THE DOL FIDUCIARY REDEFINITION – HOW SHOULD YOUR FIRM PREPARE?

**Moderator:** David Porteous, Faegre Baker, Daniels

**Panelists:**
- Mark Smith, Sutherland, Asbill & Brennan
- Jeff Walter, Chief Compliance Officer, US Bancorp
- John Robbins, Chief Compliance Officer, M&T Bank
Key Considerations

- There is a race for consultants--get yours early!
- Evaluate points where you are communicating with customers (call centers, email communication) to make sure you're not tripping advice
- Emphasize that Advisors need to create a "value" statement....value will be the key to successfully transitioning
- Moving accounts to IA (human or robo) on a wholesale basis is not the answer--may trigger scrutiny by SEC for reverse churning
- May need to consider self-directed channel (if not already in place)--and focus on education.
- If you use BIC, may want to consider "limiting" your product set in order to ease administration
- If adopted as presently proposed, DOL investigations would likely focus on “prohibited transactions”
“Investment Advice Fiduciaries” – expand universe of Section 3(21) advice fiduciaries by eliminating the regular basis and mutual understanding requirements (two part test)

• The person makes a “recommendation” for a fee or other compensation, whether direct or indirect, as to
  > Advisability of acquiring, holding, disposing of or exchanging securities or other property, including a recommendation to take a distribution or to take a rollover from the plan to an IRA or a recommendation regarding investments to be made with rollover monies or
  > Management of plan assets, including assets to be rolled into an IRA

• The person acknowledges its fiduciary status OR renders advice under a written or verbal agreement, or understanding that the advice is individualized to or specifically directed to, the advice recipient for consideration in making investment decisions
CORE PROHIBITIONS

■ ERISA prohibits fiduciary advisers from receiving compensation that varies based on their investment recommendations made and from receiving compensation from third parties in connection with a recommendation, other forms of self-dealing.
  • Will prohibit advisor from recommending IRA assets be invested in commission-based products that pay the advisor a trailing fee or other commission
  • Will prohibit providing non-discretionary advice or brokerage recommendations to an IRA owner (unless PTE)

■ BUT – self-directed brokerage accounts where the broker does not provide a “recommendation” would not be covered by the Proposed Rule
  • Although almost any interaction by a BD to assist a self-directed account could be considered fiduciary advice under Proposal (limit to education)

■ Carve-Outs – Fiduciary Status Avoided
  • Seller’s Carve-Out – transactions with large ERISA plans (>=$100M)
  • Investment Education Carve-Out – providing information and materials in connection with IRA, but no reference to specific products

■ “Best Interest Contract” Exemption from prohibitions

■ PTE 84-24
Next Steps for DOL?
Timing and Finalization

- 750 days
- 385 days

- Publish Final
- Back to OMB
- Prepare Final
- Addtl Comments
- Hearing
- Comment Period
- Publish Proposal
- OMB

Conventional vs. Accelerated
Next Steps for Industry?

January
- Final rule to OMB
  - OMB approves
  - DOL publishes

Feb to March
- Lawsuits filed?
- Implementation begins

April to Dec
- Phased compliance?

Change Management

<table>
<thead>
<tr>
<th>Key Aspect</th>
<th>Modification?</th>
<th>Change Management</th>
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</thead>
<tbody>
<tr>
<td>Plans covered</td>
<td>Unlikely</td>
<td>Start</td>
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<tr>
<td>Recommendations in scope</td>
<td>Unlikely</td>
<td>Awareness</td>
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<tr>
<td>Education carveout</td>
<td>Possible</td>
<td>Hurdle 1</td>
</tr>
<tr>
<td>BICE terms</td>
<td>Possible</td>
<td>Strategic analysis</td>
</tr>
<tr>
<td>Private claims</td>
<td>Unlikely</td>
<td>Hurdle 2</td>
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<tr>
<td>Grandfathering</td>
<td>Possible</td>
<td>Active planning</td>
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<td></td>
<td></td>
<td>Hurdle 3</td>
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<td></td>
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<td>Blueprints/workplans</td>
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<tr>
<td></td>
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<td>Hurdle 4</td>
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<td></td>
<td></td>
<td>Initiate execution</td>
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<td></td>
<td></td>
<td>Hurdle 5</td>
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<tr>
<td></td>
<td></td>
<td>Strategic differentiation</td>
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Source: Sutherland Asbill & Brennan
## Five Step Process

**OR**

### Denial
- Anger
- Bargaining
- Depression
- Acceptance

### Change Management

<table>
<thead>
<tr>
<th>Start</th>
<th>Awareness</th>
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<tr>
<td>Hurdle 1</td>
<td>Strategic analysis</td>
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<tr>
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<td>Active planning</td>
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Consider educating those in a position to make decisions on the status of the rule and the need to move quickly once the final rule is issued, mostly likely in late March/early April, and the eight month effective date for some or all of the rule requirements.

Consider establishing working group(s) to review current business models and products, determine next steps, time to complete identified tasks and who will be responsible for performing them, etc. Identify bank sweeps, money market funds, householding relationship pricing, etc.

Consider identifying which exemption(s) your business currently utilizes and analyze whether you will be able to continue to rely on it, and, if not, what business/operational changes will be required (analysis may be similar to the analysis firms conducted with regard to 408(b)(2)).

Consider cataloging the contracts, disclosures and similar documents currently provided or associated with retirement plans and IRAs; identify those that will require changes, who will be responsible for making changes and signing off on final documents, etc.

Consider cataloging all training materials so they can be reviewed and modified to reflect final rule and exemptions; determine if new training materials will need to be created; determine who will be required to receive training once the final rule is issued.

Consider cataloging all policies and procedures, surveillance and other compliance-related processes and procedures to identify which will need to be modified, established, etc. when the final rule is issued.

Consider identifying and analyzing existing compensation schedules, agreements, etc.; review for conflicts and changes that may be required under the final rule (i.e., level compensation for FAs), including agreements with outside providers (i.e., mutual fund complexes, recordkeepers, turnkey providers, annuity providers, etc.).

Consider what the business model will be if the final rule is substantially the same as the proposal and, where applicable, determine what can be done now to move to the desired business model (e.g., identify those clients that will be encouraged to move to a managed account, determine what client communications will need to be drafted and their context; if exiting the business, what steps need to be completed to resign and move accounts to a successor; etc.).

Consider creating a decision grid/project plan for each of the foregoing, including who will be responsible for final approval/signoff and the time it will take to complete.
SIFMA RECOMMENDATIONS: OPTIONS FOR BIC EXEMPTION

- Comply with the BIC Exemption entirely (all products and services offered to clients will comply with the BIC exemption, including the website, disclosures, and other requirements).
- Comply with the BIC Exemption for a subset of clients and/or limited product/service offering (e.g., limited product offering; limit clients to those with a minimum account/asset size; etc.).
- Avoid the BIC Exemption by limiting product offering to managed accounts and/or self-directed accounts only; encourage existing clients to move to a managed account where suitable.
- Avoid the BIC Exemption by ending all practices that could trigger required compliance with it (e.g., limit services to self-directed, education-only, and/or managed accounts).
- Adopt some combination of the above based on target market/business model.
Are you a "fiduciary" under the revised DOL definition? If yes, you will need to consider the following options:

Eligible for a carve-out?
Proceed with changes required by amended PTE(s).

If ineligible for a carve-out, consider the following options:

Comply with the BIC Exemption

- Entirely
  - Determine how you will provide level compensation to advisors; identify payout schedules
  - Determine how to capture and provide pre-trade disclosures
  - Determine how to block non-permissible assets and what to do with those

- Only for a subset of clients
  - Identify which clients will be served under the BIC exemption and those that will not
  - Determine how you will bifurcate accounts, systems, training, websites, etc.
  - Determine compliance procedures and policies; training needs

Avoid the BIC Exemption

- Encourage all eligible clients to move to managed accounts or self-directed
  - Determine which clients will be managed only and how and when to move existing clients
  - Draft client communications

- End all practices that could trigger BIC liability.
  - Option: Exit the business entirely - determine how to accomplish and when
  - Option: Product re-design
  - Option: Move clients to self-directed or education only
BIC Exemption - a proposed prohibited transaction exemption that will:
- Permit advisers (which can include insurance agents)
- To receive commissions and other fees
- As a result of investment advice provided to “Retirement Investors”

Retirement Investor – includes retail investors for which a seller’s carve out from fiduciary status would not be available to the financial institution or its agents - i.e.,
- Plan sponsors of plans with less than 100 participants
- Individual plan participants and beneficiaries
- IRA owners
BEST INTEREST CONTRACT
OR “BIC” EXEMPTION - APPLICABILITY

- Available in connection with the purchase, sale, or holding of an asset (including insurance and annuity contracts)
- Not available for transactions in:
  - Variable annuities
  - Annuities that are securities under federal securities law
Execution of Best Interest Contract

- Required Parties – Retirement Investor, Adviser, and Financial Institution
- Adviser and Financial Institution must contractually agree to comply with a fiduciary standard of conduct
- Precludes exculpatory provisions limiting an Adviser’s or Financial Institution’s liability, or waivers of Retirement Investor’s right to bring or participate in class actions

Contract must identify and disclose:

- Material conflicts
- Right to obtain info about fees
- Whether firm has proprietary products or receives 3rd party payments for any investments
- Give address of public firm website that discloses compensation arrangements

Prohibited contract terms:

- Exculpatory provisions, waives right to class action or other action in court re dispute
Adviser and Financial Institution must in the BIC contract:
- Acknowledge their fiduciary status
- Commit to act in the Best Interests of the Retirement Investor

**Best Interest Standard** – Adviser and Financial Institution must provide investment advice that:
- Reflects the care, skill, prudence and diligence under the circumstances then prevailing that
- Prudent person would exercise
- Based on the investment objectives, risk tolerance, financial circumstances and needs of the Retirement Investor
- Without regard to the financial or other interests of any other person
Financial Institution and Adviser must warrant that the Financial Institution has:

- Specifically identified material conflicts of interests
- Adopted written policies and procedures designed to mitigate and to ensure adherence to the impartial conduct standard

Must also warrant that neither the Financial Institution nor any affiliate will use:

- Quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives
- To the extent they would tend to encourage individual Advisers to make recommendations that are not in the Best Interest of the Retirement Investor
■ Point of Sale Disclosures (see DOL model chart)
  • Total cost of recommended investments to investor for 1-5-10 year periods (expressed as dollar amount)

■ Annual Written Disclosure
  • List of each investment purchased or sold and price
  • total $ amt of all fees and expenses paid by plan, participant or IRA for each investment bought or sold
  • total $ amt of all comp rec'd by FA and firm

■ Public Website (see DOL example)
  • direct and indirect comp payable to FA, firm and affiliate for each investment available for purchase
  • the source of the comp. and its variation among the investments

■ Further disclosures if firm limits investment options
  • Firm makes written finding that the limit does not prevent FA from providing best interest advice, comp. received is reasonable, notify investor about the limitations and if the limitation does not meet the needs, notify investor. No data needed

■ EBSA notice to DOL - Firm to notify DOL using BIC prior to receiving compensation. One time. No data needed
If DOL requests, must produce w/in 6 mos., the following for previous 6 years:

For each investment, by Qtr.:
1. aggregate shares/units bought, aggregate purchase price and investor cost, revenue rec'd by firm and affiliates and identity of each revenue source
2. same info for sales
3. same info for holdings

At the investor level
1. ID the advisor
2. quarterly return info for the investors portfolio
3. external cash flows in and out of portfolio by date

Recordkeeping - Records necessary to determine if BIC was met -- ie, the above data elements

• Maintain for 6 yrs for exam records to DOL, IRS, Plan fiduciary, ER, Participant
### Appendix II Financial Institution XZY - Transaction Disclosure Model Chart

<table>
<thead>
<tr>
<th>YOUR INVESTMENT</th>
<th>TOTAL COST OF YOUR INVESTMENT IF HELD FOR:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1 year</td>
</tr>
<tr>
<td>Asset 1</td>
<td></td>
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<tr>
<td>Asset 2</td>
<td></td>
</tr>
<tr>
<td>Asset 3</td>
<td></td>
</tr>
<tr>
<td>Account fees</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
</tr>
</tbody>
</table>
### Appendix I Financial Institution ABC - Website Disclosure Model Form

<table>
<thead>
<tr>
<th>Type of Investment</th>
<th>Provider, Name, sub-type</th>
<th>Transactional</th>
<th>Ongoing</th>
<th>Affiliate</th>
<th>Special Rules</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Proprietary Mutual Fund (Load Fund)</td>
<td>XYZ MF Large Cap Fund, Class A Class B Class C</td>
<td>[ • ]% sales load as applicable</td>
<td>[ • ]% dealer concession</td>
<td>[ • ]% of transactional fee Extent considered in annual bonus</td>
<td>[ • ]% of ongoing fees Extent considered in annual bonus</td>
</tr>
<tr>
<td>Proprietary Mutual Fund (No load)</td>
<td>ABC MF Large Cap Fund</td>
<td>No upfront charge</td>
<td>N/A</td>
<td>[ • ]% expense ratio</td>
<td>[ • ]% asset-based annual fee for shareholder servicing (paid by fund/affiliate)</td>
</tr>
<tr>
<td>Equities, ETFs, Fixed Income</td>
<td>S[ ■ ] commission per transaction</td>
<td>S[ ■ ] commission per transaction</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Annuities (Fixed and Variable)</td>
<td>Insurance Company A</td>
<td>No upfront charge on amount invested</td>
<td>S[ ■ ] commission (paid by insurer)</td>
<td>[ • ]% of commission Extent considered in annual bonus</td>
<td>[ • ]% M&amp;E fee [ • ]% underlying expense ratio</td>
</tr>
</tbody>
</table>