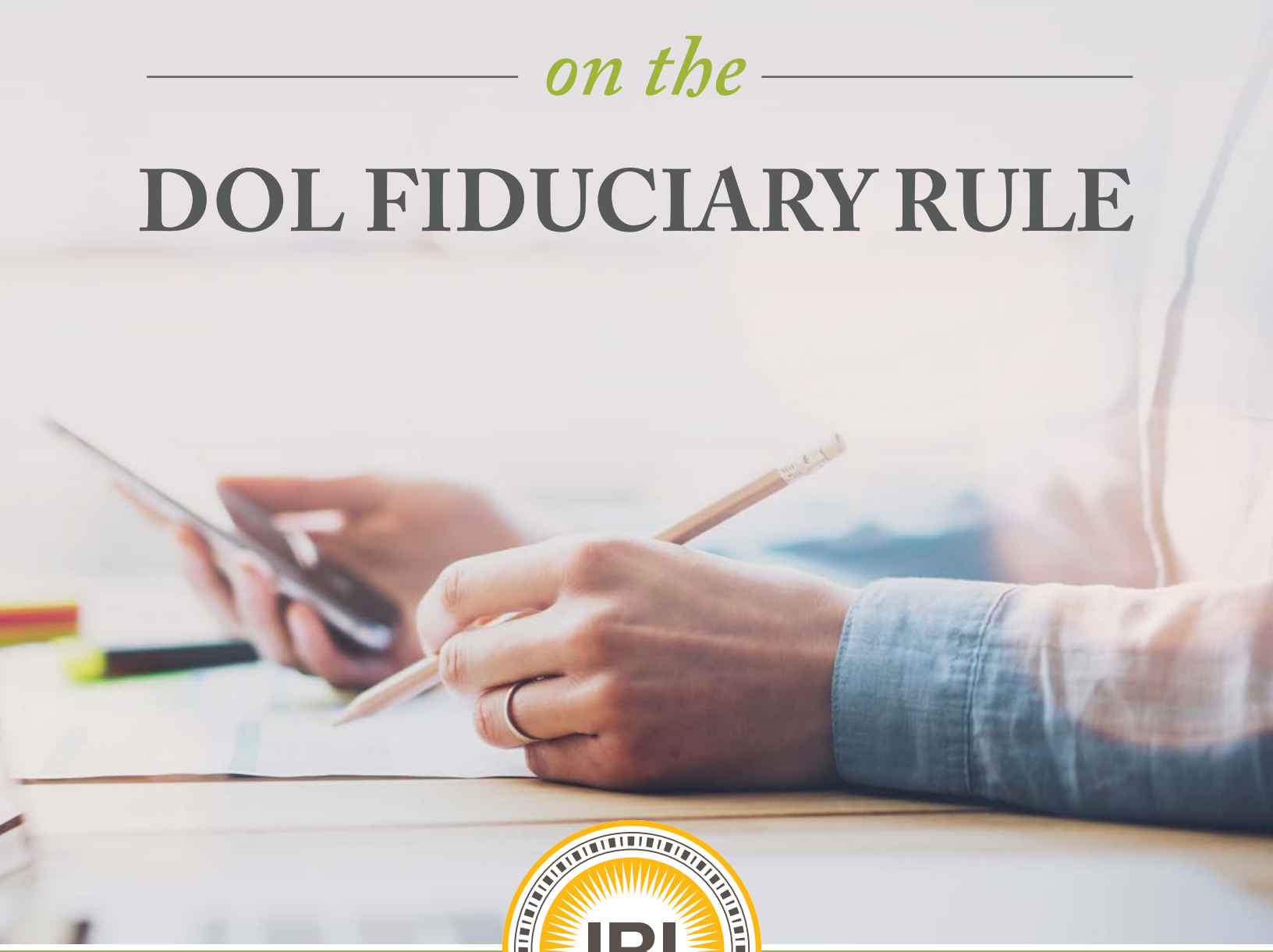
FAQ FOR FINANCIAL ADVISORS

on the

DOL FIDUCIARY RULE



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INTRODUCTION

This compilation of frequently asked questions (FAQ) was developed by the Insured Retirement Institute (IRI) to provide general information for financial advisors about the U.S. Department of Labor's recently adopted fiduciary rule (sometimes referred to as the "conflicts of interest" rule). These materials are provided for informational purposes only and not for the purpose of providing legal advice. Individual financial advisors should consult with their firm's legal and compliance departments to obtain guidance and direction with respect to any particular issue or question. Use of and access to these materials does not create an attorney-client relationship between IRI and any user. The opinions expressed below are the opinions of IRI and may not reflect the opinions of any particular IRI member company.

ABOUT THE RULE

1. What does the DOL rule do?

The new fiduciary rule replaces a rule that had been on the books since 1975 to determine whether someone is a fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA). The new rule significantly expands the universe of activities that would make someone a fiduciary under ERISA by treating almost any suggestion about investments as fiduciary advice.

Many common activities that have not traditionally been considered fiduciary in nature but would be under the new rule, including, for example, recommending or suggesting that a client:

- Rollover all or part of their retirement savings from a 401(k) plan to an IRA account, or transfer all or part of their savings from one IRA to another.
- Hire another person to provide investment advice or investment management services.
- Transition from a commission-based brokerage account to a fee-based advisory account.

While the new rule clearly treats the activities listed above as fiduciary advice, the treatment of other types of activities is less certain. Here are a few examples of activities that potentially could make you a fiduciary under the new rule, depending on the circumstances:

- Giving a mere factual description of the features of an investment product and explaining how the product can meet certain needs.
- Providing examples of how particular investment products could be used to implement an individual's asset allocation plan.
- Counseling a recent retiree about his or her likely income replacement needs and the features available under various annuity products that could help meet those income replacement needs.

While some of these activities could qualify as education, certain variations might cross over into the category of recommendations and constitute fiduciary advice. Determinations about whether specific activities will make you a fiduciary under the DOL rule will be made by your firm.

2. What is the Best Interest Contract (BIC) Exemption?

The Best Interest Contract (BIC) Exemption would allow you and your firm to continue to receive commissions and other types of compensation tied to specific products if your firm meets the following requirements:

- For IRA clients, enter into a "best interest contract" with your clients (no contract is required when you are working with an ERISA plan or a participant in an ERISA plan), including promises that you and your firm will act in your client's best interest, and will receive only "reasonable compensation" for your services.
- Establish policies and procedures to prevent material conflicts of interest from causing violations of these promises.
- Provide your clients with general information about the best interest standard and material conflicts of interest, with more detailed information available upon request.
- Maintain a free website that is updated at least quarterly and provides information about arrangements with product manufacturers and other parties for third party payments, and information about the firm's business model and advisor compensation arrangements.

Your firm will decide whether it intends to use the BIC Exemption. Firms that choose to use the BIC Exemption will develop policies, procedures and practices you will have to follow to ensure compliance with all of these requirements.

3. Are there any exceptions from the DOL rule?

While the rule broadly treats almost all interactions between advisors and clients as fiduciary advice, it does make clear that certain types of activities would not make someone a fiduciary under ERISA:

- General communications such as newsletters, research reports, general marketing materials, and speeches and presentations at conferences and widely attended events would not typically be considered fiduciary advice.
- You will also be able to provide educational information about financial, investment, and retirement matters without becoming a fiduciary, although there are some restrictions on your ability to discuss specific investment products. For example, if you are working with a participant in an employment-based plan, you can identify specific investments as part of an asset allocation model as long as you list all of the options available in the plan within each asset class. This is not permitted if you are working with an IRA owner.
- The rule also provides an exception for arms'-length sales transactions (sometimes referred to as the "seller's exception"), but it is only available if you provide advice about such transactions to an "independent fiduciary," which can be a bank, an insurance company, a broker-dealer, a registered investment adviser, or a fiduciary with at least $50 million in assets under management.

These are just three examples – Your firm will determine whether specific activities would make you a fiduciary under the rule.

4. When will the DOL rule go into effect? What is the difference between the effective date and the implementation date? How long will my firm and I have to comply with the rule?

The effective date of the final rule is 60 days after its publication in the Federal Register, or June 7, 2016. The applicability date for most parts of the final rule is April 10, 2017. Certain parts of the BIC Exemption have a delayed applicability date of January 1, 2018.

5. Will I need special fiduciary insurance (E&O coverage) for the liability imposed under the DOL rule?

While ERISA does not require fiduciaries to hold any particular type of insurance coverage, anyone who will become a fiduciary under the DOL rule should consider obtaining fiduciary liability insurance. Some firms hold fiduciary liability coverage for their advisors, so you should check with your firm to find out if you already covered.

If your firm does not provide this type of coverage for you, you should consider purchasing your own fiduciary liability policy. Given the specialized nature of this type of coverage, it would be advisable to consult with a broker who has experience and expertise dealing with ERISA fiduciary liability.

In either case, make sure you understand the coverage limits and exclusions associated with this type of coverage. For example, certain policies may limit coverage to the amount of any applicable surrender charges.

6. What should I do if I have questions about how to interpret or apply the DOL rule? Is it possible to ask the DOL for additional guidance?

You should consult with your firm before attempting to contact the DOL directly to request any guidance about the rule.

BEING AN ERISA FIDUCIARY

1. What does it mean to be a fiduciary under ERISA, and how does fiduciary status affect advisor compensation?

The DOL has emphasized the fact that a fiduciary under ERISA is required to act in his or her client's best interest. We know the vast majority of advisors are already committed to acting in their clients' best interest, but this is more than just an affirmation of that commitment. It changes advisors' legal status and holds them to new legal obligations that go beyond doing what's right for their clients.

Specifically, ERISA fiduciaries and their firms have a duty of loyalty, meaning they must act solely in the interest of their clients, and a duty of prudence, meaning they must act with the "care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity would use." Compliance with these duties is not judged based on outcomes but rather on the process followed by the fiduciary.

Moreover, ERISA fiduciaries and their firms are not allowed to receive compensation from any third parties in connection with their recommendations or compensation that varies depending on the particular investment being recommended. These are considered "prohibited transactions." The DOL can provide exemptions to allow individuals and firms to engage in "prohibited transactions" and receive compensation under certain conditions. Under the new rule, the primary exemption for most situations is the Best Interest Contract (BIC) exemption, although other exemptions (such as PTE 84-24) may also be available to allow to you receive compensation for these recommendations. See Question 2 under "About the Rule" for general information about the BIC Exemption.

2. What are the differences between my obligations as a fiduciary and the suitability standard I've always had to follow? How will being a fiduciary under the DOL rule change my responsibilities to my clients?

If you are a registered representative of a broker-dealer, FINRA rules require that you "have a reasonable basis to believe that a recommended transaction…is suitable for [your] customer, based on…the customer's investment profile." For recommendations of variable annuities, FINRA imposes even more stringent and detailed suitability requirements. Insurance agents are subject to similar obligations under most states' insurance laws and rules when recommending insurance products, including variable annuities as well as fixed and fixed indexed annuities (which are not covered by FINRA rules).

As an ERISA fiduciary, you will be required to act "solely in the interest of" your clients. This is a higher standard than FINRA's suitability rule, and will require significant changes in the way the industry does business. Your firm will develop policies, procedures and practices you will have to follow to ensure compliance with the ERISA fiduciary standard.

3. Is there a difference between being a fiduciary under this rule and being a fiduciary under the federal securities laws?

Yes. The primary difference between these fiduciary standards is how they treat conflicts of interest.

If you are an investment adviser under the federal securities laws, you must either eliminate or make full and fair disclosure of all conflicts of interest that could impact the impartiality of your advice.

By contrast, if you are a fiduciary under the DOL rule, you are prohibited from recommending a transaction if you have a conflict of interest unless you can qualify for the BIC Exemption or another prohibited transaction exemption (PTE).

4. Can my clients and I agree that I will not be an ERISA fiduciary in certain situations? For example, some clients only want advice on a one-time basis and don't need any ongoing support.

You and your clients can agree to structure your relationships in a manner that would not require you to engage in activities that would make you a fiduciary. However, if you do anything that would be considered fiduciary activity, the rule does not appear to allow you to avoid fiduciary status simply by including a disclaimer in the disclosures or other documents you provide to your clients. If you are a fiduciary under the rule, the BIC Exemption does allow you to define and limit the nature of your relationship with a particular client. Under the BIC Exemption, you and your firm must provide certain disclosures to your clients when they enter into the "best interest contract," including information about "the scope of the services provided" by you and your firm. The disclosures also must tell the client if you and your firm will monitor the client's investments and inform them of any recommended changes.

5. If I am a fiduciary under the DOL rule for a particular client's qualified accounts, will I also be a fiduciary for their nonqualified accounts?

Generally speaking, the DOL rule will not apply to a client's non-qualified accounts. However, if you advise a client to take money out of a 401(k) plan or other qualified account and move it into a non-qualified account, you would be considered to be acting as a fiduciary under the rule for the recommendation to take that distribution.

The rule is less clear in the context of holistic advice provided to a client with different types of accounts, such as a non-qualified brokerage account and an IRA. If your firm decides to use the BIC Exemption, the best interest contract between the firm and your client can specify which accounts are covered by the terms of the contract.

6. If I become a fiduciary under the DOL rule, will I have to operate under advisory agreements with my clients?

Advisors who engage in activities that would typically require an advisory agreement may be able to operate under either an advisory agreement or a best interest contract, depending on your firm's decision about whether it will use the BIC Exemption. The provisions of the best interest contract can be incorporated into an advisory agreement or into other account opening documentation. Your firm will determine how you will be expected to operate.

COMPENSATION

1. How will being a fiduciary under the DOL rule affect how I am compensated?

As a fiduciary under the DOL rule, you will likely have to comply with the requirements of a prohibited transaction exemption (PTE) to receive compensation for the advice you provide to your clients. This will apply to both existing and new clients. The BIC Exemption and most other PTEs impose a "reasonable compensation" standard that will prohibit you from receiving excessive compensation. This is a market-based standard, meaning your compensation will have to be appropriate in light of the services, rights and benefits you and your firm provide to your clients. The reasonableness of your compensation will depend on the particular facts and circumstances at the time of the recommendation. See Question 3 under "Compensation" for more information about "reasonable compensation."

The rule will also require your firm to establish policies and procedures to make sure that any differences in the amount of compensation you may receive for recommending one type of product over another (this is called "differential compensation" in the rule) are based on "neutral factors," such as the extra time it takes to sell certain products over others. For example, you may only be able to receive a higher commission for recommending a variable annuity rather than a mutual fund if you actually spend more time working with your clients to make sure the annuity is in their best interest and helping them understand the product you are recommending.

Your firm will develop policies, procedures and practices to ensure compliance with the compensation restrictions.

2. What kinds of compensation can I receive as an ERISA fiduciary?

If you become an ERISA fiduciary under the DOL rule, you and your firm will be subject to ERISA's prohibited transaction rules, which forbid compensation from any third parties and compensation that varies depending on the particular investment being recommended. Compensation includes, but is not limited to, direct and indirect sales commissions and advisory fees, as well as bonuses, awards, and other similar payments. In other words, you and your firm will generally be limited to level compensation arrangements under an advisory relationship unless you qualify for a prohibited transaction exemption (PTE) established by the DOL. Under the new rule, the primary exemption for most situations is the Best Interest Contract (BIC) Exemption. See Question 2 under "About the Rule" for more information about the BIC Exemption.

3. What does "reasonable compensation" mean?

"Reasonable compensation" is a vague and undefined standard, but the DOL has held fiduciaries to ERISA plans to this standard for many years. Under the DOL rule, to the extent you are relying on the BIC exemption, PTE 84-24 or other prohibited transaction exemptions, this standard will now have to be applied in the IRA market as well. Advisors to IRA owners have never before had a legal obligation to follow ERISA's "reasonable compensation" standard, so this will be an adjustment for that part of the industry.

"Reasonable compensation" has traditionally been interpreted and applied by the DOL as a market-based standard. Compliance with this standard will be determined based on whether your compensation is in line with amounts being received by others in the market in connection with recommendations of similar products, as well as the services, rights, and benefits you and your firm provide to your clients. This standard does not dictate any specific amount of compensation you and your firm can receive, but it can be expected to target at least true outliers (compensation that is far out of line with the market). The reasonableness of your compensation will depend on the particular facts and circumstances at the time of the recommendation.

Ultimately, each firm will make its own decision about the meaning of "reasonable compensation" and the policies and procedures needed to satisfy this standard.

4. Will I have to follow the rules in the BIC Exemption if I only receive fees or other forms of levelized compensation? Does it make a difference if the levelized compensation is at the account level or the product level?

As explained in Question 2 under "About the Rule" and Question 1 under "Being an ERISA Fiduciary," as a fiduciary under ERISA, you will not be allowed to receive compensation that varies depending on the specific product being recommended or compensation from third parties unless you satisfy the requirements of a "prohibited transaction exemption" (PTE). The BIC Exemption is one example of a PTE, but others may be available depending on the particular transaction. The DOL designed the rule to try to drive most transactions through the BIC Exemption.

Depending on the specific situation, you and your firm may be able to avoid the need to use the BIC Exemption or another PTE by using a levelized fee structure instead of commission-based compensation. This would mean that you and your firm will be paid a fixed amount, at either the account level or the product level, regardless of the specific products or actions you recommend to your clients.

Even if you only receive level fee compensation, you will still have to comply with the BIC Exemption in many cases. For example, you will need to use the BIC Exemption if you recommend that a client or potential client rollover all or part of their retirement savings from a 401(k) to an IRA, or from one IRA to another (because you would receive compensation if the client decides to rollover that you would not otherwise receive). In these instances, you and your firm may be able to rely instead on the so-called "Level Fee Fiduciary" exemption, a much less burdensome version of the full BIC Exemption (some people call this "BIC Lite").

BIC Lite requires acknowledgement of fiduciary status, a warranty of compliance with the best interest and reasonable compensation standards, and documentation of the reasons the arrangement is considered to be in the best interest of the retirement investor. BIC Lite is only available under very limited circumstances, however, because it requires that advisors only receive level fees and no other compensation be paid to the firm or any of its affiliates.

Your firm will decide whether it will seek to avoid using the BIC Exemption by using only levelized fee arrangements.

5. How will the DOL rule impact my relationships with existing clients? Can I continue to advise clients on existing investments (including recommendations about subaccount switches) and can I continue to receive trail commissions?

As noted in Question 4 under "About the Rule," you and your firm will have to begin complying with the DOL rule for both new and existing clients by April 10, 2017. Under the rule, there are a few possible ways for you to continue servicing your existing clients and receiving compensation with respect to those clients after that date.

Some of the services you provide may not make you a fiduciary in the first place, so those would not be impacted by the rule. For services that are fiduciary in nature, you may be able to continue providing those services for existing accounts without relying on the full BIC Exemption as long as you meet certain requirements.

This is referred to as "grandfathering," and the industry is still working to understand the implications of this provision. Your firm will ultimately decide whether and how its advisors may be able to rely on this provision.

In order to receive new compensation for any transactions you recommend after April 10, 2017, you and your firm will have to either structure the relationship in a way that avoids any "prohibited transactions" (see Question 1 under "Being an ERISA Fiduciary") or satisfy the requirements of the BIC Exemption. Until January 1, 2018, the rule allows firms to satisfy the best interest contract requirement with respect to existing clients without having your clients actually sign best interest contracts. Instead, your firm can send a notice to existing clients informing them of the additional rights they have under the BIC Exemption. This is called "negative consent."

Your firm will decide whether and how to enter into best interest contracts with existing, active clients for services to be rendered from that point forward. An important consideration for firms will be whether you are receiving trail commissions, and if so, whether you are providing any ongoing services in exchange for those trails.

THE BIC AND PTE 84-24

1. Who has to sign the "best interest contract" and when does it have to be signed? What if more than one financial institution is involved in a particular transaction, such as a variable annuity transaction (which involves the insurer, the broker-dealer, and the insurance agency)?

If your firm decides to rely on the BIC Exemption for advice to IRA owners, the "best interest contract" has to be signed by the firm and your client; individual advisors do not have to sign. The contract has to be signed by the time your client decides to execute a transaction you recommended. No contract is required for advice provided to qualified plans, participants or beneficiaries.

According to the DOL, only one financial institution (a bank, an insurance company, a broker-dealer or a registered investment adviser) must sign the "best interest contract." Generally speaking, the financial institution with the most direct ability to supervise your business activities will be in the best position to ensure compliance with the requirements of the BIC Exemption and should therefore sign the contract. So, for example, if you are a registered representative of a broker-dealer firm and you recommend a variable annuity, the broker-dealer firm will likely sign the best interest contract with your client. The insurance company that issues the variable annuity would not also have to sign the contract.

Each firm will establish policies and procedures its advisors will have to follow with respect to the execution of best interest contracts.

See Question 6 under "Being an ERISA Fiduciary" for information about the impact of the contract requirement for registered investment advisers.

2. How does the rule impact my client's ability to sue me if they are unhappy with their investment results?

By requiring that your firm enter into a "best interest contract" with your IRA clients, the BIC Exemption provides your clients with the ability to seek a legal remedy against your firm for a breach of the terms of that contract, including the commitments to act in your client's best interest and receive only "reasonable compensation."

To be clear, though, ERISA's best interest standard is not a "hindsight" standard or a guarantee of positive investment results. Rather, it is based on the facts and circumstances at the time of the recommendation. While clients may still try to bring a legal action if they are unhappy with their investment results, they will need to show more than just sub-par investment performance to prove that you or your firm failed to satisfy the best interest standard.

The BIC Exemption does allow your firm to include a mandatory arbitration clause in the best interest contract, and to disclaim punitive damages. However, the contract cannot include a limitation of liability or a waiver of clients' right to participate in a class action suit.

In addition to your client's ability to seek a legal remedy, the DOL (or the Treasury Department, for IRAs) may impose penalties if you or your firm fail to act in your client's best interest or comply with the promises included in the best interest contract.

3. I already have to make sure the investments I recommend to my clients are suitable. What more is required to satisfy the "best interest" standard?

Suitability requires that your recommendations be appropriate to your clients' investment objectives, risk tolerance, financial circumstances, and needs. This is an important part of meeting the best interest standard, but it is not enough. You will also have to make recommendations the way a prudent expert would, and put your own interests (and those of your firm, any affiliate, any related party, or any other party) to the side when arriving at your recommendation.

The DOL has made clear, however, that the best interest standard does not require you to determine the best product available in the entire marketplace to meet a client's needs. The standard is "best interest", not "best possible product."

Documentation will be critical to protecting yourself and your firm against any future claims by any client that alleges you did not act in their best interest. This could include keeping track of the following:

- Information you have about your clients (including information clients may have declined to provide)
- The universe of products you considered to potentially meet their needs
- Your reasons for recommending particular products over others
- Any information you provide to your clients to help them understand the recommended products and the basis for your recommendations.

Your firm will develop policies and procedures to ensure compliance with the best interest standard, including the firm's requirements with respect to documentation.

4. I understand there are new disclosure requirements under the BIC Exemption. What do I need to know about those?

If you or your firm intends to use the BIC Exemption, your firm will be required to notify the DOL in advance of that intention and must conform to data retention and recordkeeping rules.

In addition, the BIC Exemption does impose significant disclosure requirements. General information about the best interest standard and material conflicts of interest must be provided when your firm enters into best interest contract with your client, and when your client executes a recommended transaction. Your clients will have the ability to obtain more detailed information about fees and compensation upon request. Your firm will also have to maintain a free website that is updated at least quarterly with information about arrangements with product manufacturers and other parties for third party payments, and information about the firm's business model and advisor compensation arrangements.

Your firm will be responsible for satisfying these disclosure requirements, and will establish policies and procedures you will have to follow to ensure compliance.

5. What is PTE 84-24 and how is this exemption used? What are the disclosure requirements and other conditions for selling products covered by this exemption?

PTE 84-24 is an exemption from the prohibited transaction rules that allows fiduciaries to receive "insurance commissions" for recommendations to purchase "fixed-rate annuity contracts." This exemption only covers the receipt of sales commissions by advisors from the insurance company. Revenue sharing payments, administrative fees, marketing payments and other similar types of compensation are not covered by PTE 84-24. Historically, all types of annuities could be sold under this exemption, but the DOL significant narrowed the scope of PTE 84-24 when it adopted the fiduciary rule. After April 10, 2017, PTE 84-24 will only be available for recommendations of "Fixed-Rate Annuity Contracts," which are simple fixed annuities such as single premium immediate annuities (SPIAs) and deferred income annuities (DIAs). Variable annuities, fixed indexed annuities, and other similar products would not be covered.

To rely on PTE 84-24 for sales of "Fixed-Rate Annuity Contracts," you will have to satisfy certain requirements:

- Act in your client's best interest
- Receive only "reasonable compensation" for your services.
- Provide your clients with information about the sales commission you will receive from the insurance company for the recommended transaction, as well as any charges or fees that may be imposed under the recommended annuity contract.

Your firm will decide whether to use PTE 84-24 for fixed annuity recommendations. Firms that choose to use PTE 84-24 will develop policies, procedures and practices you will have to follow to ensure compliance with all of these requirements.

WORKING WITH CLIENTS

1. How will the DOL rule impact my ability to provide education to my clients?

While the rule broadly treats almost all interactions between advisors and clients as fiduciary advice, it does make clear that you can provide educational information about financial, investment, and retirement matters without becoming a fiduciary. This includes education about:

- The terms or operation of a 401(k) plan or IRA, including, for example, the benefits of participating and increasing contributions, the impact of early withdrawals, and available distribution options.
- General financial and investment concepts, estimating future retirement income needs, determining investment time horizons and risk tolerance, and general strategies for managing assets in retirement.
- Model asset allocation portfolios for hypothetical clients with different time horizons and risk profiles.
- Interactive investment materials plan participants or IRA owners can use to estimate retirement income needs, evaluate distribution options, or estimate how much retirement income could be generated by a hypothetical account balance.

In general, talking about specific investment products will cause you to cross the line from education (which would not make you a fiduciary) to advice (which would make you a fiduciary). There are limited circumstances when you may be able to include specific investment options in an asset allocation model.

Your firm will establish policies and procedures you will have to follow in order to use the education exception.

See Question 3 under “About the Rule” for more information about the exception for educational communications and other exceptions from the definition of fiduciary.

2. How will the DOL rule impact my ability to recommend IRA rollovers?

Providing advice about rollovers is one of the many common activities that have not traditionally been considered fiduciary in nature but would make you a fiduciary under the new rule. This means you will typically need to rely on a prohibited transaction exemption in order to recommend that a client rollover all or part of their retirement savings from a 401(k) plan to an IRA account, or transfer all or part of their savings from one IRA to another. Your firm will decide how it intends to treat rollover recommendations, and will develop policies, procedures and practices you will have to follow when providing advice about rollovers.

There are a few ways your firm might choose to treat rollover recommendations under the rule:

- As with any other type of recommendation, the firm could choose to use the full BIC Exemption.
- The firm could instead use the so-called "Level Fee Fiduciary" exemption, a much less burdensome version of the full BIC Exemption (some people call this "BIC Lite"). See Question 4 under "Compensation" for more information about BIC Lite.
- If you are recommending a rollover and also recommending that the rollover proceeds be used to purchase a "Fixed Rate Annuity Contract," the firm may allow you to rely on PTE 84-24 for the entire recommendation.

3. How will the DOL rule impact my ability to recommend my firm's own proprietary products?

If you are only able to offer your firm's proprietary products, special rules will apply under the BIC Exemption. As with the full BIC Exemption, these special rules will require that you and your firm comply with the best interest standard (see Question 3 under "The BIC and PTE 84-24") and the reasonable compensation standard (see Question 3 under "Compensation"), and tell your clients about any material conflicts of interest you or the firm may have (including any limitations on the universe of products you can offer). In addition, your firm will have to take certain steps to support the decision to offer proprietary products.

- These special rules may also apply if you can offer both your firm's proprietary products as well as products issued by other firms.

Each firm that offers proprietary products will adopt policies and procedures to ensure compliance with these special rules.

4. Will different rules apply depending on whether I am working with a small plan or a large plan?

While the rule does not differentiate between small and large plans, if you are working with a plan or IRA client that is represented by a sophisticated independent fiduciary, you may be able to avoid fiduciary status. Your firm will decide if you qualify for this exemption and, if so, how to comply.

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