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COMPLIANCE & ETHICS FORUM FOR LIFE INSURERS

A Basic Overview of the DOL Fiduciary Rule

*CEFLI DOL Fiduciary Rule
Summit Meeting*

May 10-11, 2016

Shifting Fiduciary Standards

A Basic Overview of the DOL Fiduciary Rule

May 10, 2016

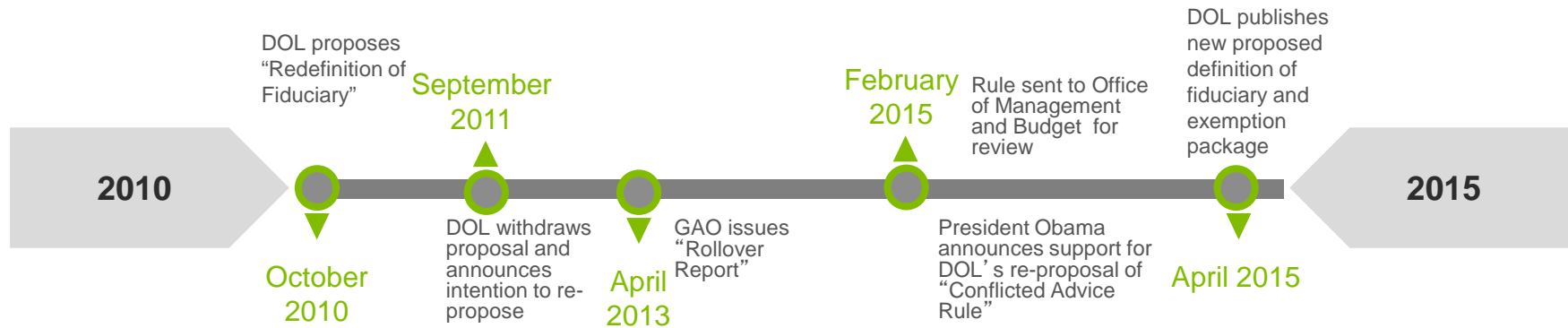


Discussion Topics

- 1 How did the financial industry get here
- 2 Compliance timeline
- 3 Business impact
- 4 Operating under the Rule
- 5 Fiduciary definitions and Prohibited Transaction Exemptions
- 6 Advice standards, oversight features, and disclosure requirements
- 7 Governance, Supervisory, and Compliance Program Considerations

How did the financial industry get here

On April 20, 2015, the Department of Labor (“DOL”) released a proposal to re-define the applicability of the fiduciary standard and withdrew its October 22, 2010 published proposed rule



Post Proposal Activities

July 20, 2015: Public comment period closed

August 2015: Public hearings

August 2015 – September 2015: Second comment period and DOL engagement with industry

October 2015 – January 2016: DOL analysis of comment letters

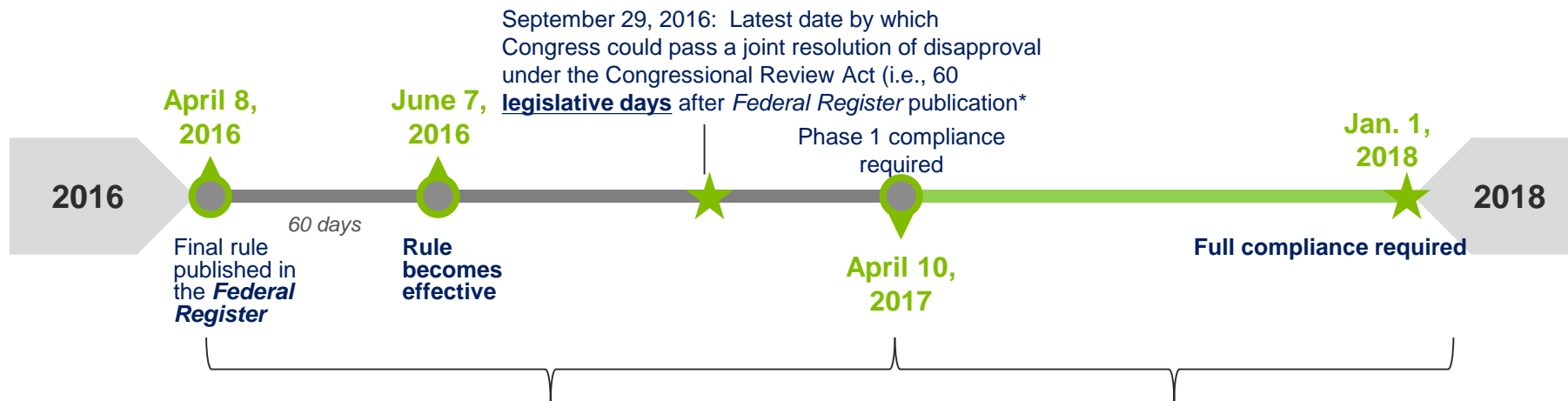
January 28, 2016 – DOL sends final rule to Office of Management and Budget (“OMB”) for review

February 2016 – April 2016: OMB and DOL conducted joint meetings with industry participants

April 8, 2016 – Final rule released

Compliance timeline

The final rule's compliance timeline will be phased in over the next 20 months, with substantial compliance requirements by **April 10, 2017** and remaining requirements by **January 1, 2018**



1 Compliance with Investment Advice Standards and Certain Exemption Requirements

- Adhere to the impartial conduct standards, including:
 - obligation to act in the customer's best interest
 - avoid misleading statements, and
 - receive no more than reasonable compensation
- Provide a notice to retirement investors that:
 - Acknowledges their fiduciary status
 - Describes their material conflicts of interest
- Designate a person responsible for:
 - addressing material conflicts of interest, and
 - monitoring advisers' adherence to the impartial conduct standards
- Maintain records that demonstrate that the conditions of an exemption have been satisfied

2 Compliance with Additional Exemption Requirements

- Firms must be in full compliance with exemptions, including:
 - Contracts
 - Warranties
 - Policies and procedures
 - Disclosures

* The rule remains effective during the Congressional review period

Overview of the rule

The Rule will have a substantial business impact for retirement financial service providers



Compliance by
4/10/17

Greatly expands definition of who is a fiduciary

- Investment advice given to qualified retirement investors required to be under a "fiduciary" standard
- Many interactions between investment professionals, plans, IRAs and their representatives are considered advice



Compliance by
4/10/17

Prohibits conflicts of interest unless an exemption is used

- "Conflicted revenue streams" that are prohibited include, but are not limited to:
 - Revenue resulting from rollovers
 - Commissions
 - 12b-1 fees
 - Revenue sharing



Phase 1 Compliance
by 4/10/17

Phase 2 Compliance
by 1/1/18

Provides exemptions to allow for common compensation and revenue streams

- Exemptions have extensive requirements to comply with:
 - Contracts
 - Advice standards
 - Oversight
 - Disclosures
 - Recordkeeping
- Exemptions include:
 - Best Interest Contract ("BIC") Exemption
 - Principal Transaction Exemption
 - PTE 84-24 for fixed rate annuities

Scope of Applicability

What:

Investment advice provided to retirement investors, which include:

- IRAs and IRA owners
- Employee benefit plans
- Plan fiduciaries
- Plan participants or beneficiaries

Who:

Individuals, and their employing firms, who provide investment advice to retirement investors, including:

- Broker-dealers
- Registered Investment Advisers
- Banks or similar financial institutions
- Insurance companies

Overview of “Fiduciary” definitions

1

Investment Advice

- Provided to a plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner and
- Provided in exchange for a fee or other compensation, direct or indirect and
- Recommends the purchase, sale or holding of securities or investment property, or
- Recommends 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; or
- Recommends investment policies, portfolio strategies, advisor selection, account arrangements, rollovers, transfers or distributions from a plan or IRA

2

Definition of Recommendation

- Communication that would reasonably be viewed as a suggestion to engage in or refrain from taking a particular course of action
- More tailored and selective communications, more likely to be a recommendation
- Providing a selective list of securities to a particular advice recipient would be a recommendation even if no recommendation is made with respect to any one security
- Series of communications, in the aggregate, even if individually they would not be a recommendation
- Makes not difference if initiated by a person or a computer software program

3

Recommendation Exclusions

- Certain communications can be exempted from the definition of a recommendation, including:
 - General communications
 - Investment Education materials
 - General information that doesn't address specific investment products, specific plan or IRA investment alternatives or distribution options
 - Asset allocation models of hypothetical individuals with different time horizons and risk profiles
 - Certain interactive investment materials

Overview of “Fiduciary” definitions

4

Fiduciary Exclusions

- **Certain persons or activities may be exempted from the definition of a fiduciary:**
 - **Transactions with independent fiduciaries with financial expertise**
 - **Swap dealers engaging in swap transactions with an employee benefit plan**
 - **Plan employees providing advice in their capacity as an employee**
 - **Financial Institution providing only execution services to a plan or retirement investor**

5

Limited Fiduciary

- **Fiduciary responsibility may be limited:**
 - **To the portion of plan assets to which investment advice is provided**
 - **To the portion of plan assets over which discretionary authority is held**

Overview of the common Prohibited Transaction Exemptions

Focus on BIC Exemption, PrTE and PTE 84-24

	Best Interest Contract Exemption	Principal Transaction Exemption	PTE 84-24
What it does	<u>Where applicable</u> , allows for fiduciaries to receive otherwise prohibited compensation in relation to investment advice to retirement investors		
Where it may be applied	All asset classes	<ul style="list-style-type: none"> • <u>Principal or riskless principal transactions</u> with retirement investors • Purchase recommendations for the following asset types: <ul style="list-style-type: none"> • CDs; UITs • Debt Securities: Corporates; Agencies; Treasuries; Asset-backed GSEs • Sell recommendations for any asset type 	<ul style="list-style-type: none"> • Fixed-rate annuities • Insurance contracts • Certain mutual fund sales to plans
Where it may not be applied	<ul style="list-style-type: none"> • Principal transactions • Discretionary accounts • Robo-advice given as a non-level fee fiduciary 	<ul style="list-style-type: none"> • Discretionary accounts • Underwriting transactions • Self or affiliate issues • Non-investment grade debt 	Variable annuities
What it requires (at a high level)	<ol style="list-style-type: none"> 1. Enter into a <u>written contract</u> with investors 2. Provide <u>advice under a</u> “best interest” or fiduciary standard (<u>higher standard</u> than “suitability”) 3. Implement <u>oversight</u> features designed to ensure adherence to standards 4. Provide <u>disclosures</u> to investors 5. Retain certain <u>records</u> 	<ol style="list-style-type: none"> 1. Enter into a <u>written contract</u> with investors 2. Provide <u>advice under a</u> “best interest” or fiduciary standard (<u>higher standard</u> than “suitability”) 3. Implement <u>oversight</u> features designed to ensure adherence to standards 4. Provide <u>disclosures</u> to investors 5. Retain certain <u>records</u> 	<ol style="list-style-type: none"> 1. Provide <u>advice under a</u> “best interest” or fiduciary standard (<u>higher standard</u> than “suitability”) 2. Provide <u>disclosures</u> to investors

Overview of the advice standards and oversight features required to comply with the BIC and PrTE

Financial institutions and advisers must adhere to “Impartial Conduct Standards” and make warranties regarding oversight and supervision practices designed to ensure compliance with those standards

Advice Standards

- Adhere to Impartial Conduct Standards, including:
 - Provide advice in the investor’s best interest, reflecting the care, skill, prudence and diligence under the circumstances then prevailing
 - Receive only “reasonable” compensation
 - Make no misleading statements

Oversight Features

- Adopt policies, procedures and controls to ensure adherence to Impartial Conduct standards
- Designate a person(s) responsible for:
 - addressing material conflicts of interest; and
 - monitoring for adherence to the impartial conduct standards
- Prohibit quotas, incentives or enhanced compensation intended to cause a misalignment of the Adviser and client’s interests

BIC disclosures overview

Financial institutions and advisers must make certain disclosures to investors in order to meet the requirements of the BIC



Contract

Given at contract/initial transaction execution

- Best interest standard
- Material Conflicts of Interest; fees and compensation
- Option to request policies, procedures and specific fees and compensation grids
- Provides link to Institution's website for model disclosures
- Proprietary products and third party payments
- How to raise concerns about advice received
- Proprietary products and third party payments
- Frequency of account and investment monitoring and alerting



Transaction

Given at execution of subsequent transactions

- Best interest standard
- Material Conflicts of Interest; fees and compensation
- Option to request policies, procedures and specific fees and compensation grids
- Provides link to Institution's website for model disclosures



Website

Must maintain a website and update at least quarterly

- Business model and Conflicts of Interest associated with such a model
- Typical fees and charges
- A model contract with disclosures
- Conflicts of Interest policies and procedures
- A list of product manufacturers providing third party payments
- Compensation and incentive arrangements with Advisers

PrTE disclosures overview

Financial institutions and advisers must make certain disclosures to investors in order to meet the requirements of the PrTE



Contract

Given at contract/initial transaction execution

- Informs Investor of instances where the financial organization is permitted to engage in principal transactions
- Discloses Material Conflicts of Interest; fees and compensation
- Option to request policies, procedures and specific fees and compensation grids and information about the principal traded asset
- Provides link to Institution's website for model disclosures
- Indicates frequency of account and investment monitoring



Pre-Transaction

Given prior to execution of transaction

- Informs Investor, either orally or in writing, of instances where the financial organization is permitted to engage in principal transactions



Post-Transaction

Given after execution of transaction

- Provides written confirmation of the Principal Transaction or Riskless Principal Transaction
- May be satisfied by compliance with Rule 10b-10 under the Securities Exchange Act of 1934



Annual

Provided to an investor in writing on an annual basis

- Each principal transaction executed during the period, including date and price
- Contract assent is terminable at any time by the investor
- Option to request information about the principal traded assets
- Disclosures are reviewed for accuracy no less than quarterly and updated within 30 days as necessary and available on firm's website
- A link to Institution's website for policies and procedures

PTE 84-24 disclosures overview

Financial institutions and advisers must make certain disclosures to investors in order to meet the requirements of PTE 84-24

PTE 84-24 Disclosures Overview

Requires the following disclosures be made prior to the execution of a transaction

1. **Affiliation** - The affiliation of the adviser to the insurance company
2. **Commission** - The insurance commission that will be paid directly or indirectly by the insurance company to the agent, broker, or consultant
3. **Commission** - If applicable, separate identification of the amount of the insurance commission that will be paid to any other person
4. **Other monetary items** - Any charges, fees, discounts, penalties or adjustments which may be imposed under the recommended contract
5. **Acknowledgement** - Written acknowledgement from the retirement investor that they have received the disclosure information and approve of the transaction

What needs to be done

Things that need to be done by April 10, 2017

1. Adhere to the Impartial Conduct Standards

What this means:

The impartial conduct standards are in addition to any current applicable standards (e.g., suitability and will require firms and financial advisers to do the following:

- **Give advice that is in the investor's best interest** that is based on the investment objectives, risk tolerance, financial circumstances, and needs of the investor, without regard to incentives to the adviser, financial institution or other parties
- **Receive only "reasonable" compensation related to the recommendation**, which considers factors including the market pricing of services and underlying asset(s), and the complexity of the product
- **Make no misleading statements** about investment transactions, fees, and compensation, material conflicts of interest and other matters relevant to the investment decision

2. Provide certain disclosures to the investor upon the execution of recommended transactions

What this means:

At the time that a transaction is executed that was the result of an investment advice recommendation, a notification must be provided to the investor that:

- **Acknowledges the fiduciary status** of the financial institution and individual adviser
- **States that impartial conduct standards have been adhered to** in the provision of the investment advice
- **Describes the material of conflicts interest** of the financial institution
- **Discloses whether proprietary products are offered or third party payments are received** with respect to any investment recommendations

What needs to be done- continued

Things that need to be done by April 10, 2017

3. Designate a person(s) responsible for addressing material conflict of interest and monitoring for adherence to the impartial conduct standards

What this means:

The impartial conduct standards are in addition to any current applicable standard (e.g., suitability) and will require firms and financial advisers to do the following:

- Financial institutions must **create a “Conflicts and Conduct Officer” type position**
- This position must be **designated to a person or persons, who is identified** by name, title or function
- This **position will be responsible for implementing a formalized system** and process for:
 - Addressing material conflicts of interest designed to prevent violations of impartial conduct standards
 - Monitoring for adherence to the impartial conduct standards

4. Maintain records that demonstrate that conditions of an exemption have been satisfied

What this means:

Record keeping requirements include the following:

- The Financial Institution **must maintain records for a period of six years**, from the transaction date, that are necessary to determine whether the conditions of the exemption have been met with respect to a transaction
- These **records will need to be accessible and made available** for examination upon request

What needs to be done

Things that need to be done by January 1, 2018

5. Firms must be in full compliance with the Rule and exemptions

What this means:

In addition to all prior requirements, firms must be in full compliance exemptions specific to:

- Contracts
- Warranties
- Policies and procedures
- Disclosures

6. Expand Compliance Program to ensure that Firms are in full compliance with the Rule and exemptions

What this means:

- Develop/enhance Policies and Procedures to ensure meet Rule requirements
- Monitor for Impartial Conduct Standards
- Determine impact to Suitability Review
- Determine record keeping requirements met
 - Notification if relying on BICE
 - Retention schedule updated to align with Rule – 6 years
- Expand inspection and testing programs

Governance, Supervisory and Compliance Program Considerations

While the Rule doesn't stipulate what a compliance program should include the following are provided for Companies to consider

Designate a person(s) designated as Conflict and Conduct Officer

- Address material conflicts of interest
- Monitor for adherence to the impartial conduct standards
- Involve in early stages - development of policies, procedures, training, communication and marketing material review, product and commission strategies

Establish Policies and Procedures

- Implement Impartial Conduct Standards and incorporate in Compliance Manual. Adopt policies, procedures and controls to ensure adherence
- Design to prevent violations – develop strong due diligence processes for the selection and monitoring of products and service providers
- Develop procedures that require Advisers to document their decision process to support the client recommendation.
- Modify existing suitability review requirements to incorporate ERISA Impartial Conduct Standard requirements (loyalty, prudence and care)

Establish Training Program

- Provide advisers and impacted individuals with clear understanding of Rule requirements, effect on how they conduct business, operational changes, and how it applies to them.

Compensation Models

- Review existing sales incentives, any form of inducements, and commission and compensation arrangements

Governance, Supervisory and Compliance Program Considerations - continued

While the Rule doesn't stipulate what a compliance program should include the following are provided for Companies to consider

Contract and Disclosures

- Provide disclosures to client of all compensation, conflicts, and fees and expenses relating to the relationship, advice and recommendations
 - Develop Point of Sale disclosures
 - Develop disclosures should client request additional information

Monitoring and Testing Considerations

- Assess that procedures are reasonably designed to prevent and promptly detect potential violations of impartial conduct standards
- Compliance testing
 - suitability and fiduciary standards met; recommendations documented; point of sale contract and disclosures provided to client
 - marketing materials and communications – content doesn't include specific recommendations that would then qualify as fiduciary
- Review commission models, sales incentives, contests, bonuses, quotas, etc. that may cause Advisers to not meet best interest standards
- Review BIC contract and disclosure content that the needed information to comply with requirements is provided
- Review web-site content and disclosure to meet Rule requirements

Common challenges clients are facing

1. **The Rule's impact on product design and offerings, advisers, business processes, operations and IT, compensation models**
2. **An implementation playbook by the Applicability date**
3. **Where to apply the BIC Exemption and how to operationalize**
4. **Impartial Conduct Standards**
5. **What is "reasonable compensation"**
6. **Requirements for proprietary product sales**
7. **Training needs for impacted individuals**
8. **Marketing material and communication content**
9. **Adviser-client point of sale process, contract and documentation**
10. **Website and disclosures**
11. **The "Conflict & Conduct Officer" role, responsibilities and procedures**
12. **A defensible compliance program**
13. **Communications program**

Questions?

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