

# THE 2016 DOL FIDUCIARY RULE FOR THE INVESTMENT OF RETIREMENT ASSETS: WHAT YOU NEED TO KNOW

## WHAT'S NEXT

ESTATE PLANNING COUNCIL OF CENTRAL TX  
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## **DOL Fiduciary Rule: WHAT YOU NEED TO KNOW**

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- History & Overview
- DOL Rule: Definition of a Fiduciary
- DOL Rule Exemptions:
  - Best Interest Contract (BIC) Exemption
  - Other Exemptions
- Key Dates

## DOL Fiduciary Rule: WHAT'S NEXT

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### ■ CHALLENGES

- Legislation
- Pending Litigation

### ■ IMPACT ON FIRMS AND REPRESENTATIVES

- Investment Advisers
- Broker-Dealers
- Insurance Companies
- Plan Sponsors

## DOL Fiduciary Rule: OVERVIEW & HISTORY

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- WHAT
  - Seven rules and rule amendments promulgated by the U.S. Department of Labor
  - EXTEND THE FIDUCIARY DUTY STANDARD OF CARE that governs institutional retirement fund managers under ERISA
    - to commission-based retail sales by stockbrokers and insurance agents who sell investment products in retirement accounts
      - with transaction-based compensation
      - previously subject only to a suitability standard.
- PURPOSE:
  - CONSUMER PROTECTION
    - eliminate financial harm to consumers that arises from inherent conflicts of interest between customers and retail investment firms and their sales agents regarding recommendations of commission-based products.

# DOL Fiduciary Rule: OVERVIEW & HISTORY

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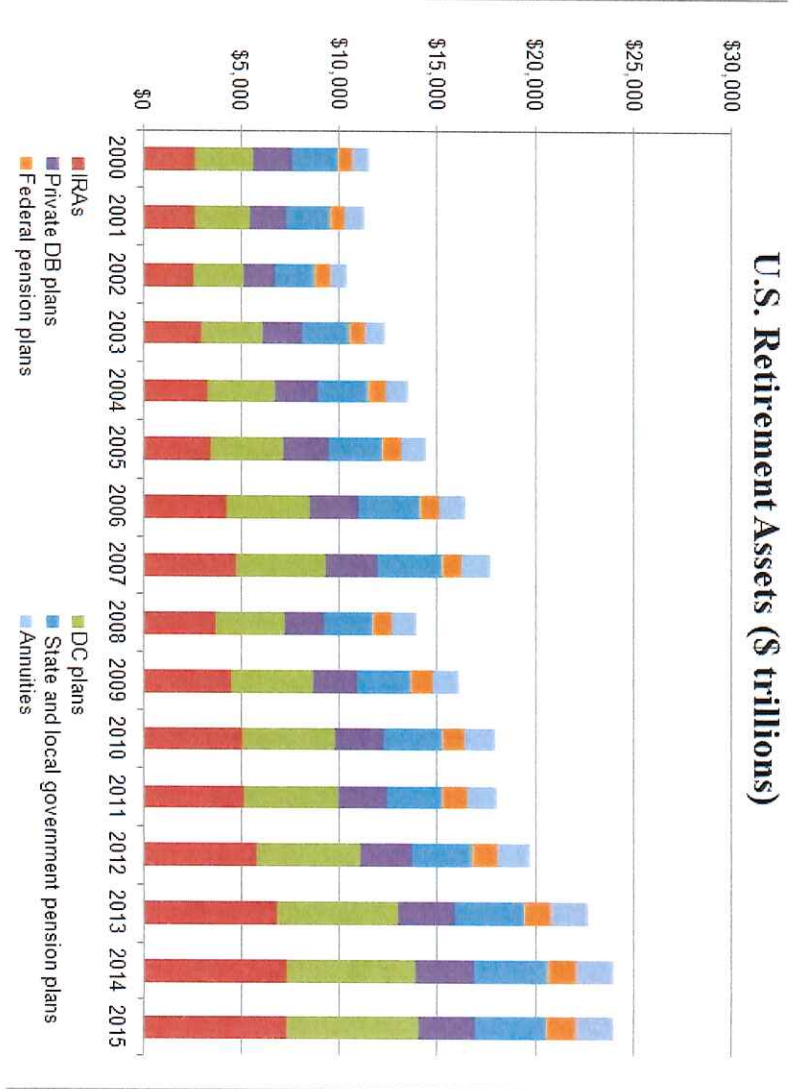
- WHY:
  - (Per DOL)\* Fiduciary duty is in the best interest of retired consumers
    - largely cannot replace losses in asset value.
  - Major shift in retirement assets between 1975 and 2015
    - Decreased options in ERISA defined benefit plans; increased participation in defined contribution plans
    - Growth of retirement plans authorized under the IRS Code – IRAs, 401ks
    - Increase in retirees who self-manage retirement assets in rollover accounts,
      - outside of ERISA fiduciary protections
    - Increase in retail sales influence of commissioned stockbrokers and insurance agents in investment decision-making of retirement assets
  - Applies to an estimated \$20Trillion in assets
- Resulted in major shift in standard of care that applies to the investment of retirement assets
  - From Fiduciary Duty (higher)
  - To Suitability (lower)

# DOL Fiduciary Rule: OVERVIEW & HISTORY

## Retirement Assets

### Potential \$\$ Subject to Suitability Standard

- IRAs
- Defined Contribution Plans (via Rollovers)
- Private Defined Benefit Plans (via Rollovers)



## **DOL Fiduciary Rule: OVERVIEW & HISTORY - TIMELINE**

<b>DATE</b>	<b>ACTION</b>
<b>JULY 2010</b>	Dodd-Frank signed into law; requires SEC to study and report on impact of multiple standards of care in the financial services industry; authorizes SEC to promulgate related rules
<b>OCTOBER 2010</b>	DOL publishes proposed rule applying fiduciary duty to retirement assets
<b>DECEMBER 2010</b>	DOL withdraws notice of proposed rule
<b>JANUARY 2011</b>	SEC Staff issues report recommending adoption of fiduciary duty for all providers of investment advice
<b>MARCH 2012</b>	SEC requests industry reports on existing and proposed industry practices

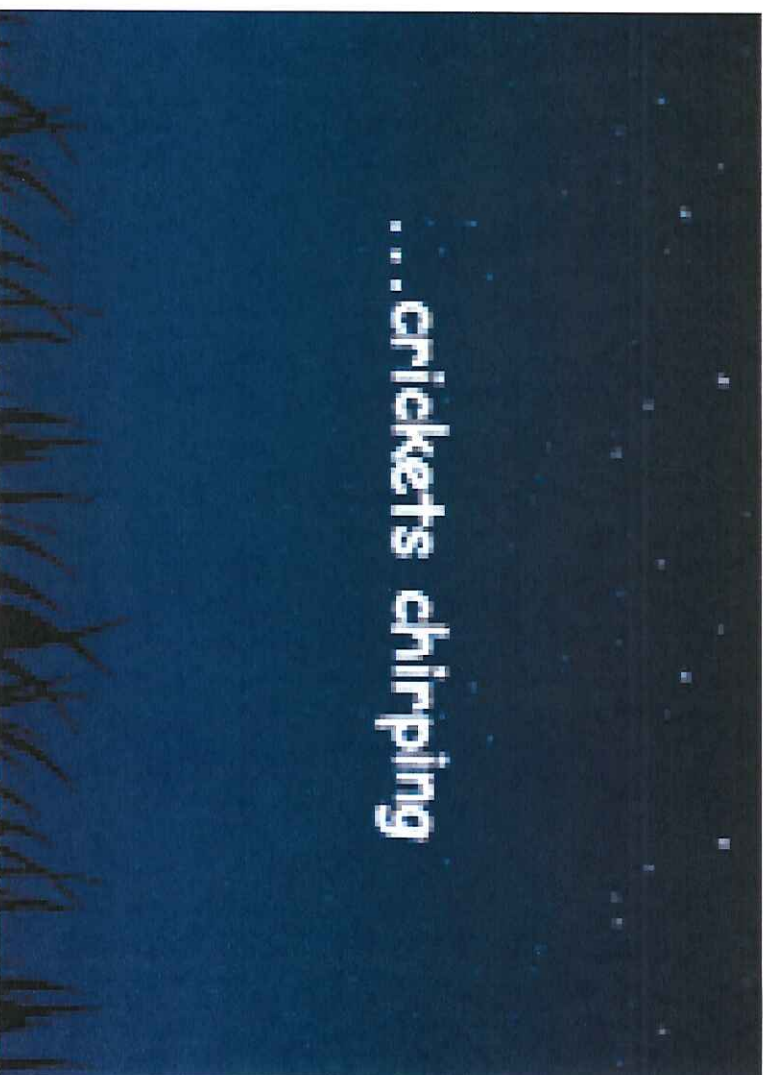


# DOL Fiduciary Rule: OVERVIEW & HISTORY - TIMELINE

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## *SOUNDS OF SILENCE*





# DOL Fiduciary Rule: OVERVIEW & HISTORY - TIMELINE

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## DOL Fiduciary Rule: OVERVIEW & HISTORY - TIMELINE

DATE	ACTION
FEBRUARY 2015	Pres. Obama directs DOL to proceed with rulemaking to apply fiduciary duty to retirement accounts
APRIL 2015	DOL publishes revised proposed rule
APRIL 2016	DOL issues final rule
APRIL – MAY 2016	Congress passes Jt. Resolution to disapprove and nullify DOL rule.
JUNE 2016	Pres. Obama vetoes Jt. Resolution 88, congressional override vote fails
JUNE 2016	Multiple lawsuits filed seeking injunctive relief to prevent implementation of DOL

## **DOL Fiduciary Rule: OVERVIEW & HISTORY**

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- HOW:
  - Fiduciary Conflict of Interest Rule:
    - Expanded definition of “fiduciary” to include retail sales agents, and
    - Expanded application to a broad class of retirement assets under ERISA and the IRS Code, including IRAs, 401Ks, and IRA Rollovers.
  - Exemption - Creation of a contract option, the **Best Interest Contract Exemption (BICE)**,
    - allows commission-based products and revenue sharing, and
    - incorporates a new consumer remedy arising out of a contract cause of action
  - Creation of or amendment to additional exemptions for certain prohibited transactions
    - Includes variable and index insurance products and mutual funds

# DOL Fiduciary Rule: OVERVIEW & HISTORY

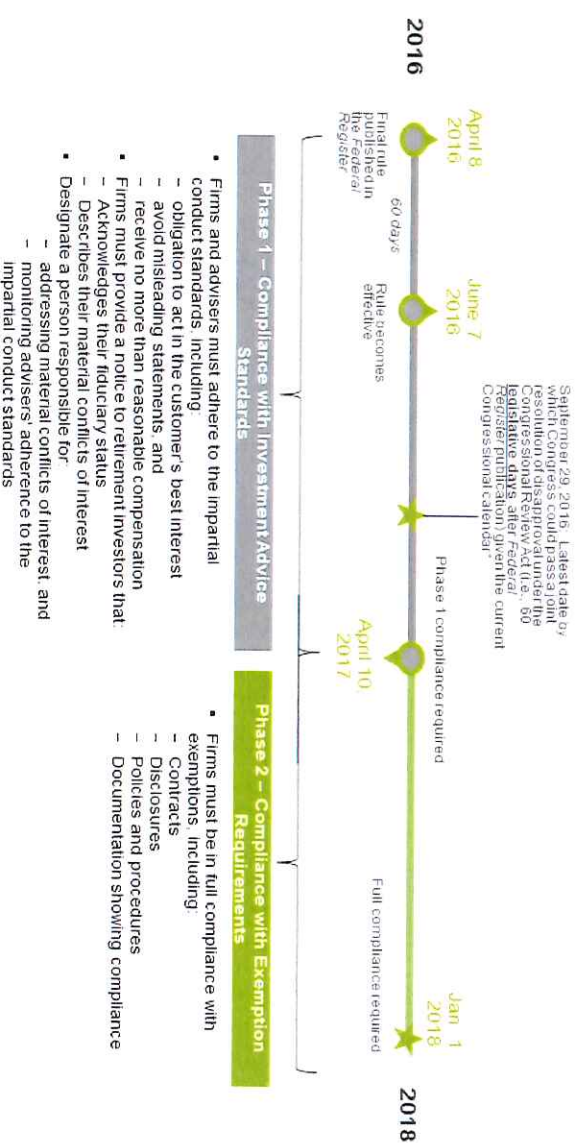
WHEN: April 10, 2017 (basically)

Rule issued and effective June 7, 2016;

Applicability date April 10, 2017, for expansion of fiduciary duty and BICE;

Applicability Jan. 1, 2018 for phase-in of additional exemption requirements

## DOL Conflict of Interest Rule Implementation Timeline



\* The rule remains effective during the Congressional review period

## DOL Rule: Definition of a Fiduciary

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- Fiduciary Conflict of Interest Rule –
  - Expansion of the definition of “fiduciary” and its application

## DOL Rule: Definition of a Fiduciary – STANDARD OF CARE

- Duty of Care and Loyalty
- Fiduciary under ERISA and the Texas Uniform Prudent Investor Act, Tex. Prop. Code §1117 *et seq.*



## DOL Rule: Definition of a Fiduciary – STANDARD OF CARE

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- Sec. 117.004. **STANDARD OF CARE; PORTFOLIO STRATEGY; RISK AND RETURN OBJECTIVES.** (a) A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.
- (b) A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.
- (c) Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:
  - (1) general economic conditions;
  - (2) the possible effect of inflation or deflation;
  - (3) the expected tax consequences of investment decisions or strategies;

## **DOL Rule: Definition of a Fiduciary – STANDARD OF CARE**

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- (4) the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property;
- (5) the expected total return from income and the appreciation of capital;
- (6) other resources of the beneficiaries;
- (7) needs for liquidity, regularity of income, and preservation or appreciation of capital; and
- (8) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.
- (d) A trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets.
- (e) Except as otherwise provided by and subject to this subtitle, a trustee may invest in any kind of property or type of investment consistent with the standards of this chapter.

## DOL Rule: Definition of a Fiduciary – STANDARD OF CARE

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- Contrast with the Suitability Rule of FINRA Rule 2111 or Texas Insurance Code, Tex. Ins. Code §1115 *et seq.*
- A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation.

## **DOL Rule: Definition of a Fiduciary – STANDARD OF CARE**

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### **▪ TEXAS INSURANCE CODE**

▪ Sec. 1115.051. **SUITABILITY OF ANNUITY PRODUCT REQUIRED.** (a) In recommending to a consumer the purchase of an annuity or the exchange of an annuity that results in another insurance transaction or series of insurance transactions, the agent, or the insurer if an agent is not involved, **must have a reasonable basis to believe that:**

▪ (1) the recommendation is **suitable** for the consumer on the basis of the **facts disclosed by the consumer** as to the consumer's investments and other insurance products and as to the consumer's financial situation and needs, including the consumer's suitability information;

▪ (A) age; (B) annual income; (C) financial situation and needs, including the financial resources used for the funding of the annuity; (D) financial experience; (E) financial objectives; (F) intended use of the annuity; (G) financial time horizon; (H) existing assets, including investment and life insurance holdings; (I) liquidity needs; (J) liquid net worth; (K) risk tolerance; and (L) tax status.

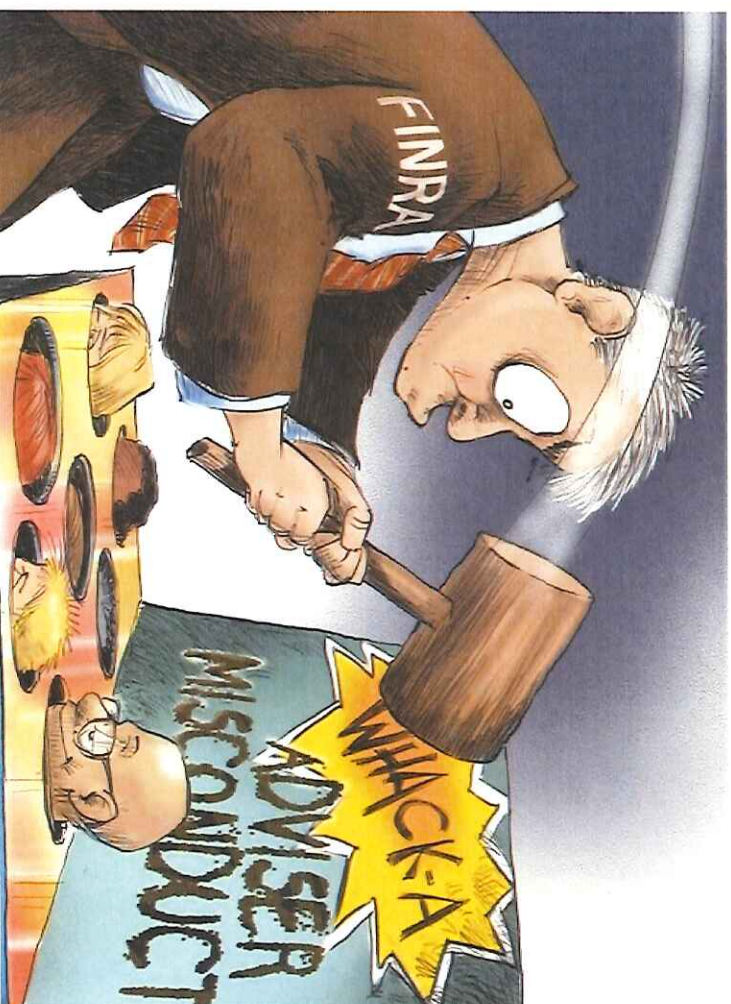
## **DOL Rule: Definition of a Fiduciary – STANDARD OF CARE**

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- (2) the consumer has been reasonably informed of various features of the annuity, such as the potential surrender period and the surrender charge, any potential tax penalty if the consumer sells, exchanges, surrenders, or annuitizes the annuity, mortality and expense fees, investment advisory fees, potential charges for and features of riders, limitations on interest returns, insurance and investment components, and market risk;
- (3) the consumer would benefit from certain features of the annuity, such as tax-deferred growth, annuitization, or a death or living benefit;
- (4) the particular annuity as a whole, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the annuity, and any riders or similar product enhancements are suitable, and, in the case of an exchange or replacement, the transaction as a whole is suitable, for the particular consumer based on the consumer's suitability information;

## DOL Fiduciary Rule: OVERVIEW & HISTORY

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## DOL Rule: Definition of a Fiduciary

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- A PERSON IS A FIDUCIARY IF, FOR A FEE:
  - renders investment advice
    - A recommendation as to the advisability of acquiring, holding, disposing of, or exchanging, securities or other investment property, or a recommendation as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred or distributed from the plan or IRA; and

## DOL Rule: Definition of a Fiduciary

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- A recommendation as to the management of securities or other investment property, including, among other things, recommendations on
  - investment policies or strategies,
  - portfolio composition,
  - selection of other persons to provide investment advice or investment management services,
- types of investment account arrangements (brokerage versus advisory), **OR**
- recommendations with respect to rollovers, transfers or distributions from a plan or IRA, including whether,
  - in what amount,
  - in what form, and
- to what destination such a rollover, transfer or distribution should be made

## DOL Rule: Definition of a Fiduciary

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- renders investment advice
  - to a plan, a plan fiduciary, plan participant or beneficiary, IRA or IRA owner
  - for a fee or other compensation, whether direct or indirect
  - regarding retirement assets
    - applies to ERISA plans, and
    - expansion to retirement accounts under the IRS Code, including §223(d)
  - IRAs, Keoughs, Health Savings Plans, etc.

## DOL Rule: Definition of a Fiduciary

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NOT A “RECOMMENDATION” (AND, THUS, NOT FIDUCIARY ADVICE)

- Platform Marketing:
  - Marketing and making available investment platforms to plans without regard to individualized plan/participant needs, with appropriate disclosures; not available in the IRA market.
- Selection and Monitoring Assistance:
  - Identifying options meeting the plan fiduciary’s specifications in connection with developing an investment platform, or responding to a plan RFP on a limited basis with respect to investments available on a platform, with appropriate disclosures; not available in the IRA market.
- General Marketing Communications:
  - Furnishing information (to a plan or IRA owner) that a reasonable person would not view as an investment recommendation (i.e., general circulation newsletters, broadcast commentary, widely attended speeches, general marketing data performance reports, etc.).
- Providing Investment Education:
  - Making investment-related education available to a plan, plan fiduciary, participant, beneficiary, or IRA owner if the information does not include specific “investment recommendations except as discussed below under “Investment Education vs. Fiduciary Advice.”

## DOL Rule Exemptions

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- Exemptions
  - Under the rule, advisors who provide fiduciary investment advice to plan sponsors, plan participants and IRA owners are not permitted to receive payments creating conflicts of interest without a specific prohibited transaction exemption

## DOL Rule Exemptions

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- **BICE – Best Interest Contract Exemption**
  - Standard: the Adviser and the Financial Institution must give prudent advice that is in the customer's best interest, avoid misleading statements, and receive no more than reasonable compensation;
  - The exemption attempts to balance the preservation of existing products and delivery models, i.e., commission-based sales (certain types of fees and compensation common in the retail market, such as brokerage or insurance commissions, 12b-1 fees and revenue sharing payments) with protecting consumers;



## DOL Rule Exemptions

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- Requires all vendors to acknowledge fiduciary duty in writing;
  - Regarding non-ERISA and IRA accounts, requires vendors to enter into a written contract with consumers to act in the consumer's "best interest" and to disclose conflicts of interest, including all compensation;
  - "Level Fee" Fiduciaries that, with their Affiliates, receive only a Level Fee in connection with advisory or investment management services, do not have to enter into a contract with Retirement Investors, but they must provide a written statement of fiduciary status, adhere to standards of fiduciary conduct, and prepare a written documentation of the reasons for the recommendation;

## DOL Rule Exemptions

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- Requires vendors to take certain steps to minimize the impact of conflicts of interest;
- Financial Institutions must adopt policies and procedures reasonably designed to mitigate any harmful impact of conflicts of interest; and
- disclose basic information about their conflicts of interest and the cost of their advice.

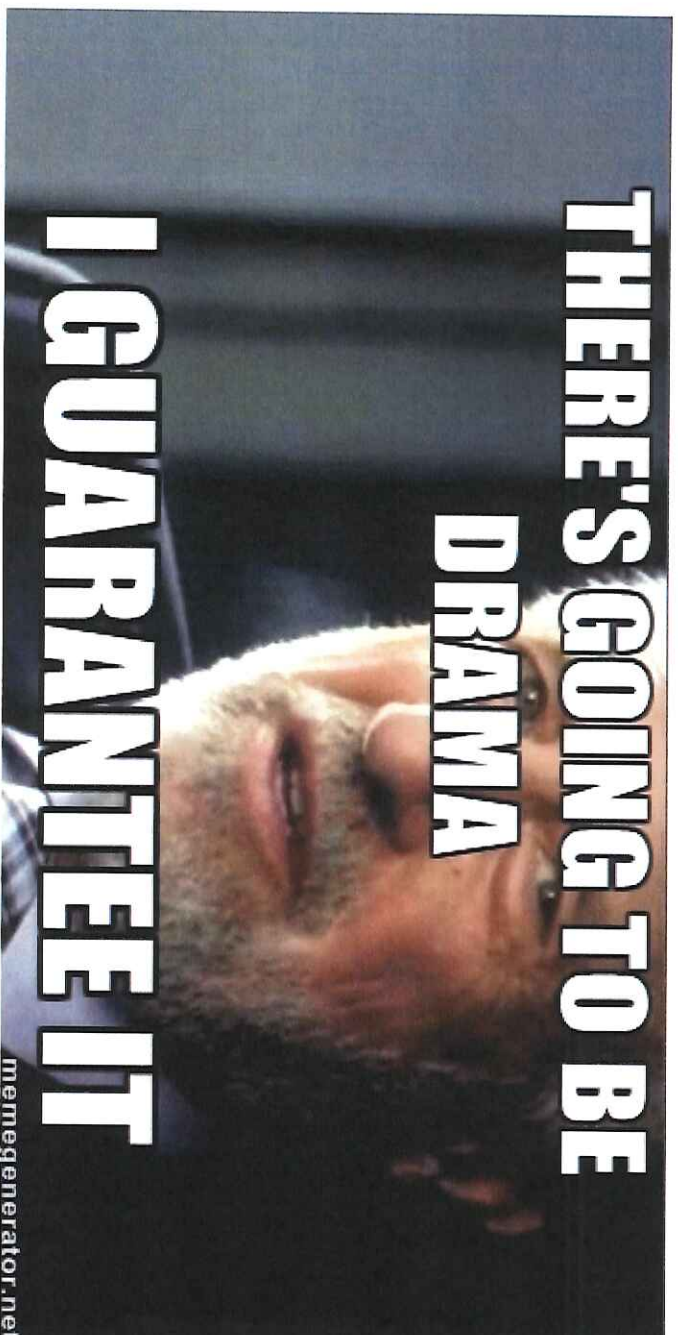
## DOL Rule Exemptions

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- Other exemptions
  - Allows principal trades on long inventory;
  - Compensation allowed for extension of credit to facilitate settlement of trades involving debits;
  - Insurance products;
    - Preserves prohibited transaction exemption (PTE) for fixed rate annuities;
    - **Revokes PTE for variable and index annuities and applies the BICE requirements;**
  - Agency cross transactions and mutual funds;
    - Revokes prior PTE and applies the BICE requirements.

## DOL Rule Challenges

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## DOL Rule Challenges

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### CHALLENGES

- Legislation
  - House Jt Resolution 88 – passed, vetoed, Congress failed to overturn veto
- Pending Litigation
  - Common arguments:
    - DOL exceeded authority;
    - DOL rule will result in:
      - individuals could lose access to trusted financial advisors;
      - rule will raise the cost of receiving advice, and
      - fewer small business offering retirement plans.

## DOL Rule Challenges

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### PENDING LITIGATION

- Consolidated Case: *Chamber of Commerce v. Perez*, No. 3:16-01476-M (June 1, 2016); *Am. Council of Life Insurers v. Dep't of Labor*, No. 3:16-01530-C (June 8, 2016); *Indexed Annuity Leadership Council v. Perez*, No. 3:16-1537-N (June 8, 2016);
  - Motion for Summary Judgment, hearing set Nov. 17, 2016;
- *Market Synergy Group, Inc. v. U.S. Dep't of Labor*, No. 5:16-4083 (D. Kan. Jun. 8, 2016);
  - Plaintiff's Motion for Preliminary Injunction; hearing held Sept. 21, 2016;
- *Nat'l Ass'n for Fixed Annuities v. Perez*, No. 1:16-1035 (D.D.C. Jun. 2, 2016)
  - Hearing held Aug. 25, 2016 on NAFA's motion for a preliminary injunction and for summary judgment, as well as the DOL's cross-motion for summary judgment; motions pending.



## DOL Rule IMPACT ON FIRMS AND REPRESENTATIVES

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- Registered Investment Advisers
  - subject to requirements regarding advice relating to whether to make a rollover or take a distribution; and
  - level fee requirements will apply;
    - must provide a written statement of fiduciary status,
    - adhere to standards of fiduciary conduct, and
    - prepare a written documentation of the reasons for the recommendation.

## **DOL Rule IMPACT ON FIRMS AND REPRESENTATIVES**

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- **Broker-Dealers (and Representatives)**
  - Adhere to fiduciary standards
  - Notify customers of fiduciary status
  - Develop Policies, Procedures & Training for supervisory and producer functions
    - Standards and disclosure requirements
    - Documentation requirements
  - Analysis of conflicted transactions

## DOL Rule IMPACT ON FIRMS AND REPRESENTATIVES

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- **Broker-Dealers (and Representatives) *cont.***
  - Evaluate products for compliance with DOL Rule or BIC exemption and take appropriate action regarding products that do not comply
    - Eliminate non-complying products;
      - For example, Merrill Lynch has announced it will no longer open commission-based IRA accounts, will open only fee-based accounts (either current wrap or robo accounts), will require conversion of current accounts unless accounts continue on an unsolicited order basis only;
  - Allianz and a few other insurance companies have announced that they will develop a fee-based annuity, details to come

## DOL Rule IMPACT ON FIRMS AND REPRESENTATIVES

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### ■ Broker-Dealers (and Representatives) *cont.*

- Products involving transaction-compensation that give rise to conflict of interest:
  - Must operate pursuant to BIC requirements
    - Requires detailed analysis and disclosure regarding amount and basis (justification) of fees and conflicts;
  - Increased cost of doing business
    - Firms will have to engage in a cost/benefit analysis of non-exempt transactions
      - Ultimate standards likely to develop through litigation
    - High commissions on certain products likely will not survive
      - VAs, index-annuities, load mutual funds, private placements, limited partnerships

## DOL Rule IMPACT ON FIRMS AND REPRESENTATIVES

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- Broker-Dealers (and Representatives) *cont.*
  - “Advice” regarding rollovers will be formalized
    - Standards for educational materials and sales seminars/lunches will be enhanced to eliminate biased views, or
  - Sales pressure will be deferred to follow-up meetings

## **DOL Rule IMPACT ON FIRMS AND REPRESENTATIVES**

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- Insurance Companies (& Agents)
  - Index Annuities will be subject to fiduciary rule or BIC exemption
  - Advice to rollover retirement funds now subject to fiduciary rule
  - Distribution advice, including whether to annuitize, subject to fiduciary rule
  - Variable Annuities subject to same requirements as Broker-Dealers, as now

## **DOL Rule IMPACT ON FIRMS AND REPRESENTATIVES**

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### **■ Plan Sponsors**

- Confirm non-fiduciary status of employees
  - Corporate treasury, investment, or human resources staff
    - No compensation, including bonus
- Review “Investment Education” materials
  - modify if necessary to avoid recommendations
  - fill in blanks in investment education information
  - draft procedure for content and monitoring of staff and plan service providers regarding interactions with plan participants

## DOL Rule IMPACT ON FIRMS AND REPRESENTATIVES

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### Plan Sponsors, *cont.*

- Review and validate conduct of plan service providers who provide or implement rollover, distribution, or investment advice
  - Compliance with fiduciary duty or best interest exemption
  - Develop procedures for creation, receipt, and maintenance of enhanced disclosure and documentation requirements



## DOL Fiduciary Rule UPDATES

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- Updates
  - Pending Litigation
  - Firm Responses
  - Consumer Demand
  - SEC Rulemaking

## DOL Fiduciary Rule

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