

The new fiduciary landscape



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The Department of Labor (DOL) is now front and center



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What it means to be a “fiduciary”



As a fiduciary, an advisor’s recommendations must be in the client’s best interests.

You may already be acting as a fiduciary according to existing rules, but you will need to make changes to meet the heightened DOL fiduciary standard.



What it means to be a “fiduciary”



The new DOL fiduciary standard is the most stringent standard of care for advisors in our industry



- Regulates Broker-Dealers
- *BD-registered representatives are currently held to a “suitability standard”*



- Regulates the securities industry and registered investment advisors
- *Fee-based advisors already operate under a fiduciary standard*



- Regulates retirement assets (ERISA)
- *More stringent fiduciary standard covers all retirement assets, effective April 2017*

As of April 2017, everyone in the business of advising on and selling products to retirement accounts will be held to the DOL fiduciary standard



Fiduciary standard: The new normal



The DOL Fiduciary Standard

- Prohibits ALL conflicts of interest in retirement accounts
- A conflict may include variable compensation, earned directly by the advisor or indirectly by their affiliated firm
- Conflicts CANNOT be cured through disclosure (*unlike SEC Fiduciary Standard*)
- The only way to avoid conflict (also known as a “prohibited transaction”) is setting levelized fees or utilizing a prohibited transaction exemption



Key takeaways from today

- Learn the basics of being a fiduciary
- Understand how the DOL rule applies to your practice
- Define your true value to clients
- Discover how to build a winning practice in the new fiduciary environment



Let's get started

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DOL Fiduciary Basics



Outcomes

- Review the background and reasoning behind the changes to the Department of Labor (DOL) fiduciary standard
- Analyze the final DOL fiduciary rule and its impact to financial advisors
- Discuss the key factors impacting the choice between levelized compensation and an ongoing Best Interest Contract (BIC) framework to comply with the DOL rule



Background on the new DOL regulations



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Understanding the Department of Labor regulations

The DOL is charged with preserving retirement assets and eliminating potential conflicts of interest

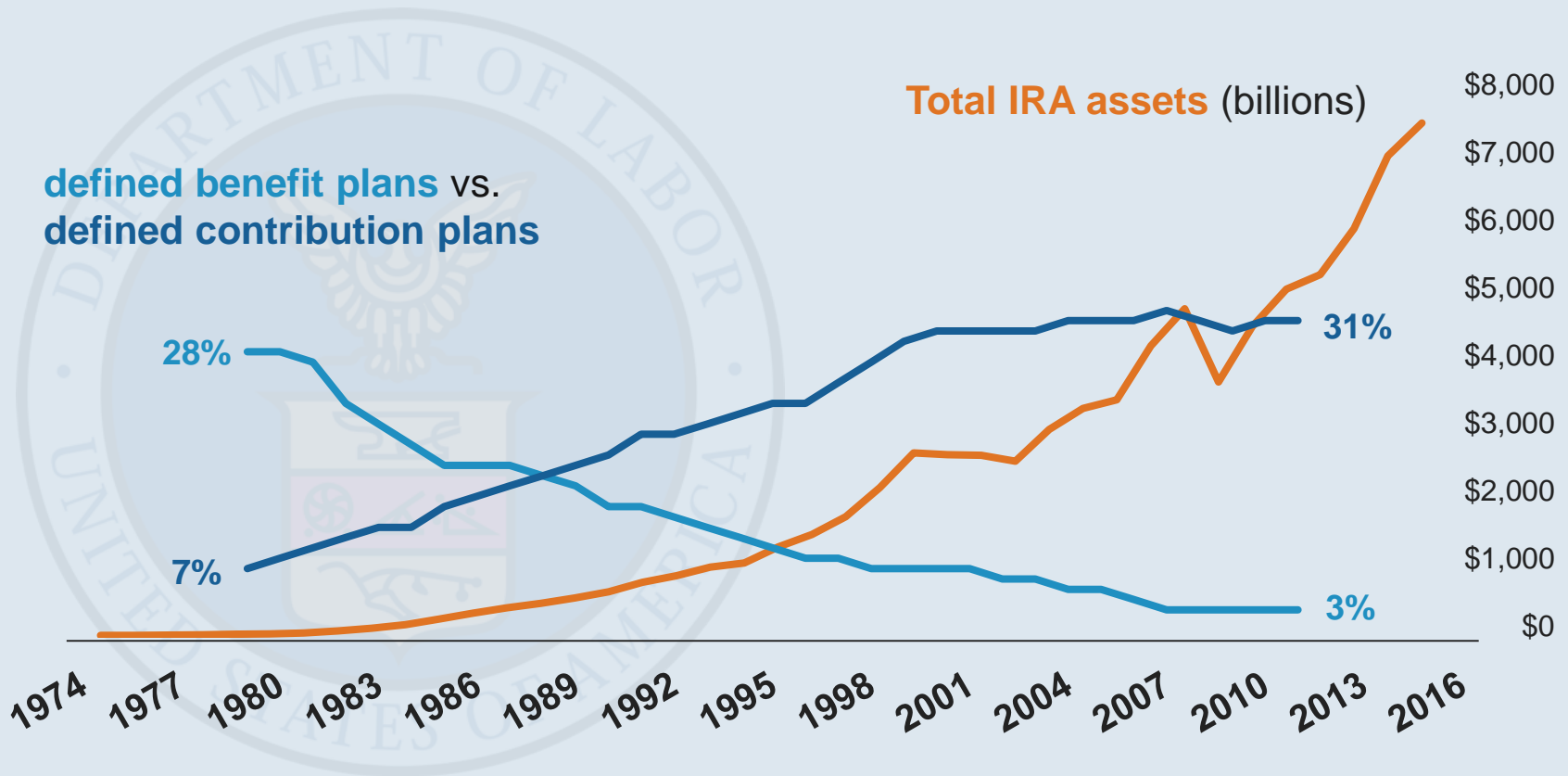
Over the past 40 years, retirement investments have shifted toward defined contribution plans and into IRAs



Under the new rule, all financial advisors managing retirement assets, including IRAs, **are deemed to be fiduciaries**, subject to strict prohibitions on conflicts of interest



An increase in Defined Contribution plans and IRAs



percent of private sector workers participating in an employment-based retirement plan by plan type, total IRA assets in billions



Source: EBRI.org, ICI.org

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What does the rule say?



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Under the DOL rule:



You are required to provide recommendations in the best interest of your clients, free of all direct or indirect conflicts of interest.

What is considered a “recommendation”?

Includes both the decision to move assets as well as how to invest them:

- ✓ Advising on taking a distribution of assets from a plan, including assets to be distributed / rolled over from a plan or IRA.
 - Whether to, in what amount, in what form, and to what destination
- ✓ Recommendations of a third party investment manager for retirement assets
- ✓ Advising on buying, selling, or holding retirement investments



What is not a recommendation?

The DOL has expressly permitted certain preliminary communications, but their scope is limited.

1. General advertising

- Non-individualized advertisements for advisor's services

2. Investor education

- General information regarding retirement planning

3. “Hire me” conversation

- Discussing with clients the benefits of your services

In each case, the more individualized and specific a communication, the more likely it is to be considered a ‘recommendation’



Debunking media myths

MYTH

“The DOL rule has been significantly weakened; it won’t change how I run my business”

FACT

Though the final rule is more workable than the proposal, all brokers and advisors touching retirement assets (including IRAs) must change their practices to comply with the rule.



Debunking media myths

MYTH

“As long as my clients sign a Best Interest Contract (BIC) I am not held to a fiduciary standard and don’t need to worry about conflicts of interest ”

FACT

The BIC exemption permits the advisor/firm to offer products that may compensate them differentially, (i.e. commission products) but you are still a fiduciary under the BIC, subject to impartial conduct and best interest requirements.



Debunking media myths

MYTH

“My relationship with clients and the recommendations I make for them are essentially unchanged”

FACT

When working with client retirement accounts, all recommendations are now held to a fiduciary standard and must put the interests of the client ahead of their own. Even a fee-only RIA now must deliver new disclosures in order to transition accounts to fees or to roll over to an IRA.



New glossary for retirement assets

FIDUCIARY STANDARD

- Must act in client's best interests
- Under DOL Fiduciary standard, conflicts cannot be cured through disclosure

CONFLICTED COMPENSATION

- Investment products that compensate the advisor (or firm) differentially create a conflict of interest.
- The advisor must eliminate the conflict through level fees or utilize an exemption (e.g. BIC)

LEVELIZED FEES

- A level-fee account can be used to ensure that potential investments do not compensate the advisor differentially, removing conflicts

BEST INTEREST CONTRACT EXEMPTION

- A binding written agreement allowing differential compensation, but requiring significant disclosures, contractual liability, and that all advisor recommendations be in client's best interest



A high-angle, top-down photograph of two men in business suits sitting at a table in a meeting room. They are both looking at documents on the table. The man on the left is pointing at a document, while the man on the right is holding a tablet displaying a chart. The entire image is overlaid with a semi-transparent blue filter. The text 'What this means to you' is centered on the left side of the image.

What this means to you



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The key issue is the method of advisor compensation

Levelized Compensation



Recommended Products



Advisor



Payment (fee)



Client

Conflicted / Non-Levelized Compensation (BIC Needed)



Recommended Products



Payment (commission)

- Front load
- 12b-1 fees
- trail commissions



Advisor



Client



The impact on product offerings

For retirement assets, advisors will generally need to choose

Levelized Compensation: VS. **Commission-based Compensation with BIC Exemption:**

Level fees avoid the conflict of variable compensation

- Only transactional (one-time) disclosures needed to establish value of fee-based relationship
- Advisor is demonstrating *value of the relationship*

Ongoing BIC framework permits non-level compensation

- Applies to products such as:
 - Mutual Funds with front loads or trails
 - Proprietary Products
 - Insurance Products including variable or indexed annuities*
- Requires detailed disclosures and increased liability
- Advisor must continually defend relative value of *the investment product versus the alternative products available*

*Certain insurance contracts and fixed annuities do not require a BIC

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Best Interest Contract Exemption (BIC)

While the ongoing BIC Exemption allows non-level compensation, the advisor and firm must demonstrate that **it is in the best interest of the client.**

- The BIC is a written contract between financial institution and client acknowledging fiduciary status of institution and advisor
- Signed when the investor opens account, but contract applies to all prior communications and advice related to that investment decision



Best Interest Contract Exemption (BIC)

Utilizing a BIC exemption is not without challenges.

The advisor/firm must:

- Acknowledge that recommendations are in client's best interests and that the compensation does not create conflicted advice
- Provide details on all fees or charges paid by investor along with other detailed disclosures
- Consent to lawsuits by clients, including class actions, to enforce the terms of the BIC
- Client may request an annual summary of fees and their impact on the investment



Source: [dol.gov](https://www.dol.gov), [pwc.com](https://www.pwc.com)
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One-time Transactional Disclosure

Used for a transition to fee-based, or a plan distribution / rollover

Unlike the ongoing BIC, the one-time disclosure does not have the same continuing disclosures as the ongoing BIC.

Unlike the ongoing BIC, the one-time disclosure is likely to be a set of (ADV-like) disclosures demonstrating the benefit of the transition and the fees to be charged.

This disclosure is being called the 'level fee' exemption, the 'one-time' / 'transactional' BIC, or "BIC-light"



Source: dol.gov, pwc.com

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Potential conflicts from indirect compensation

The DOL fiduciary rule forbids conflicts across both the advisor and affiliated firm, i.e. at the Broker Dealer level

Example 1 Scenario:

Advisor using affiliate firm's products, such as their BD's proprietary platform, may generate differential compensation for the firm



Potential Problem:

The advisor and their affiliated firm (such as the BD) are linked under the rule.
The firm will need to levelize all compensation or utilize BIC to comply with the rule

Example 2

Where the advisor has 'discretion' to make investment allocations or rebalances (advisor as portfolio manager), advisor may not be aware of differential compensation to their firm



The BIC exemption cannot be applied to discretionary accounts. Compensation for these accounts will need to be levelized across the firm



What you need to do



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Preparing for Implementation

After understanding the basics of the DOL rule, determine what actions to take:

- Stay up to date on key developments
 - In industry
 - Broker Dealer
 - Product Providers
- Understand the investment profiles of your clients:
 - Identify what types of investments they have
 - Understand grandfathering for existing investments
 - Segment based on potential actions to be taken
- Determine a strategy for each client for existing and new business
 - The use of Levelized Fee vs. Ongoing BIC Framework
 - + Make an informed choice that fits your client's needs
 - Develop approach for future clients Post-implementation date.



Timeline for implementation



April 6, 2016: DOL's final fiduciary rule unveiled to public



April 10, 2017: New fiduciary standard in effect

- Transition period for ongoing BIC: April, 2017 to January 1, 2018
 - Firms will not yet need to comply with all of the reporting / paperwork specified by the BIC, but must act as a fiduciary and disclose all material conflicts during this period.
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January 1, 2018: Full compliance with the BIC exemption required



The Grandfathering Provision

Exempts investments that would otherwise require an ongoing BIC that were made or implemented through a systematic purchase program prior to April, 2017, subject to significant restrictions

- Upon the April 2017 implementation, advisors must still send clients a communication within 30 days disclosing fee arrangement, conflicts, and obtaining clients' negative consent to remain in the product.
- Exemption only applies until next 'fiduciary' interaction



Grandfathering

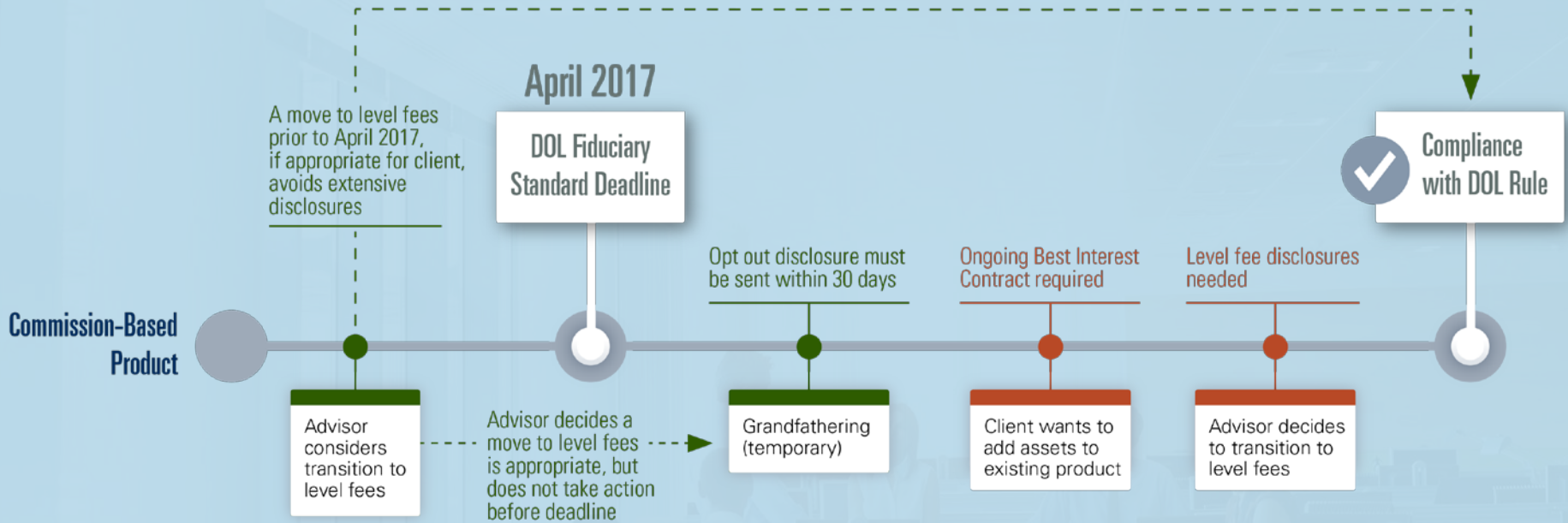
This grandfathered status is only temporary.

- Advisors will be required to resolve conflicted compensation during the next ‘fiduciary interaction’, which may include:
 - quarterly meeting discussing investment status
 - additional asset investment
 - any change in client circumstances resulting in advice
- Advisors cannot simply avoid activity on the account:
 - As a fiduciary, the advisor will have a duty to monitor the account
 - If an advisor continues to earn compensation without activity, the advisor may be exposed to “reverse-churning” claims

Grandfathering will serve as a useful tool to bridge the gap but is not a long-term solution to the DOL Fiduciary Rule



Moving to fees — grandfathering timeline



Case Studies: Advisor Perspectives



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Advisor Perspectives: A Move to Levelized Fees

Potential Scenarios

- A client is considering a rollover from a 401k into an IRA
- An advisor recommends a client with existing commission-based investments transition into a fee-based account
- New client relationship

Situation: transition requires disclosure under DOL rule

- The recommendation to move from an outside investment where the advisor does not earn a fee to one held with the advisor is a conflict of interest under the DOL rule.
- Depending on the scenario, the move from the sunk cost of a commission product into a recurring fee account, could also be considered a conflict.



Advisor Perspectives: A Move to Levelized Fees

Implementing a solution: the level-fee disclosure

The DOL rule provides a mechanism for this transition. At account opening, the advisor must provide a set of one-time (ADV-like) disclosures demonstrating the benefit of the transition and the fees to be charged.

After using the level-fee disclosures to move the client into the levelized fee solution, their account will be compliant going forward as long as the advisor continues to earn a level fee.



Advisor Perspectives: A Move to Levelized Fees

BOTTOM LINE:

As a level-fee fiduciary, the advisor will demonstrate their value through their **relationship with the client.**



Advisor Perspectives: Ongoing BIC Framework

Potential Scenarios

- The advisor recommends commission-based products to new clients or for new investments from existing clients
- The client has existing commission-based products and the advisor recommends to stay in that product or add more assets

Situation: Variable compensation is an ongoing conflict

The recommendation will require an Ongoing Best Interest Contract (BIC)



Advisor Perspectives: Ongoing BIC Framework

Implementing a solution:

The Ongoing Best Interest Contract will need to be entered into to provide an exemption to conflicts of interest stemming from non-levelized compensation.

Because the recommendation is an ongoing conflict, it requires ongoing disclosures for the life of the investment.

- Determine who will create BIC contract disclosures (BIC, product manufacturer, RIA)?
- Advisor should review disclosures to make sure they can comply with the representations made.



Advisor Perspectives: Ongoing BIC Framework

BOTTOM LINE:

As a fiduciary utilizing the BIC, the advisor will be required to defend the value of **the specific products recommended** to the client in comparison to other available solutions.



Steps to take

- Understand the basics of the DOL rule
- Stay up to date on key developments
 - Industry, Broker Dealer, Product Providers
- Understand the investment profiles of your clients:
 - Identify what types of investments they have
 - Understand grandfathering for existing investments
 - Segment based on potential actions to be taken
- Determine a strategy for each client for existing and new business
 - The use of Levelized Fee vs. Ongoing BIC Framework
 - ✦ Make an informed choice that fits your client's needs
 - Develop approach for future clients Post-implementation date.

Let AssetMark help you through the process



Q&A

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