

New Department of Labor dates: Real relief or red herring?

Perspective on compliance and implementation timeline for the DOL Conflict of Interest Rule

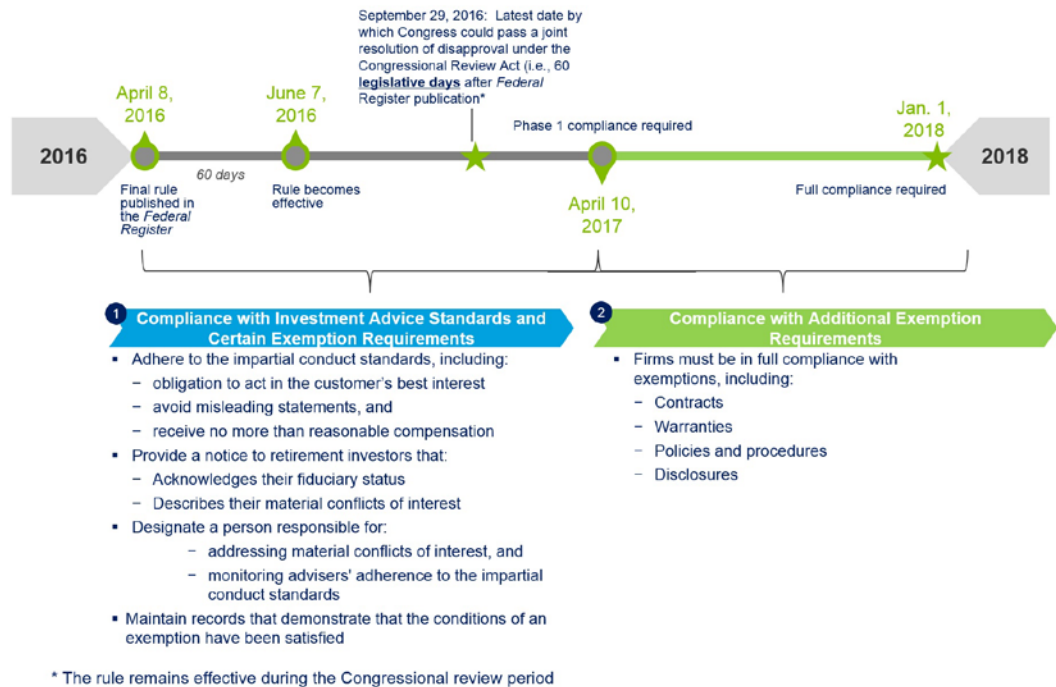


On April 8, 2016, the Department of Labor (DOL) published to the Federal Register the final version of the Conflict of Interest Rule (the Rule). Many initial reports have highlighted the January 1, 2018 full compliance date and view the new date as significant relief for the industry. However, a careful examination of the final rule may show that this view is more perception than reality.

The Rule, which in its final form expands the definition of fiduciary advice to cover IRAs and IRA participants, likely will pick up many financial advisers, their firms and affiliates (Advisers) that were not previously considered fiduciaries with respect to these types of client accounts. Impacted Advisers must be compliant by April 10, 2017, with ERISA fiduciary standards, which impose a trust law standard of care and undivided loyalty, instead of a lower standard of care which may have been previously permissible (e.g. suitability).

Additionally, fiduciaries who wish to continue to receive compensation or engage in “prohibited transactions”, that would be otherwise be deemed prohibited under ERISA fiduciary standards, will need to rely on an exemption (e.g., the Best Interest Contract Exemption (BIC) or the Principal Transaction Exemption (PrTE)) by April 10, 2017. However, not all of the requirements of the BIC and the PrTE will need to be met until January 1, 2018 for the exemptions to be applied, although substantial requirements will still need to be met by April 10, 2017.

DOL Conflict of Interest Rule implementation timeline



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For Advisers that will rely on the BIC and/or PrTE, there are four main requirements that will have to be complied with by April 10, 2017, that may represent substantial changes to an Adviser's current client service standards, operations, technology, and supervision and compliance functions.

These four requirements, which we discuss in more detail below, are:

1. Advisers must adhere to the impartial conduct standards, including providing investment advice that must be in the best interest of the investor
2. Certain disclosures must be given to the investor upon the execution of recommended transactions
3. Firms must designate a person (e.g., a Conflicts and Conduct Officer) responsible for addressing material conflicts of interest, and monitoring advisers' adherence to the impartial conduct standards
4. Firms must begin maintaining records that demonstrate that the conditions of an exemption have been satisfied

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 standard (e.g., suitability) and will require firms and financial advisers to do the following:

- a) **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

b) **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

c) **Make no misleading statements** about investment transactions, fees, and compensation, material conflicts of interest and other matters relevant to the investment decision

Considerations for meeting the April 10, 2017 deadline

Best interest standard:

- Creation and implementation of definitions, requirements, training and other control mechanisms designed to ensure that advice is provided under the higher “best interest standard” rather than other standards that may have previously applied, such as the “suitability standard”
- Additionally, firms will need to decide what information they need to capture in order to evaluate and support that investment advice, at the time when given, is in the best interest of the retirement investor
- Although the contract components of the BIC and PrTE, which allow for class action litigation, do not need to be in place until January 1, 2018, once executed they are retroactive to cover advice given on or after April 10, 2017. This underscores the importance of creating processes and controls designed to appropriately document why advice was in the best interest of a customer as well as how the firm evaluated whether the advice met that standard

Only charge reasonable compensation:

- Creation and implementation of definitions, requirements, training and other control mechanisms designed ensure that compensation is reasonable
- Evaluation of current compensation arrangements between financial institutions, individual advisers, and third-parties to understand whether revisions are required to meet reasonability requirements
- Creation and implementation of ongoing monitoring and surveillance processes to evaluate compensation arrangements for reasonability

Avoid misleading statements:

- Understanding and documentation of fees, compensation and material conflicts of interest that are relevant to investment decisions
- Evaluation of communications, sales and marketing practices to ensure that they are free of misleading statements regarding fees, compensation and material conflicts of interest
- Creation and implementation of ongoing monitoring and surveillance processes to detect for potentially misleading statements

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:

a) **Acknowledges the fiduciary status** of the financial institution and individual adviser

- b) **States that impartial conduct standards have been adhered to** in the provision of the investment advice
- c) **Describes the material of conflicts interest** of the financial institution
- d) **Discloses whether proprietary products are offered or third party payments are received** with respect to any investment recommendations

Considerations for meeting the April 10, 2017 deadline

Provide disclosures upon execution of transactions

- Create and implement a process for identifying investors who will be required to receive disclosures and monitoring to ensure that disclosures are sent
- Create disclosure document with required components
- Create and implement process for sending disclosures

Describe the material conflicts of interest

- Perform analysis to understand and document where “the Financial Institution has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor”

Disclose whether third party payments are received

- Perform analysis to understand and document instances where the financial institution receives a third party payment with respect to any investment recommendation

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

What this means

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

Considerations for meeting the April 10, 2017 deadline

- Define and document mandate and responsibilities of new role
- Identify a person or persons, with requisite experience, authority and capacity capable of filling the role
- Design and implement processes and controls for identifying and addressing material conflicts of interest

- Design and implement processes, controls and technologies for monitoring a firm's adherence to the Impartial Conduct Standards

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

What this means:

- a) 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
- b) These **records will need to be accessible and made available** for examination upon request

Considerations for meeting the April 10, 2016 deadline:

- Understand and document the records that will be required to demonstrate that the conditions of an exemption have been met
- Assess whether changes are needed to the current books and records program to ensure that records required by this rule are maintained for their required retention period
- If necessary, implement changes and ongoing monitoring processes designed to ensure compliance

Next steps

Deloitte continues to analyze the final Rule and will continue to provide our point of view on what steps organizations should take to mobilize and implement the substantial changes that will be required by April 10, 2017.

We have designed a structured approach for implementation that helps organizations not only comply with the Rule, but also capitalize on the opportunities that the Rule's disruption has created. Organizations affected by the final Rule may contact Deloitte with questions about the Rule and activities to support planning, preparation, implementation, and compliance.

Contacts

For more information, please contact:

Susan Levey

Deloitte Advisory Director
Deloitte & Touche LLP
slevey@deloitte.com

Maria Gattuso

Advisory Principal
Deloitte & Touche LLP
mgattuso@deloitte.com

Karl Ehram

Advisory Principal
Deloitte & Touche LLP
kehrsam@deloitte.com

Josh Uhl

Advisory Senior Manager
Deloitte & Touche LLP
juhl@deloitte.com

Craig Friedman

Advisory Senior Manager
Deloitte & Touche LLP
cfriedman@deloitte.com

Scott Parker

Principal
Deloitte Consulting LLP
scparker@deloitte.com

Daniel Rosshirt

Principal
Deloitte Consulting LLP
drosshirt@deloitte.com

Bruce Marcus

Advisory Director
Deloitte & Touche LLP
bmarcus@deloitte.com

Sean Cunniff

Specialist Leader
Deloitte Services LLP
scunniff@deloitte.com

Sameer Shroff

Advisory Senior Manager
Deloitte & Touche LLP
sashroff@deloitte.com

For further information, visit our website at www.deloitte.com/us/DOL-fiduciary

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