

DOL Fiduciary Rule: Impact on Retirement Plan Sponsors, Plan Advisers and Service Providers

Navigating the Expanded Definition of Investment Advice, Qualifying for Exclusions or Exemptions, Compliance, and Implementation

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The DOL Fiduciary Rules:

*Impact on Retirement Plan
Sponsors, Plan Advisers, and
Service Providers*

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Agenda

- Rollout and New Effective Date of Fiduciary Rule
- New Fiduciary Advice Definition
- Exclusions from Fiduciary Advice Definition
- Framework of BICE Exemption
- Transition BIC and Proposed Extension
- Full Blown, Disclosure and Streamlined BIC
- Other PTEs
- Outcome of Review of Rule and PTEs
- How Advisers and Limit Liability Until Full Implementation
- Impact on Plan Sponsors

Introduction

- Broadening of Fiduciary Definition
 - DOL's new rule would broaden scope of advisors deemed to be IRA/plan fiduciaries
 - Targets broker-dealers (BDs) and registered reps (RRs) earning commission-based compensation
 - Would change IRA marketplace
 - and similar accounts including HSAs, Archer MSAs, Coverdells, Keogh plans, and sole proprietor plans
 - Would impact registered investment advisers (RIAs)
 - (1) Offering rollover advice and
 - (2) Managed account programs



Rollout and New Effective Date of Fiduciary Rule

Rollout of Fiduciary Rule

- Rulemaking Process
 - DOL proposal published on April 20, 2015
 - New fiduciary rule was finalized on April 8, 2016
 - Includes new “investment advice” definition and related prohibited transaction exemptions (PTEs)
- Phase-in of New Requirements
 - Scheduled to become effective on April 10, 2017
 - Certain PTE conditions were to be phased in on this date, and other conditions go into effect on Jan 1, 2018

New Effective Date of Fiduciary Rule

- Phase-in of New Requirements Upended
 - February 3rd - Presidential Memorandum mandated further study of the Fiduciary Rule and related exemptions
 - April 7th - Applicability date delayed 60 days
- Effective Date Delayed to June 9th, with full implementation on January 1, 2018



New Fiduciary Advice Definition

New “Investment Advice” Definition

- Required Context for Investment Advice
 - Advisor acknowledges it is acting as a fiduciary under ERISA or IRC, or
 - Written or unwritten understanding that advice is based on particular investment needs of client, or
 - Advice is directed to specific person(s) regarding advisability of a particular investment decision
- Required Nature of Investment Advice
 - Advisor makes a “recommendation” for a fee or other direct or indirect compensation

“Recommendation” Defined

- Covered Recommendations to Plan/IRA
 - On advisability of investing in property, or
 - Relating to management of property including:
 - IPS, strategies, portfolio composition
 - Selection of other persons to provide advice
 - Selection of account (brokerage vs. advisory)
 - Transfers or rollovers from Plan/IRA
- “Recommendation”
 - Reasonably viewed as suggestion to engage in particular course of action (*i.e.*, call to action)

Observations on New Fiduciary Definition

- Changes to “Investment Advice”
 - Includes one-time advice (without “regular basis” condition)
 - No need for “mutual understanding” of parties
 - Advice may address particular investment needs or a particular investment decision (and does not necessarily need to be individualized)
 - Client only needs to receive advice (which does not need to be “primary basis” for decisions)
 - Expressly revises definition to cover investment management recommendations

Observations on “Recommendation”

- “Hire Me” Recommendations
 - Fiduciary advice only covers recommendations for selection of other persons to provide advice
 - Advisor’s “Hire Me” recommendation is not conflicted fiduciary advice
- Rollover Advice
 - Recommending a rollover distribution is fiduciary advice
 - Covers rollover advice that does not include any actual investment recommendation
- Impact on Solicitors
 - “Content, context and manner of presentation”
 - Line between fiduciary and non-fiduciary status can be easily crossed



Exclusions from Fiduciary Advice Definition

6 Exclusions from “Investment Advice”

- Exclusions from “Recommendations”
 - Platform Providers
 - Investment Education
 - General Communications
- Exclusions from “Fiduciary” Definition
 - Sellers to Institutional Fiduciaries
 - Swap Counterparties
 - Plan Sponsor Employees

NOTE: *Exclusion not apply if the advisor acknowledges its fiduciary status*

Exclusion #1: Platform Providers

- Requirements for Exclusion
 - DC Plan recordkeepers may market investment options available through their platforms (without regard to individualized needs)
 - Must disclose that platform does not provide impartial fiduciary advice
 - Can identify options that meet objective criteria (where financial interests are disclosed)
 - Can identify sample list of options based on plan size or current options in response to RFP (where financial interests are disclosed)
 - Can provide objective financial data and benchmark comparisons

Exclusion #2: Investment Education

- Similar to Current Safe Harbor (IB 96-1)
 - Plan Information
 - General Financial/Retirement Information
 - Asset Allocation Models
 - Interactive Investment Materials
- Observations
 - Exclusion applies to both Plans and IRAs
 - Asset allocation models and interactive materials cannot reference specific options unless
 - They are subject to oversight of plan sponsor
 - Options with similar risk/return are identified
 - Statement on how more info may be obtained

Exclusion #3: General Communications

- Definition of “General Communications”
 - Reasonable person must not view as investment recommendation
- Examples
 - Newsletters, talk shows
 - Speeches and conferences
 - Research or news reports
 - Market data
 - Performance reports
 - Prospectuses

Exclusion #4: Independent Fiduciary with Financial Expertise

- Scope of Exclusion
 - Covers advice provided by seller of investment products to fiduciary of a Plan/IRA
- Independent Fiduciary
 - Bank, insurance carrier, RIA or BD
 - If not above, must have at least \$50M in AUM (e.g., investment committees)
- Requirements for Exclusion
 - Seller informs that it is not providing impartial fiduciary advice
 - Seller does not receive any direct compensation
 - Seller reasonably believes that fiduciary is capable and independent

Exclusion #5: Swap Counterparty

- Conditions for Fiduciary Exclusion
 - Counterparty is swap dealer (or security-based swap dealer) or major swap participant
 - Not acting as “advisor” to plan under Commodity Exchange Act or Securities Exchange Act
 - Does not receive any direct compensation
 - Written representation from plan fiduciary that it understands:
 - Advice is not impartial fiduciary advice
 - It is exercising independent judgment

Exclusion #6: Plan Sponsor Employees

- Advice from Employee to Plan Sponsor
 - Exclusion applies if employee does not receive compensation beyond employee's normal pay
 - Carve-out is designed to protect employees from potential fiduciary liability
- Advice from HR Employee to Co-Worker
 - HR employee's duties do not include providing advice
 - HR employee is not licensed (or required to be licensed) under securities or insurance law
 - No compensation beyond normal pay



Framework of BIC Exemption

Fiduciary Rule and Exemptions

- New “investment advice” definition confers fiduciary status on all types of advisors
- Prohibited transaction rules ban advisors from earning variable compensation (commissions)
- Exemption required for brokers and insurance agents, including advisors to IRAs
- DOL has created Best Interest Class Exemption

Best Interest Contract (BIC) Exemption

- Scope of BIC Exemption
 - Advisor can earn variable compensation (such as commissions) for non-discretionary advice
 - Covered “retail” clients include:
 - Participants
 - IRAs (and HSAs, Archer MSAs and Coverdell)
 - Non-ERISA Plans (e.g., Keogh, Solo Plans)
 - ERISA Plans (with less than \$50 million)
- Observation
 - No relief for variable compensation arising from discretionary advice

Framework of BIC Exemption

- 4 Alternative Versions of BIC
 - “Full Blown” BIC for IRAs and Non-ERISA Plans
 - “Disclosure” BIC for ERISA Plans
 - “Streamlined” BIC for Level Fee Fiduciaries
 - “Transition” BIC for Transition Period (June 9, 2017-January 1, 2018)



Transition BIC and Proposed Extension of Transition Period

Transition BIC: June 9, 2017 - January 1, 2018

- All plan/IRA clients
- Relief from June 9, 2017 to January 1, 2018
 - Impartial Conduct Standards only apply
 - Other BIC requirements are waived for transition period (until Jan. 1, 2018)

Transition BIC: June 9, 2017- January 1, 2018

- Impartial Conduct Standards (ICS) must be satisfied:
 - At time of recommendation, the recommendation is the Best Interest of Client
 - Compensation received cannot exceed reasonable compensation
 - Statements relating to investment decision not materially misleading
- FAB 2017-02 temporary enforcement policy in effect
 - “Working diligently and in good faith”

Recent Events

- August 30th/31st – Official proposal to delay January 1, 2018 applicability date by 18 months, until July 1, 2019.
- August 30th – FAB 2017-03 announces enforcement policy (and IRS will not assess excise tax) if the only failure in the written contract is a waiver or qualification of the retirement investor's right to bring or participate in a class action lawsuit.

DOL Likely to Finalize Proposed Delay

- Any new prohibited transaction exemptions for “clean shares” or seller’s exemption would need time to be implemented
- SEC coordination will take additional time

What if the Transition Period is Extended to July 1, 2019?

Fiduciary Rule applicable on June 9th - Same

Less stringent exemption conditions apply – Same

Impartial Conduct Standard (ICS) must be satisfied - Same

However, FAB 2017-02 temporary enforcement policy has not been extended through July 1, 2019



Full Blown, Disclosure and Streamlined BIC

“Full Blown” BIC: IRAs and Non-ERISA Plans

- Required Terms for Contract
 - Fiduciary standard of care
 - General disclosures for compensation and conflicts
 - Giving specific compensation figures upon request
 - Compliance policies mitigating conflicts
 - Mandatory arbitration with reasonable venue is permitted (but must not limit class action rights)
- Other Requirements
 - Transaction disclosures for each investment
 - Focusing on fiduciary standards and conflicts
 - 1-year relief if advising purchase of same product
 - Webpage focusing on business model and conflicts

“Disclosure” BIC: ERISA Plans

- General
 - Requirements mirror those for “Full Blown” BIC
 - But no written contract is required
 - Must give written statement of fiduciary status and general disclosures on compensation and conflicts
- List of Requirements
 - Written statement and general disclosures
 - Giving specific compensation figures upon request
 - Compliance policies mitigating conflicts
 - Transaction disclosures for each investment
 - Webpage focusing on business model and conflicts

BIC Compliance Policies

- General
 - Required for “Full Blown” BIC for Non-ERISA Plans and IRAs and “Disclosure” BIC for ERISA Plans
 - Differential compensation paid from BD firm to rep must be based on neutral factors tied to services (like time or expertise needed to sell investment)
- Expectations
 - DOL appears to be expecting BD firms to change their payout grid for reps
 - For example, payouts to rep may vary for different investment categories, but not for similar investments in same category (such as VAs)

DOL Notice for BIC Exemption

- Required Notice to DOL
 - Required for “Full Blown” BIC for Non-ERISA Plans and IRAs and “Disclosure” BIC for ERISA Plans
 - One-time notice must be filed with DOL before firm can rely on BIC Exemption
 - Notice does not need to identify plan or IRA client
 - DOL approval is not required

“Streamlined” BIC: Level Fee Fiduciary

- When Does a Level Fee Fiduciary Need BIC?
 - Offering rollover advice to participants when plan sponsor is existing client, resulting in higher fees
 - Offering rollover advice to “off the street” participants
 - Moving from commission- to fee-based services
(e.g., moving from A share with 25 bps to advisory services for 100 bps)
- Streamlined BIC Requirements
 - Advisor gives written statement of fiduciary status
 - Advisor documents (internally) reason for rollover recommendation being in client’s best interest
 - No need for compliance policies or other disclosures

Other PTEs

- PTE 84-24 and Annuity Sales
- PTE 2016-02 (Principal Transactions Exemption)
- PTE 86-128



Outcome of Review of Rule and PTEs

Outcome of Review of Rule and PTEs

Three possible outcomes

- Rescission
- No change
- Continue in effect with modifications

Additional prohibited transaction exemption for “clean shares” may be added as an alternative to the BICE

BICE may be simplified



How Advisers Can Limit Liability Until Full Implementation

Limiting Liability Until Full Implementation

- Identify and code all retirement investors as ERISA Plans, non-Title I Plans, IRAs, etc. This will help the firm to track disclosures, procedures, etc., that apply to each type of retirement investor.
- Make sure written policies and procedures for ERISA and other qualified retirement accounts such as IRAs and similar accounts (*e.g.*, Archer MSAs, HSAs, Coverdell accounts, Keogh plans, and sole proprietor 401(k) plans) incorporate the Impartial Conduct Standards and require compliance with those standards in making recommendations to retirement accounts. Periodic compliance training for advisors may be appropriate. Compliance manuals and written supervisory procedures (as required by FINRA Rule 3120) should be reviewed and updated.
- The Fiduciary Rule became fully applicable on June 9, 2017. If not already done, consider revising agreements to make clear the services for which the firm is and is not acting in a fiduciary capacity. Any registered representatives of broker-dealer firms should be licensed as investment advisor representatives, if not done already.

Limiting Liability Until Full Implementation

- Implement processes and controls for the delivery of non-fiduciary services to ensure that fiduciary advice is not inadvertently provided.
- If not already completed, review compensation structures and revenue streams to identify any potential conflicts.
- Implement steps to review recommendations to retirement accounts and conduct surveillance to ensure compliance with the best interest standard.
- Review advisor compensation for recommendations to retirement accounts to ensure that it is reasonable in the context of your financial institution as a whole.

Limiting Liability Until Full Implementation

- Consider reviewing corporate compensation and individual advisor compensation against market benchmarks to understand where corporate and individual compensation is set compared to the market. Documenting the benchmarking process is important.
- Review use of proprietary products and investments that generate third-party payments in retirement accounts to make sure use of such products is consistent with the best interest standard.
- Review all sales and marketing materials and disclosures with a view to identifying and eliminating any statements that could be viewed as misleading or inadvertently deemed to constitute a fiduciary recommendation.

Limiting Liability Until Full Implementation

- Review disclosures for retirement accounts to ensure that disclosures are accurate and fairly inform retirement investors of direct and indirect compensation received by the firm and its advisors and potential conflicts of interest.
- IRA rollovers are clearly a point of concern for the DOL and, to the extent the firm advises individuals on IRA rollovers, that activity should be treated as a fiduciary activity unless it can be clearly and conclusively established that the firm's role is purely informational.
- Although internal documentation is not a technical requirement at the moment for IRA rollovers (and rollovers of similar accounts such as Archer MSAs, HSAs, etc.) under the BICE's level fee exemption, firms should nevertheless consider maintaining records in support of the rollover decision.

Limiting Liability Until Full Implementation

- Make sure appropriate persons (such as the CCO, General Counsel, or their delegates) are made responsible - and do so by formal, written appointment - for overseeing compliance with the Impartial Conduct Standards.
- Consider reviewing how onboarding of discretionary accounts are handled. Under the fiduciary rule, what was formerly considered to be sales activity could be viewed as an investment recommendation to retain the firm for discretionary services. Use of “BICE for a Day” type language (minus the private right of class action lawsuit) in new or existing agreements could help cure this. Although this is not necessarily a point of emphasis for the DOL, it should not be ignored.
- Review existing fiduciary insurance and E&O policies to ensure persons responsible for compliance with the Impartial Conduct Standards are covered for the discharge of their duties. In addition or alternatively, these individuals may be indemnified by the financial institution.



Impact of Fiduciary Rule on Plan Sponsors

Impact on Plan Sponsors

- New fiduciary relationship requires review of service agreement
- Ongoing monitoring to ensure conditions of the Plan Sponsor Employee exclusion to the Fiduciary Rule are met
- May be asked to represent that plan sponsor is a “sophisticated fiduciary”
- Review 408(b)(2) notices
- Account balances of terminated participants may increasingly remain in the plan

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