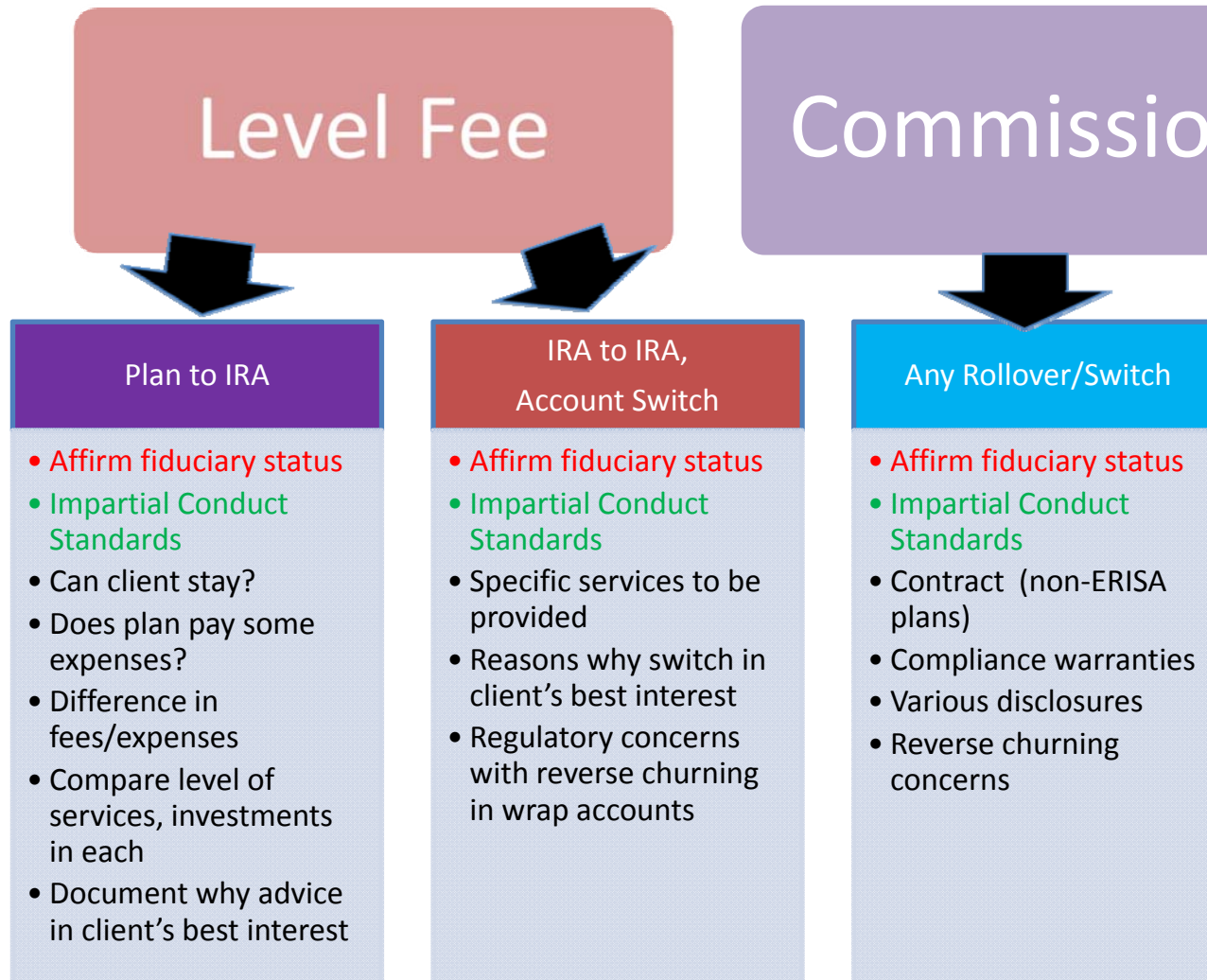
- ‘Rollover advice’ includes
 - Plan to plan transfers
 - Plan to IRA rollovers
 - IRA to IRA rollovers
 - Switching from brokerage to fee (wrap) account
 - Distributions
- Different DOL requirements may apply, depending on type of accounts and products involved, form of compensation
- BICE is an impediment to rollovers from a plan to an IRA
- Level-fee exemption (stream-lined BICE) offers new rollover possibilities

Rollover Advice Requirements



Note: Previous discretion over account nullifies PTE availability

Rollover Advice – Standards Vary



Impartial Conduct Standards Duties



- Duty of loyalty
 - ‘Best Interest’ of the client
 - Advice is without regard to the financial interests of the advisor
 - Reasonable compensation
 - Disclosure of conflicts
 - Incentive compensation generally prohibited
- Duty of care
 - Prudence standard
 - Based on investment objectives, risk tolerance, financial circumstances, investor’s needs

Loyalty and Suitability Standards Vary



ERISA

- 'Sole interest' std.
- Applies to all advice recipients
- Investment objectives
- Financial circumstances
- Risk tolerance
- Needs of investor
- Prudent Man Rule, i.e., "acts with care, skill, prudence and diligence under circumstances then prevailing..."

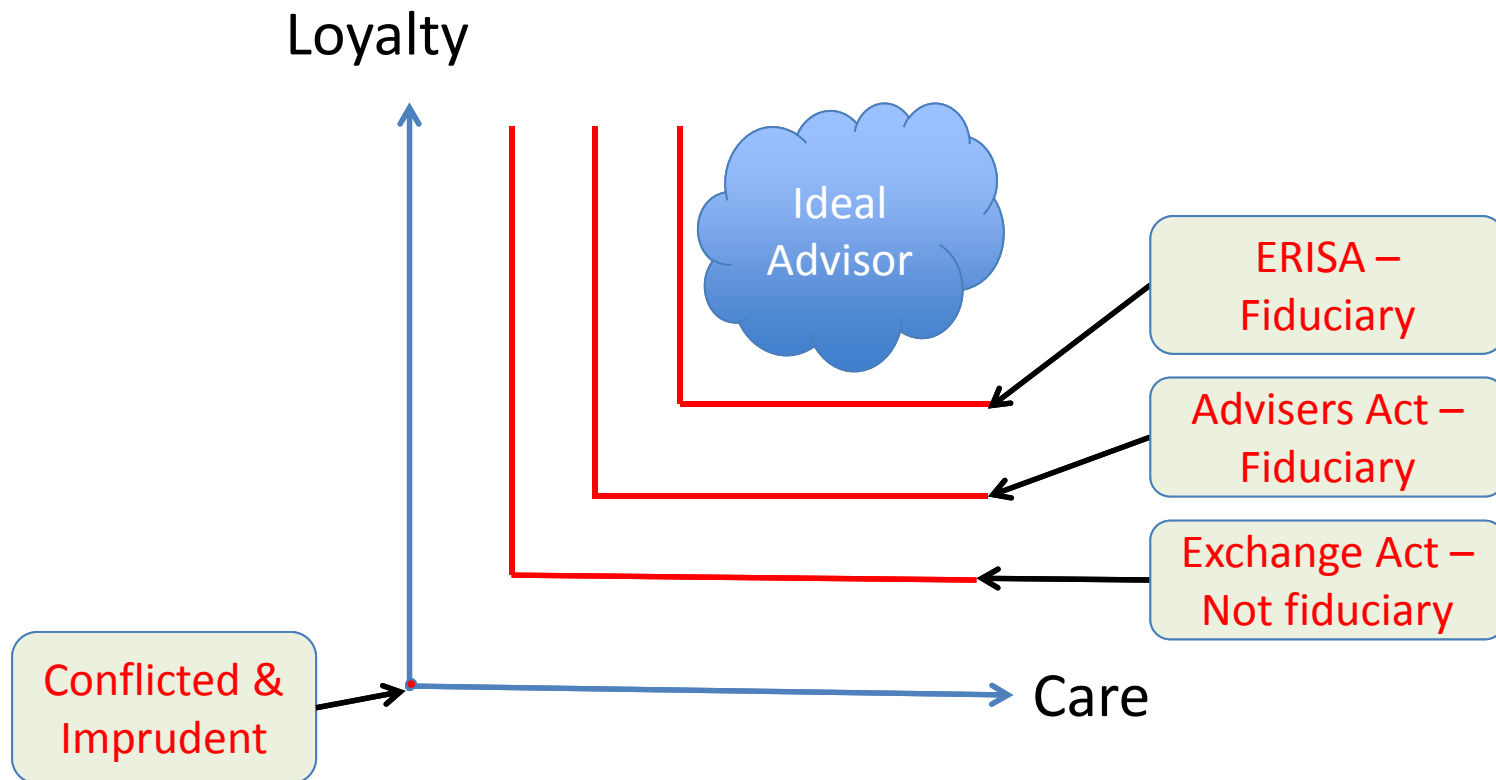
Advisers Act

- 'Best interest' std.
- Applies to all clients
- Investment objectives
- Financial situation
- Investment experience
- Advice is suitable in context of overall portfolio
- Suitability rule notes similarity to ERISA's prudence standard and trust law

BD/Insurance

- No fiduciary std.
- Investment objectives
- Financial situation and needs
- Investment experience
- Risk tolerance
- Age
- Other investments
- Tax status
- Time horizon
- Liquidity needs

Regulatory oversight



The professional advisor's mandate

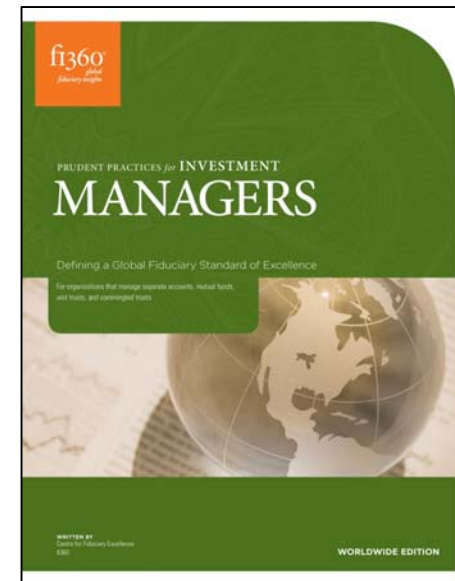
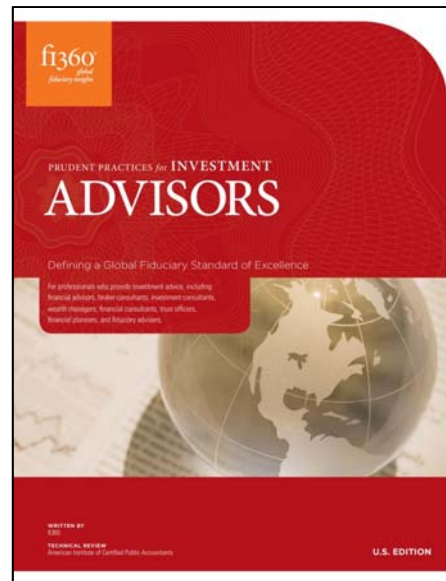


- *Do what is right for the client – Duty of Loyalty*
- *Deliver professional-grade products and services – Duty of Care*
- *Run a sustainable business without compromising fiduciary principles*
- *In short, do what is right, skillfully and profitably*

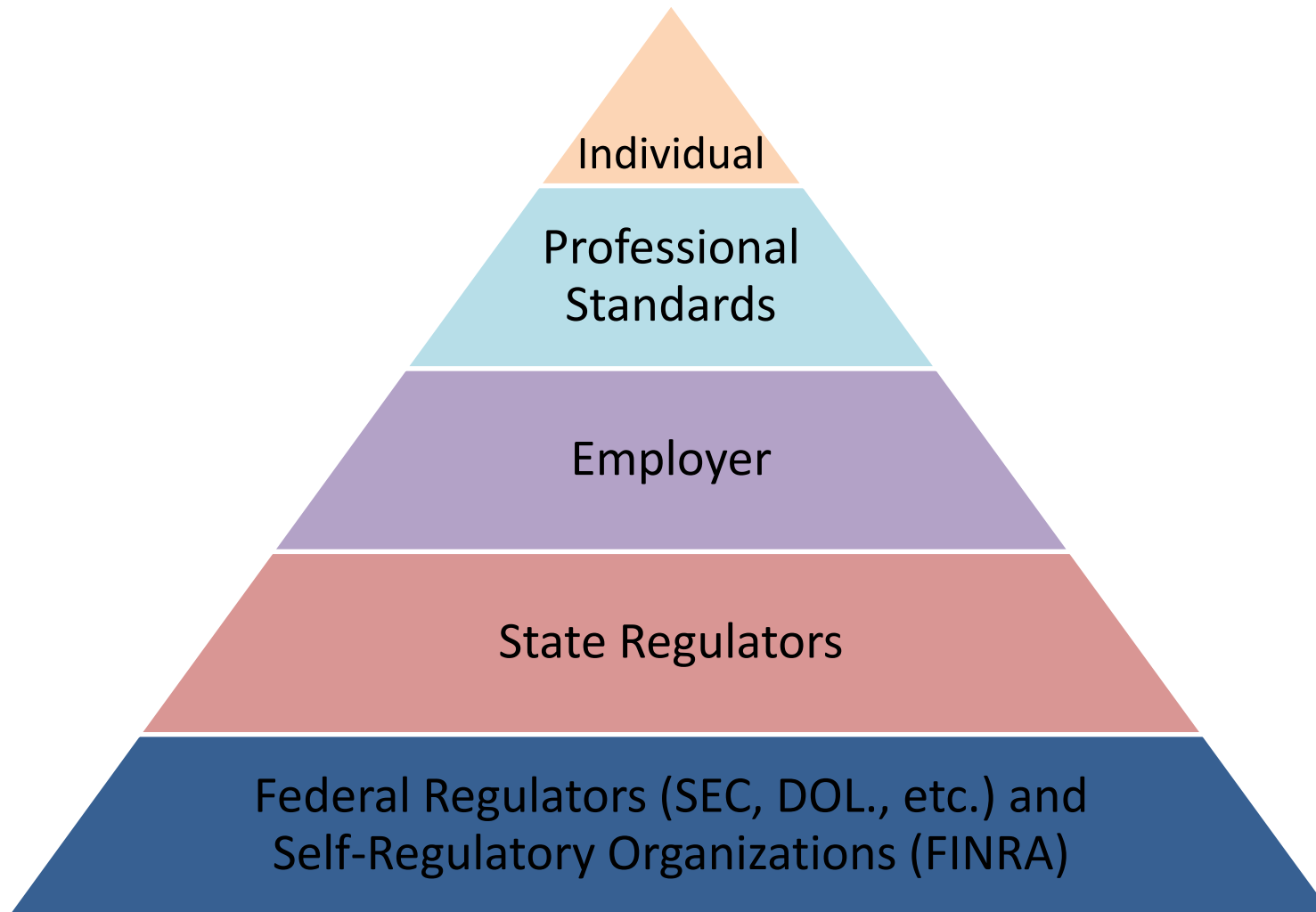
Prudent Investment Practices



- Define an Investment Fiduciary Standard of Excellence for professional fiduciary investment advisors
- Written by fi360, substantiated in law, regulations, and best practices
- Technical Review by the AICPA

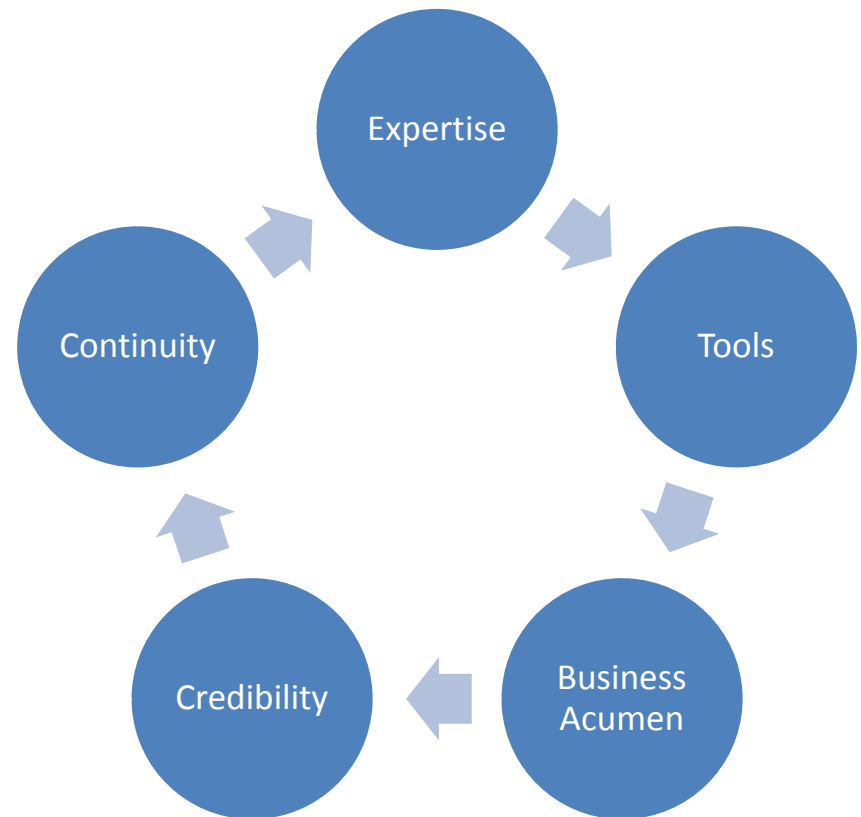


Move up the pyramid to compete



How Can You Differentiate?

- **Credibility**
 - Personal/Professional
 - Company
- **Capabilities**
 - Special skills
 - Tools for efficiency and effectiveness
- **Continuity**
 - Process-driven
 - Professional company culture
- **Results**
 - Set goals and milestones
 - Benchmark success for your clients and your business



Questions

Additional information on fiduciary trends can be found at

fi360 Fiduciary Talk Podcast

www.fi360.com/fiduciarytalk

Also available on iTunes

and

fi360 Blog

www.fi360.com/blog

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