DOL's FIDUCIARY Standard:
How Our Values Stay the Same and Our Practices Transform

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1. The Department of Labor's (DOL) long-awaited final regulations on *fiduciary standards of care for retirement plans* were announced on April 6, 2016.

    a. DOL Fiduciary rules become final in mid-June 2016.

    b. Implementation will generally be effective April 10, 2017 with aspects of compensation exemptions effective January 1, 2018.

2. There has generally been resistance to the new rules within the financial services industry.

    a. Lawsuits and legislation threatened.

    b. Denial and anger has been a predominant advisor/producer reaction.

    c. "When they're running you out of town, get at the head of the line and make it look like a parade."

3. The rules are complex; mostly specific but at other times vague.

    a. Advisors will have increased responsibilities to serve their client's best interest when it involves providing investment advice and products to qualified plans, IRA, Roth IRA and Rollovers.

b. This is probably the biggest rule change for producers and advisors since regulations responding to the Great Depression

4. Regulations regarding advisor and broker behavior started more than 80 years ago.

   a. Following the depths of the Great Depression, the Securities Act of 1933 established the suitability standard for the sale of securities.

   b. The Investment Advisers Act of 1940 established the obligation of fiduciary standards when rendering investment advice.

   c. ERISA was passed in 1974 - compelling fiduciary duties for those providing advice to retirement plans.

   d. Following the depths of the Great Recession, the U. S. Treasury explored Financial Regulatory Reform …

   e. … followed by SEC, DOL, FINRA, and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

   f. In 2015, DOL proposed rule " …to address conflicts of interest in retirement advice, savings middle-class families billions of dollars every year."

   g. Final regulations, with some surprises, announced April 6, 2016.

5. You either *are* or *are not* a DOL Fiduciary. You *are* a fiduciary if you give advice for compensation to a plan or plan participant within an ERISA plan or Roth/IRA/IRA Rollover and if you …

   a. Provide advice that includes moving money within, from, or to an ERISA plan or an IRA/IRA Rollover or Roth IRA. Health Savings

Accounts (HSA) and Coverdell Education Accounts are also included;

b. Make recommendation regarding distributions, plan rollovers and/ or IRA investments;

c. Make recommendations related to asset management;

d. Make referrals to person/entity to provide advice or management for a fee.

6. If you are a fiduciary, transactions generating a sales commission are deemed *prohibited transactions.* There are two exemptions allowing commissions under rigorous rules - but *fiduciary* duties are never exempted.

   a. *Best Interest Contract* exemption (BIC) allows commissions for the sale of indexed and variable annuities and mutual funds as long as the compensation is reasonable and the products are suitable. A signed contract is required between the financial institution and the plan sponsor or participant. The contract allows a customer to participate in class action lawsuits, not withstanding arbitration clauses.

      For mutual funds, variable annuities, and fixed index annuities, this exemption provides conditional relief for compensation such as commissions and revenue sharing, that an adviser and the adviser's employing firm might receive in connection with investment advice to retail retirement investors – but which leaves the obligation of fiduciary in place.

   b. Prohibited Transaction Exemption 84-24 (PTE 84-24) allows commissions to be paid for the sale of fixed income annuities and (where otherwise allowed) life insurance.

PTE 84-24 is similar to the BIC Exemption - for traditional (not index) annuities and non-variable life insurance - and does not require an annual contract between agent and client.

PTE 84-24 is a principles-based PTE permitting non-discretionary investment advice fiduciaries to continue to receive certain types of prohibited compensation – commissions – if they agree contractually to adhere to a “best interest” standard.

c. The sale of disability insurance and term life insurance is specifically excluded from the products covered by the rule.

d. Even with an exemption, all compensation must be reasonable, and all work with clients must be in their best interest.

7. What *is* a fiduciary?

a. Notice we’ve referred to “DOL FIDUCIARY” under the final rules. But there could be different – *simultaneous* – standards!

Trustees under UPIA

CFP Certificants

Members of Society of Financial Service Professionals (FSP)

Insurance agents in New Jersey

b. A fiduciary must comply with a *client's best interest* standard, which includes these common elements:

Put the client’s interest first (also referred to as loyalty);

Act with prudence; that is, with the skill, care, diligence and good judgment of a professional;

Do not mislead clients; provide conspicuous, full and fair disclosure of all important facts;

Avoid conflicts of interest;

Fully disclose and fairly manage, in the client's favor, any unavoidable conflicts …

… and be able to PROVE IT!

c. Unlike "CFP" or "FSP" fiduciary, the DOL imposes the standards of impartial conduct when your advice comes in contact with qualified money and under these standards, commissions are prohibited.

   While commissions may be earned under one of the two product-specific exemptions, the advisor is always considered a fiduciary and may have ongoing liability to the client for the consequences of the advice (and the derivative product recommendation).

8. What is *Best Interest?*

   Consider the duty of a fiduciary to incorporate the Goldilocks Rule: With suitable recommendations, provide disclosure that is not too little - and not too much - but in an amount that is JUST RIGHT so the client can make a decision that *she* believes is in her *best interest*!

9. What is *suitable?*

   To serve the Client's Best Interest – think of a slot machine – reconfigured to process 2 or 3 suitable options based on objective and subjective information, allowing clients to think about / discuss / evaluate / take action!

10. What business models might we find an intersection with retirement plan advice?

IAR within a BD or IMO's RIA (Series 65) / fee-only / fee-based

IAR within a proprietary RIA (Series 65) / AUM

Series 6/63 traditional and variable Life/Annuities + Mutual Funds

Series 7/63 traditional and variable Life/Annuities + Securities

Life-only agent (Life/DI/LTC but no annuity sales)

Life-only agent selling all life products including annuities

Attorneys and accountants under certain circumstances

Planners who *only* charge for advice

Any client-facing advisor who charges fees for advice

(Large Plan practitioners largely won't see a difference)

11. What will happen to an agent/advisor's E&O insurance?

   a. Prudent advisors needs to cover their exposure - requiring fiduciary E&O because of the "add-on" of the suitability obligation – now that you have a fiduciary obligation.

   b. CalSurance anticipates premiums of $5,000 - $6,000 a year for the fiduciary exposure.

   c. Likely a BIG hike in premium expense – at least initially!

12. Liability issues to which a DOL Fiduciary could be vulnerable

    a. Value of the investment/policy declines or doesn't meet expectations;

    b. Another advisor causes a "disturbance in the force" by suggesting the client wasn't offered the BEST product available – and/or paid too much for it – and/or were charged too high a commission/fee;
    c. Family member (i.e. beneficiary) complains that the inheritance isn't as big as expected – (or as big as they hoped!);

    d. Suzie Orman implies your client made a bad choice;

    e. Compensation was not reasonable;

    f. Form of prohibited compensation listed in the rule;

    g. Failure to disclose material conflict.

13. Failure to meet Best Interest issues

    a. Product type (NLG vs IUL vs WL);

    b. Product differences (IUL "A" vs IUL "B") – including financial strength differences;

    c. Product compensation universes (AUM vs Annuity)

14. How insurance and investment products will change

    a. Annuities will likely move to "trails" such as 50 bps per year

       Eliminate replacement activity?

Eliminate surrender charges?

Make annuities a more fungible asset class?

b. Life insurance may *ultimately* move away from "heaped" to "levelized" commissions (a series of 10% followed by 2-3%?)

Reduce replacement activity?

Reduce surrender charges?

Make it much harder to "get started" selling life insurance?

c. "Load" Mutual funds might follow the trails approach

Make it much harder to "get started" selling mutual funds?