



## **DOL Fiduciary rule**

Designating a Conflicts Officer or  
Conflicts Committee

## Introduction

As covered firms continue to operationalize the Department of Labor’s (DOL) Conflict of Interest Rule<sup>1</sup> and the related prohibited transaction exemptions ahead of the initial April 2017 compliance date, the industry is faced with making challenging strategic decisions regarding the designation of a conflicts officer under the rule, and questions continue to arise.

The Best Interest Contract (BIC) Exemption requires<sup>2</sup> firms to designate a person or persons responsible for (1) addressing “material conflicts of interest” (i.e., when an adviser or 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) and (2) monitoring advisers’ adherence to impartial conduct standards outlined by the exemption.<sup>3</sup>

This provision, which was included as a recommendation in the proposed version of the BIC exemption but adopted as an explicit requirement in the final version, is not very prescriptive, leaving the details of the designation largely up to the firm. However, the proposed version may be helpful in conveying the DOL’s thinking with respect to the designation of an employee or group of employees, referred to as either “Chief Conflicts Officer” or “Conflicts Committee” throughout this document.

The final version of the BIC exemption simply notes that one “important consideration” in addressing conflicts of interest is an institution’s “attentiveness to the qualifications and disciplinary history of the persons it employs to provide such advice.”<sup>4</sup> The proposed version of the exemption elaborates a bit further, stating that an “individual compliance officer or a committee could monitor adherence to the Impartial Conduct Standards and consider ways to ensure compliance.”<sup>5</sup> Unlike the final version, which does not explicitly suggest the designation of a “committee” to fulfill this role, the proposed version seems to convey the DOL’s belief that such an approach to this requirement is acceptable.

Given the ambiguity surrounding this provision of the BIC exemption, questions surrounding this designation continue to emerge. This paper considers several of the most fundamental questions, including the timing of the designation, the composition (in the case of a committee approach), and where in the organization the Chief Conflicts Officer or Conflicts Committee should sit.

<sup>1</sup> Department of Labor, “Definition of the Term ‘Fiduciary’; Conflict of Interest Rule—Retirement Investment Advice,” 81 Fed. Reg. 20946, (April 8, 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-04-08/pdf/2016-07924.pdf>.

<sup>2</sup> Department of Labor, “Best Interest Contract Exemption,” 81 Fed. Reg. 21002, (April 8, 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-04-08/pdf/2016-07925.pdf>.

<sup>3</sup> Id., at 21033.

<sup>4</sup> Id., at 21035, n.63.

<sup>5</sup> Department of Labor, “Proposed Best Interest Contract Exemption,” 80 Fed. Reg. 21960, (April 20, 2015), available at <https://www.gpo.gov/fdsys/pkg/FR-2015-04-20/pdf/2015-08832.pdf>.

### When is an institution required to appoint a Chief Conflicts Officer or Conflicts Committee?

Institutions are required to comply with the BIC exemption—including the requirements to adhere to impartial conduct standards and to appoint a Chief Conflicts Officer or Conflicts Committee—by April 10, 2017.

However, a firm would be well-advised to make its designation in advance of this applicability date in order to allow the officer or committee to become an integral part of the firm's larger compliance preparation efforts. Specifically, the officer or committee should have an active role in formulation of the policies and procedures required by the BIC exemption and their operationalization, and in setting policy to address conflicts of interest.

### Should a firm designate a person or a committee?

Although it is clear that the DOL leaves this question open to institutions—and the industry view is still forming—the initial sentiment seems to favor a committee approach.

Among other advantages offered by this model are the ability to (1) leverage existing committee structures, (2) shield one individual from a perceived sense of full liability,<sup>6</sup> and (3) access the expertise and transparency that senior cross-functional members can provide, providing the committee a better view to identify and address conflicts. In addition, advocates of the committee model point out that the breadth and depth of responsibilities associated with this role underscore the need for having more than one person performing these functions.

Yet, there seem to be certain advantages associated with designating an individual as well, including the avoidance of groupthink and the adoption of a more nimble approach. In addition, designating an

individual would signal clear accountability as opposed to the shared responsibility model that comes with designating a committee.

Firms should remain cognizant that, no matter which approach they take, the DOL has stressed above all else the “qualifications and disciplinary history” of the person or persons responsible for addressing material conflicts of interest and monitoring adherence to impartial conduct standards outlined by the BIC exemption. Given the broad mandate of the Chief Conflicts Officer or Conflicts Committee, any individual that is designated to serve in this role—in either operating model—will need to have sufficient access to information within the firm as well as authority to set appropriate policies at the firm so as to properly perform the mandates under the exemption.

### If a firm opts to designate a Chief Conflicts Officer, should the officer come from within the firm or outside of the firm?

Either approach could work, but firms should realize the pros and cons of both.

If a firm decides to designate an officer from outside of the organization, they will have a larger pool from which to select, allowing them to find a candidate with the right qualities for the position. In addition, this approach would allow a firm to hire an individual for the explicit purpose of establishing policies and procedures related to conflicts of interest. Finally, an outside voice may bring fresh perspective on key issues, such as compensation, misleading statements, and the Best Interest standard.

On the other hand, if a firm opts to designate a Chief Conflicts Officer from within the organization, they will likely already know both the business and any existing material conflicts of interest, allowing the officer to hit the ground running.

### What attributes should a firm seek in candidates?

In order to effectively carry out the responsibilities of this position, a firm should look for the following attributes in candidates for the Chief Conflicts Officer position or members of the Conflicts Committee:

1. Power—able to raise issues with senior management and make impactful decisions
2. Independence—being uninfluenced by business goals or conflicted revenues
3. Knowledge—understands the business, including services and products offered by the firm and its affiliates
4. Experience—has experience in monitoring and/or surveillance, whether directly or through an oversight or reporting-line function

Of course, this list is non-exhaustive, but represents a good starting point for firms considering candidates for this role.

If a firm opts to establish a committee structure, it should consider a range of types of positions and people to serve on it, including the Chief Compliance Officer, Chief Operating Officer, Chief Legal Officer, the head of the new products committee, the heads of various business lines, and the head of distribution/sales. Again, this list is non-exhaustive, but gives firms a sense of how they might position their Conflicts Committee.

### Should there be one enterprise-wide Chief Conflicts Officer/Conflicts Committee or separate roles per line of business?

The role should be enterprise-wide so that all business areas and conflicts are fully considered. With diverse companies, the business unit heads should be involved at an enterprise-wide committee level, allowing their issues and material conflicts to factor into the identification and management of related conflict risks.

<sup>6</sup> Although the exemption does not attach any increased liability to the role, Chief Compliance Officers in other contexts have been named in recent enforcement actions. In addition, enforcement actions related to failures to supervise compliance personnel have recently been announced.

### Where should the officer or committee sit within the firm?

Many firms have asked whether the Chief Conflicts Officer or Conflicts Committee should serve as a first or second line of defense role. Although there is not consensus in the marketplace on this issue—and the BIC exemption does not specify one way or another—the current view of many (but not all) of our clients is that it is a senior business line executive. While the rule may imply that this is more naturally a compliance role due to the monitoring responsibilities, the authority to compel entities or individuals to take, amend, or refrain from taking actions to meet rule requirements is typically a business supervisory role. We believe that firms may be better suited to position the officer or committee chair as a first line function to allow for a greater degree of authority.

Firms that view this position as a first line of defense role interpret it as supervisory in nature. They also believe that it requires an officer or committee to understand how businesses that serve retirement investors operate, where material conflicts exist or might emerge, and how advisers may violate impartial conduct standards.

Alternatively, firms that see it as a second line of defense role have emphasized the explicit role of monitoring for material conflicts of interest and adhering to the Impartial Conduct Standards, which is seen as a second line function. The role of the Compliance Officer is integral to developing and administering a rigorous DOL compliance program, and they should actively work with and support the Chief Conduct Officer or Conduct Committee to monitor sales practices and adherence to rule requirements.

### To whom should the officer or committee report?

As with many of the previous issues raised, there are differing views throughout the

industry, but we have seen firms agree on certain guiding principles.

The Chief Conflicts Officer should be a senior-level position (or, if a firm opts for a Conflicts Committee, it should be comprised of senior-level executives) with the power to escalate issues directly to senior executives without intermediation.

In addition, the officer or committee should not report to anyone whose compensation is tied to conflicted revenue streams or the financial success of financial advisors.

### What infrastructure is needed to support the officer or committee, and what current infrastructure can you leverage?

The officer or committee requires infrastructure that makes volumes of information accessible and digestible, including:

1. Records of investment advice given and the rationale behind this advice that support the Best Interest standard
2. Trends analysis (i.e., reports that show patterns and trends that may indicate violations of the Impartial Conduct Standards)
3. Testing and reports that show the effectiveness of controls to mitigate material conflicts and that help detect potentially emerging material conflicts

In addition, the position requires surveillance systems for the ongoing monitoring of advisors' behavior for potential Impartial Conduct Standard violations. The position also requires recordkeeping systems for efficient investigations of issues, timely reporting to the DOL, and to support compliance with Impartial Conduct Standards.

With respect to leveraging existing infrastructure, firms should evaluate current surveillance and compliance functions, as well as recordkeeping, data warehousing,

and reporting capabilities. Firms should also review existing oversight committees and compliance functions to identify where processes that align with the role of the Chief Conflicts Officer or Conflicts Committee already exist.

Finally, firms should look to their service providers to better understand services they might offer, and leverage compliance for testing.

### What level of oversight at the affiliate level does the officer or committee require?

The officer or committee needs to be aware of material conflicts of interest at the affiliate level and understand what controls are in place to prevent these conflicts from affecting the exercise of the best judgment of an adviser or the financial institution as a fiduciary in rendering advice to a retirement investor.

In addition, the officer or committee should receive regular reports from affiliates on their material conflicts and the policies and procedures that are in place to mitigate such conflicts.

### Next steps

Deloitte continues to analyze the DOL final rule and prohibited transaction exemptions 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 to both comply with the rule and capitalize on the opportunities that its disruption has created. Organizations may contact Deloitte with questions about the rule and activities to support planning, preparation, implementation, and compliance.

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