The ASA Group

FIDUCIARY BEST PRACTICES

HELPFUL HINTS TO ESTABLISHING A FIDUCIARY PRUDENT PROCESS

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Department of Labor Impartial Conduct Standards

The Department of Labor's Conflicts of Interest Rule, or the Fiduciary Rule, requires financial professionals to meet the impartial conduct standards of (1) making recommendations in the "best interest" of the client, (2) earning reasonable compensation, and (3) not making misleading statements. Fiduciaries historically have met these standards by establishing a repeatable, prudent process regarding their investment advice.

In this new "fiduciary world," this concept may be new to some, but even experienced fiduciaries are always improving their process – and the Fiduciary Rule reinforces the constant changing framework of fiduciary best practices.

It is important to prepare. So, before you ever work with a client, you should have a clear idea on the scope and steps you will take when getting to know your client and recommending products. To meet your fiduciary obligations, here are some prudent practices you can employ:

Build a Product Platform

From an annuities product perspective, here are some things to think about and decide ahead of time:

Who – Which carriers and BGAs will you work with? What is the minimum rating for a carrier to be on your platform? What services do you want from a carrier or BGA? What do you look for in client service standards? Can you continue to service clients if you are no longer appointed?

What – What products and features are important to meet clients' needs? Do the products pay reasonable compensation, or are they outliers that could be considered unreasonable? Are the costs and any surrender charges reasonable?

When – You should have a high-level idea of when to use a particular product for a client need. Does the carrier have a focus or does it have a wide variety of products to serve your clients?

In short, you need to know your products and be able to manage them. Many broker-dealers have narrowed their product shelf for this fiduciary world. There is no reason you shouldn't do the same.

Know Your Clients Suitability

This probably goes without saying, but at a minimum, you need to know your client's:

- Financial circumstances, including current assets, liquidity, income and expense needs, net worth, current portfolio, insurance protection, etc.
- Investment objectives, risk tolerance and time horizon
- Investment experience
- Need for an annuity

Rollover Validation Process

Not every situation will involve a rollover from a qualified plan or IRA, but a good many will. FINRA has identified a number of factors that should be considered when a rollover is a possibility. Even if you are not subject to FINRA, the standard has been set to consider the following:

- Review the "Four Options" with the client when assets are in an employer-based plan, e.g., 401(k): rollover to IRA, rollover to new employer plan, keep money in the plan, take distribution

- Compare employer plan features to IRA features: availability of plan loans, negative tax effects of moving employer stock from a plan to IRA, distribution options under the plan compared to an IRA
- Compare plan services with IRA services
- Compare fees and expenses of the plan with those of the IRA
- Compare plan investments versus IRA investments: What solutions are available with an IRA that are not available in the plan, and vice-versa?
- Protection from creditors and legal judgments while in a plan versus state law

Reasonable Compensation

Your prudent process should also document why your compensation is reasonable. What is reasonable? The DOL is clear that a market- based standard is the measure of reasonableness. What this means is that the value of the services you deliver meets the "rates" within the market. Factors to consider include the complexity of the product and the time and effort you put into the case. The product does not need to be the lowest cost or generate the lowest fees. But, the compensation must be transparent and bear a reasonable relationship to the value of the services offered (reflecting the time, complexity of the case, and the level of expertise you brought to the recommendation and prudent process). From a practical standpoint, you should not be recommending products where the compensation gives the appearance of being an outlier in the industry.

Recommendation

By this point, you have done quite a bit of preparation, and the assumption is that the recommendation is justified based on the client's needs and you have followed a prudent process to come up with the "best interest" product. So, make the recommendation, document the rationale behind it and provide all required disclosures, e.g., a PTE 84-24 Disclosure Statement and Acknowledgement.

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