



# DOL's Fiduciary Rule & BIC Exemption

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# The Current Landscape

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- Fiduciary Status
  - “Investment advice for a fee” or discretionary authority or control
- Consequences for Plans
  - Comply with duties of prudence and loyalty
  - Avoid prohibited transactions
- Consequences for IRAs
  - No general fiduciary duty, by must avoid prohibited transactions
- Prohibited Transactions
  - Broad prohibition
  - Excise tax (15% of amount involved per year)
  - Enforceability (plans v. IRAs)
  - Prohibited Transaction Exemptions (PTEs)

# DOL's Concerns

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Because ...

- Increased Participant role
- Growth of IRA market
- Increased complexity of products & need for experts
- "Evasion" of fiduciary status permitted by current rule

DOL decided to ...

- Expand the definition of "investment advice"
- Modify (limit) existing exemptions
- Focus on conflicts in IRA Rollovers
- Adopt a new Best Interest Contract Exemption

Resulting in ...

- More fiduciaries
- ERISA-fication of IRA market

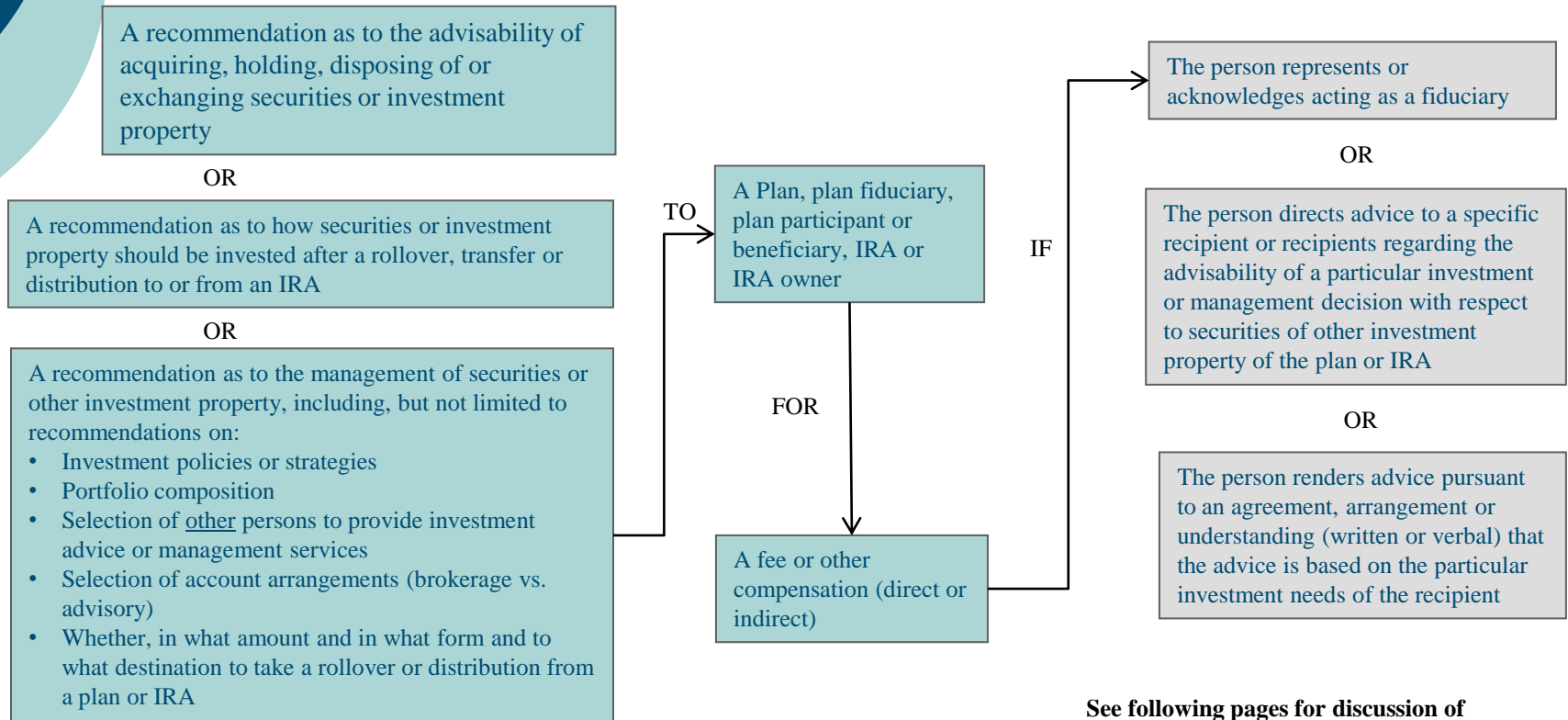
# Future of Fiduciary Rule

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- Effective date
  - Generally applicable April 10, 2017
  - Transition relief through January 1, 2018
  - Grandfathering
- Additional DOL guidance
  - Commitment to addressing issues
- Challenges to rule
  - Congress
  - Courts
  - Next administration

# Framework for Analyzing Investment Advice Fiduciary Status under the 2016 Final Regulation

**A Person is an Investment Advice Fiduciary IF he or she makes certain “recommendations” to certain recipients, for a fee, and either acknowledges fiduciary status or the arrangement otherwise meets other conditions, unless certain exceptions apply.**



See following pages for discussion of definition of “recommendation” and exceptions

# Definition of Fiduciary Advice

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- First, advice must be provided for a fee or other compensation . . . it could be paid directly or indirectly (such as through 12b-1s or some other form of revenue sharing)





# Definition of Fiduciary Advice

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- Second, the person must provide one of two types of “recommendations” to a plan, plan fiduciary, plan participants, plan beneficiaries, or an IRA or IRA owner:
  - A recommendation relating to buying, selling, or exchanging an investment within a plan or IRA or after amounts are distributed from a plan or IRA

# Definition of Fiduciary Advice

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- A recommendation relating to the management of an investment – including recommendations relating to:
  - Investment strategies
  - Portfolio composition
  - Other people to provide advice or investment management services
  - Rollovers and distributions . . . whether to do it, in what form, or to a specific destination



# Definition of Fiduciary Advice

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- Third, the one of the following relationship conditions are met:
  - Person represents or acknowledges they are acting as a fiduciary;
  - the advice is provided pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the “particular needs” of the person who receives it; or
  - the advice is directed to a specific advice recipient about the advisability of a particular investment or management decision with respect to securities or other investment property of the plan or IRA

# Fiduciary Framework

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- Two basic steps to decide whether “advice” is fiduciary investment advice:
  - Is it a “recommendation”?
  - Is there another rule that keeps the activity from being a fiduciary act?



# Definition of Recommendation

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- Recommendations – An Objective Definition?
  - “[A] communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action.”

# Definition of Recommendation

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- Recommendations – An Objective Definition?
  - Key considerations:
    - Level of individualization to a recipient
    - Providing a list of securities is considered a recommendation
    - Aggregation principle– actions and communications can be looked at together to make a “recommendation”
    - Recommendations can occur by a person or by robo-advice

# Framework for Analyzing Investment Advice Fiduciary Status under the 2016 Final Regulation

**A recommendation is a communication that, based on its content, context and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action.**

<b>Recommendation Characteristics</b>	<b>NOT a Recommendation</b>
Objective not subjective	Non-individualized platforms offered to participant-directed ERISA plans, if certain conditions met
The more individually tailored a communication is to a specific recipient, the more likely it is to be a recommendation	Selection and monitoring including RFP response sample line-ups if certain conditions met
Select lists of securities characterized as appropriate for an investor would constitute a recommendation, even if no one security is recommended	Certain types of general communications that a reasonable person would not view as an investment recommendation
Actions may be aggregated to form a recommendation, even if no individual action is a recommendation	Investment education – permits education similar to that currently allowed under IB 96-1, but populating asset allocation models or interactive materials with specific investment alternatives not permitted for IRAs

# Exceptions from the Rule

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- Activities that are not recommendations
  - Platform providers
    - Plans but not to IRAs or individual participants or beneficiaries
    - “Without regard to the individualized needs of the plan or its participants”
    - A common question . . . what about bundled services like managed accounts and QDIA services?
  - Selection and monitoring assistance
  - General communications

# Exceptions from the Rule

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- Activities that are not recommendations
  - Education (but not advice!)
    - The world before the final regulation
    - Changes to asset allocation models.
      - For IRAs: No specific investments named
      - For Plans: Can name designated investment alternatives . . . but must include other funds with similar risk/return characteristics

# Seller's Exception

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- Sales and interacting with independent plan fiduciaries (whether plan or IRA) with financial expertise
  - Banks, insurance carriers, RIAs, broker-dealer, an independent fiduciary with \$50 million under management or control
  - Written representations
  - Important to wholesalers and the daisy chain



# “Hire Me”

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- A recommendation that oneself or one’s affiliates be hired is non-fiduciary, consistent with existing 408(b)(2) regulations
- But recommending investment transactions (including rollovers moving from commissions to level fee) in connection with selling one’s advisory or management services is fiduciary
- For rollovers, BIC may be the only viable option, even with level fee.

# BIC Exemption

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- A kinder, gentler BIC?
- Broader coverage
  - Available to cover both plan-level and participant/IRA holder advice
- Less onerous contract formation
- Fewer IT intensive disclosures
- Remains true to DOL's "North Star"
  - Enforceable "best interest" standard of conduct

# Three Pathways

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- Pathway 1 – Full BIC
  - For advice to IRA investors
  - Bi-lateral contract
- Pathway 2 – Unilateral BIC
  - For advice to “ERISA investors”
  - Unilateral set of acknowledgements and disclosures
- Pathway 3 – BIC Light
  - For “Level Fee Fiduciaries” providing rollover recommendations
  - Streamlined requirements

# BIC Relief Elements

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- Fiduciary Acknowledgement
  - The financial institution affirmatively states in writing that it and its advisers act as fiduciaries under ERISA, or the Code or both with respect to investment recommendations
- Impartial Conduct Standards
  - Provide advice that is in the investor's best interest (i.e., prudent and "without regard" to competing financial or other interests)
  - Not receive compensation that is in excess of what is reasonable
  - Not make materially misleading statements about the transaction, fees and compensation or material conflicts

# BIC Relief Elements

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- Warranties
  - Adoption of policies and procedures
  - Identification of material conflicts and BIC compliance officer
  - No use of quotas, appraisals, etc. except to the extent designed to avoid a misalignment of interests
- Disclosures
  - In writing
  - At or prior to execution of transaction
  - Good faith errors curable within 30 days

# BIC Relief Elements

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- Ineligible contract provisions
  - Disclaim or limit its or advisor's liability
  - Require waiver or qualification of investor's right to participate in class action
  - Require mediation of claims in unreasonable or distant venues
- Permissible limitations
  - Mandatory arbitration for non-class actions
  - Punitive damages
  - Right of rescission

# BIC Web Disclosure

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- Freely accessible to public
- Updated quarterly
- Discussion of business model and material conflicts
- Typical account fee schedule
- Written description of policies and procedures
- List of all product manufacturers and other parties providing third party payments
- Compensation and incentive arrangements for advisors

*Good faith errors may be cured within 7 days*

# Pathway 1 – IRA Investors

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- Bilateral contract to cover advice to IRA investors
- Requires all of the relief elements
  - Fiduciary acknowledgement
  - Impartial conduct standards
  - Warranties
  - Disclosures
  - Absence of ineligible provisions
- Manual or e-signature of client needed for new accounts
- Negative consent procedure for contracts in place prior to January 1, 2018



## Pathway 2 – ERISA Plans

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- Same as pathway 1
- Except no bi-lateral contract required
- Reason – ERISA enforcement rights

# Pathway 3 – BIC Light

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- Level fee fiduciaries
  - Levelized for advisor and financial institution
- BIC elements required
  - Fiduciary acknowledgement
  - Impartial conduct standards
- Elements not required
  - Warranties
- Special Requirement
  - Financial institution must document why a rollover recommendation or a switch from a commission-based to a level fee arrangement is in investor's best interest



# Proprietary Products

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- Investor is provided with written disclosure of restrictions
- Investor is fully informed of material conflicts
- Financial Institution reasonably concludes restrictions will not cause imprudent recommendations
- Compensation is reasonable
- Advisors recommendation is not based on advisor's own financial interest or interests other than investment objectives, risk tolerance, financial circumstances and needs of investor



# Questions & Answers

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