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# Fiduciary Roles Under ERISA And Their Evolution in the Marketplace

## Speakers



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## Demographics Driving Policy

Much of the current guidance of the Department of Labor, the Treasury Department, the SEC and FINRA is being driven by demographics

And, for our purposes, the greatest demographic “driver” is the aging of the boomers in a defined contribution world.

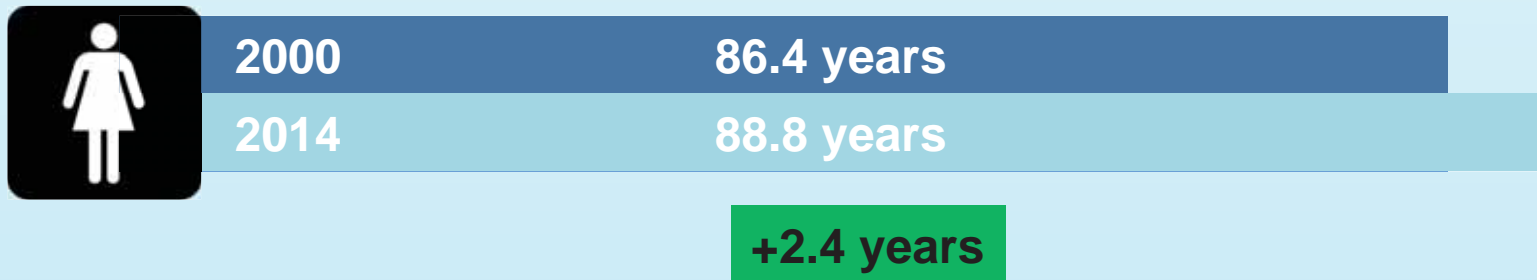
# The Retirement Dilemma

The concern is two-fold:

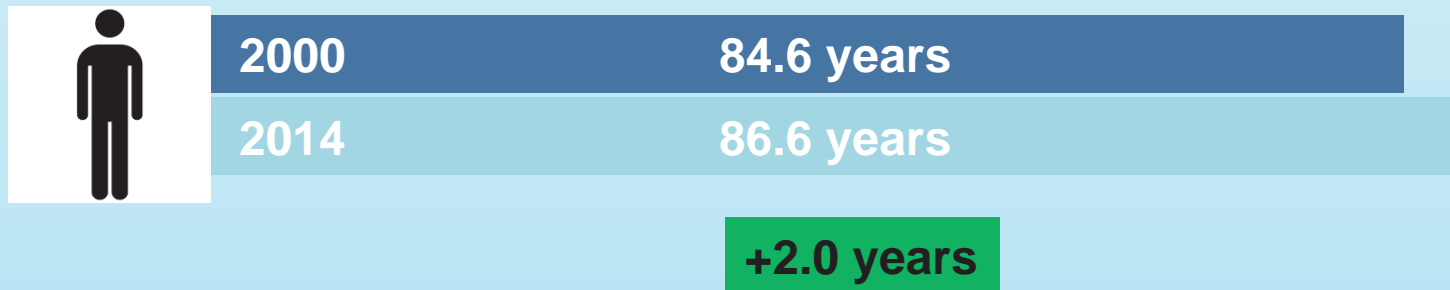
- Will participants have enough money when they retire?
- How will participants withdraw their money, so that they do not exhaust their accounts or IRAs before they die?

## Increase in life expectancy for 65-year-olds (From Society of Actuaries Report)

### Women



### Men



# Withdrawal Rate Risk

Table 3. Estimated Probability by CRS That A Retirement Account Will Last for at Least a Specific Number of Years

	<u>Initial annual drawdown rate</u>		
	4%	5%	6%
<b>Probabilities that money will last a given number of years, excluding the impact of investment fees and taxes</b>			
25 years or more	97.7%	87.8%	65.2%
30 years or more	94.0	77.0	49.5
35 years or more	89.4	66.9	38.8

Source: CRS Monte Carlo simulation of a portfolio consisting of 35 percent S&P 500 index and 65 percent AAA-rated corporate bonds.

*But, see “The 4 Percent Rule is Not Safe in a Low-Yield World,” Finke, Pfau and Blanchett.*



# DOL Regulatory Agenda

## Pension Benefit Statements—Projection of Income

*“As part of this initiative, the Department will explore whether, and how, an individual benefit statement should and could present a participant's accrued benefits in a defined contribution plan (i.e., the individual's account balance) as a lifetime income stream of payments, in addition to presenting the benefits as an account balance.”*

## The Issue: Participant Understanding

		Changed retirement age to later	Expect to retire at age 70+ or never
I have a clear idea of how much I need to save for a comfortable retirement	<b>Disagree</b>	47	43
	<b>Agree</b>	36	26
I have a good idea of what I can expect from my retirement plan	<b>Disagree</b>	53	47
	<b>Agree</b>	37	26

*Which Workers Are Delaying Retirement and Why?", Towers Watson Insider, September 2014.*

## The DOL and Projections of Retirement Income

	1. Account Value	2. Monthly Income after Retirement	3. Survivor Monthly Income
A. Estimated for Current Account Value	\$124,023.02	\$459.92	\$229.96
B. Projected at Retirement	\$665,715.09	\$2,468.67	\$1,234.34

- All future projections are shown in today's dollars, which account for inflation. Inflation changes the purchasing power of money. Presenting your projections in today's dollars will give you an idea of how much you could buy with your retirement account when you retire.
- Caution: projected values at retirement are only estimates.

## DOL Regulatory Agenda—Retirement Income

- **Prognosis**

- **Issues**

*Assumptions*

*Projections*

*Other plans/IRAs*

- **Practical effects**

*Change of perspective*

*Benchmark*

*Advice on deferrals*

*More services*

## DOL Regulatory Agenda—Annuities

### Selection of Annuity Providers— Safe Harbor for Individual Account Plans:

*“Based on the RFI comments, the Department is developing proposed amendments to the annuity selection safe harbor primarily focused on the condition in the safe harbor relating to the ability of the annuity provider to make all future payments under the annuity contract.”*

# DOL Regulatory Agenda

## Conflict of Interest Rule-Investment Advice

*“This rulemaking **would reduce harmful conflicts of interest** by amending the regulatory definition of the term “fiduciary” set forth at 29 CFR 2510.3-21(c) to more broadly define as fiduciaries, employee benefits plans, and **individual retirement accounts (IRAs)** those persons who render investment advice to plans and IRAs for a fee . . .”.*

## The DOL and IRA Rollovers

The Department of Labor's 2005 guidance on "capturing rollovers" from retirement plans was the first step in regulating advisory services for distributions and rollovers. (DOL Advisory Opinion 2005-23A)

## The GAO and IRA Rollovers

The GAO's March 2013 report: "401(k) PLANS: Labor and IRS Could Improve the Rollover Process for Participants," has heightened the awareness of conflicts of interest in the rollover process and increased the likelihood of greater regulation of IRA rollovers.



# FINRA Report on Conflicts of Interest (October 2013)

Why?

*Customer liquidity events and suitability monitoring:*

*Firms monitor the suitability of registered representatives' recommendations around key liquidity events in an investor's lifecycle where the impact of those recommendations may be particularly significant, for example, at the point where an investor rolls over his pension or 401(k). [Emphasis added.]*

## Suitability

*If Rule 2111 is triggered, a registered representative must have a reasonable basis to believe that **the recommendation is suitable for the customer, based on information about the options obtained through reasonable diligence**, and taking into account factors such as tax implications, legal ramifications, and differences in services, fees and expenses between the retirement savings alternatives. [Emphasis added.]*

## FINRA Regulatory Notice 13-45

- Investment Options★
- Fees and Expenses★
- Services★
- Penalty- Free Withdrawals
- Protection from Creditors and Legal Judgments
- Required Minimum Distributions
- Employer Stock

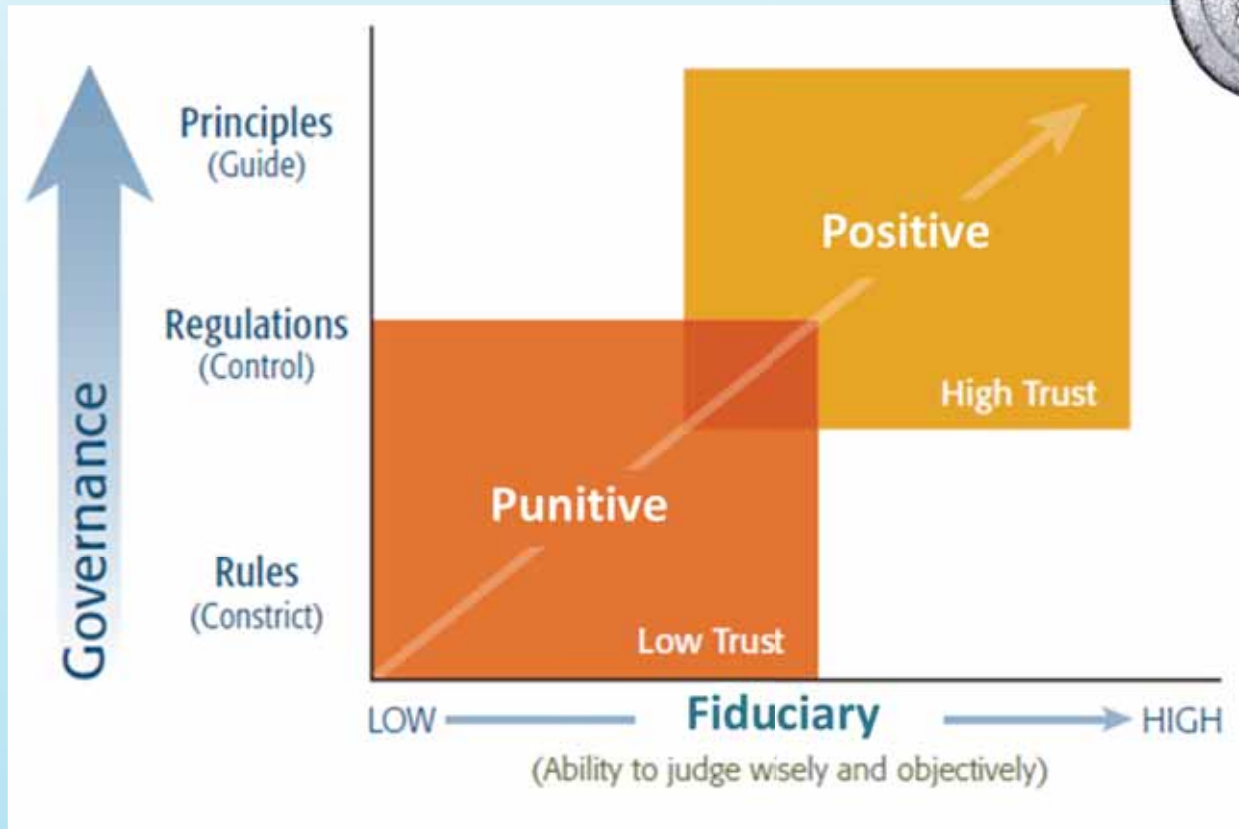
*...the list is not exhaustive*

## FINRA Examination Priorities: For 2014 and 2015

*In 2014, reviewing firm rollover practices will be an examination priority, and staff will **examine firms' marketing materials and supervision in this area.** **FINRA will also evaluate securities recommendations made in rollover scenarios** to determine whether they comply with suitability standards in FINRA Rule 2111. [Emphasis added.]*

*Note: Also in SEC 2014 and 2015 Examination Priorities.*

## Two Faces of a Fiduciary Standard: Positive and Punitive



# Governance (Decision-Making Hierarchy)

## Leadership (Voluntary)

You have the ability to inspire and the capacity to serve others.

## Stewardship (Voluntary)

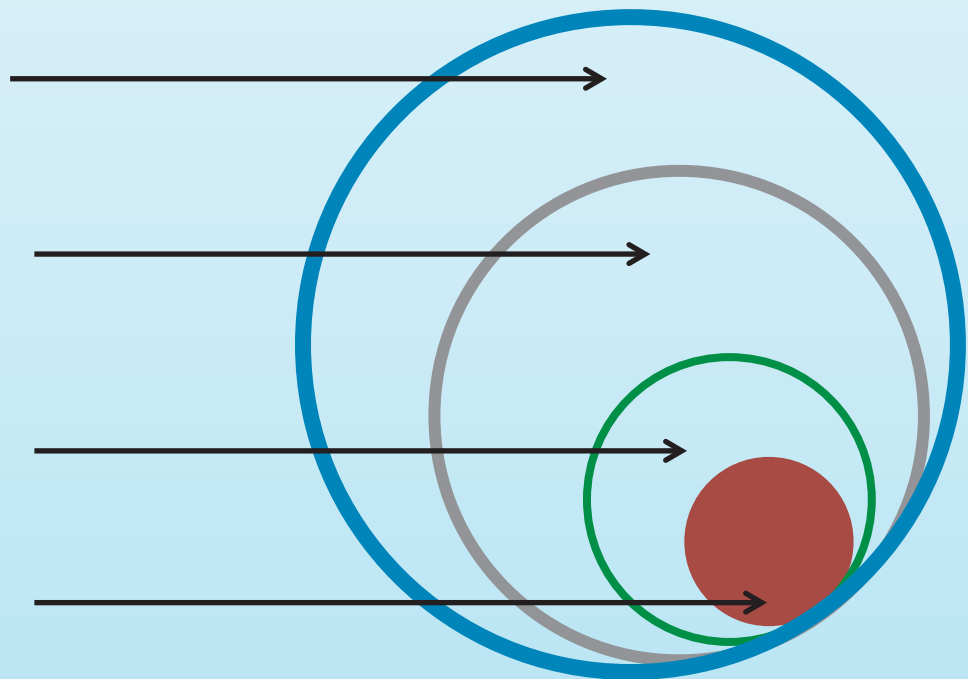
You have a passion and discipline to place the interest of others first.

## Fiduciary (Regulated)

You have a legal requirement to place the interests of others first

## Suitability (Regulated)

You have a reasonable basis for how you treat others.



# Fiduciary Evolution

*We're at the front of  
the 3<sup>rd</sup> wave*

## 1<sup>st</sup> Wave

(1985-1999)

What's a prudent process?

## 2<sup>nd</sup> Wave

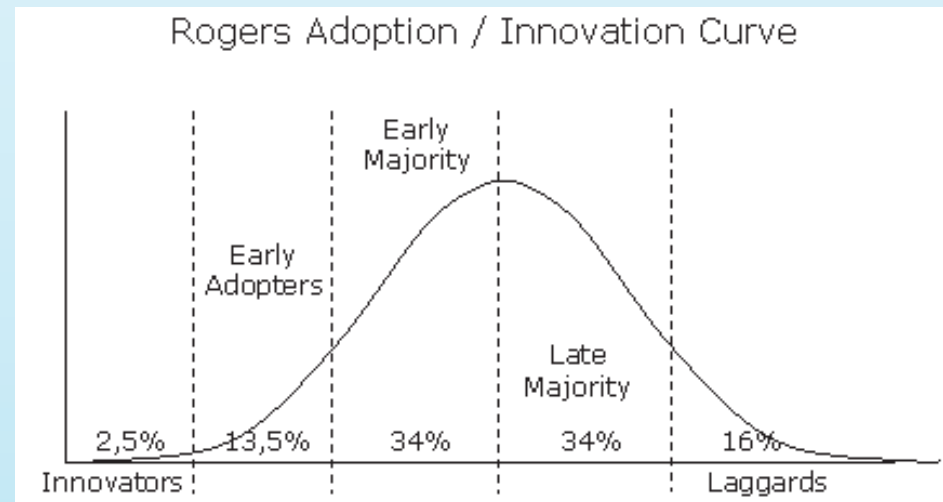
(2000-2012)

What are the best practices?

## 3<sup>rd</sup> Wave

(2013-Present)

What's our leadership role?



## Leadership Role

*In terms of defining a higher professional standard of care, **Leadership** is the new **fiduciary***

*Clients “get” **leadership**; they don’t “get” **fiduciary***



## Leadership Role

***Fiduciary** is a floor, not a ceiling – you should never be satisfied by being merely compliant with a **fiduciary** standard*

***Leadership** and **stewardship** evoke an even higher sense of purpose than **fiduciary***



*Charles Barkley on CNBC  
Feb. 12, 2015*

*Who manages your money?*

***"Raymond James. I'm [at] Raymond James. Birmingham, Ala. My guy's name is Glenn Guthrie. I've been with him for 27 years and I trust him with my life."***

*That's a leadership and stewardship response – there is no other vocabulary that can adequately express Barkley's genuine feelings.*

**What has the greatest impact  
on participant outcomes?**

## The answer is trust.

Great companies have **great** 401(k) plans

Poorly led companies have **poor** 401(k) plans

## Unfortunately, most companies are poorly led

**70%** of workers are not inspired or emotionally engaged by the company they work for

**75%** of plan participants don't trust the advice

## Most 401k “fixes” are going to require a leadership response

When you talk with executives and directors you have to talk in terms of **leadership** – try to talk **fiduciary**, you’re going to be sent back to the investment committee.

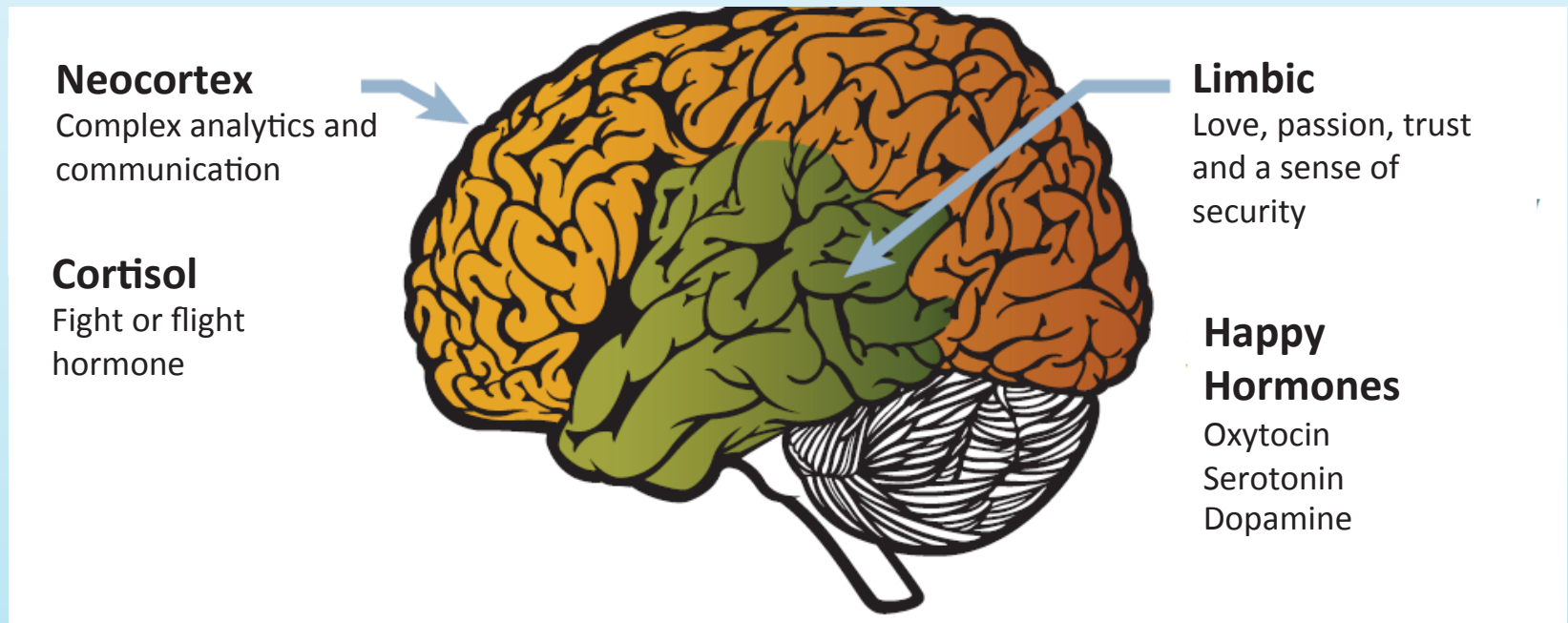
# Clients “get” leadership, they struggle with fiduciary

**Leadership** is exhilarating – **Fiduciary** is exhausting!

There are physiological reasons why.

## Fiduciary section of the brain

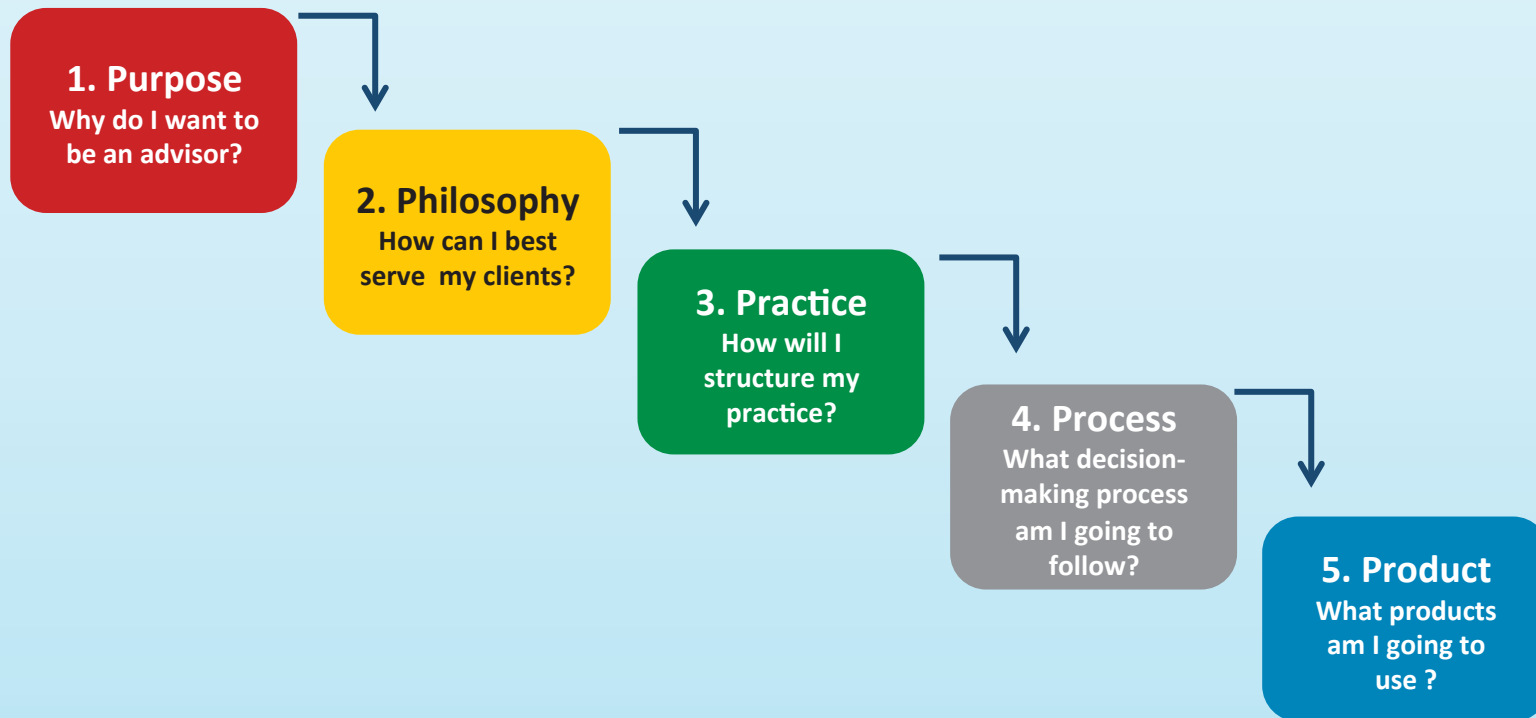
## Leadership section of the brain



**Key:** Cortisol is an inhibitor to the creation of the happy hormones



# The Pentagonal Hierarchy™



Thought leadership: Rick Ferri, Shaun Wurzbach,  
Don Trone and Mary Lou Wattman

# The Pentagonal Hierarchy™



# The Pentagonal Hierarchy™



Many advisors make the mistake of reversing the hierarchy and start by defining themselves in terms of Process or Product

# The Pentagonal Hierarchy™



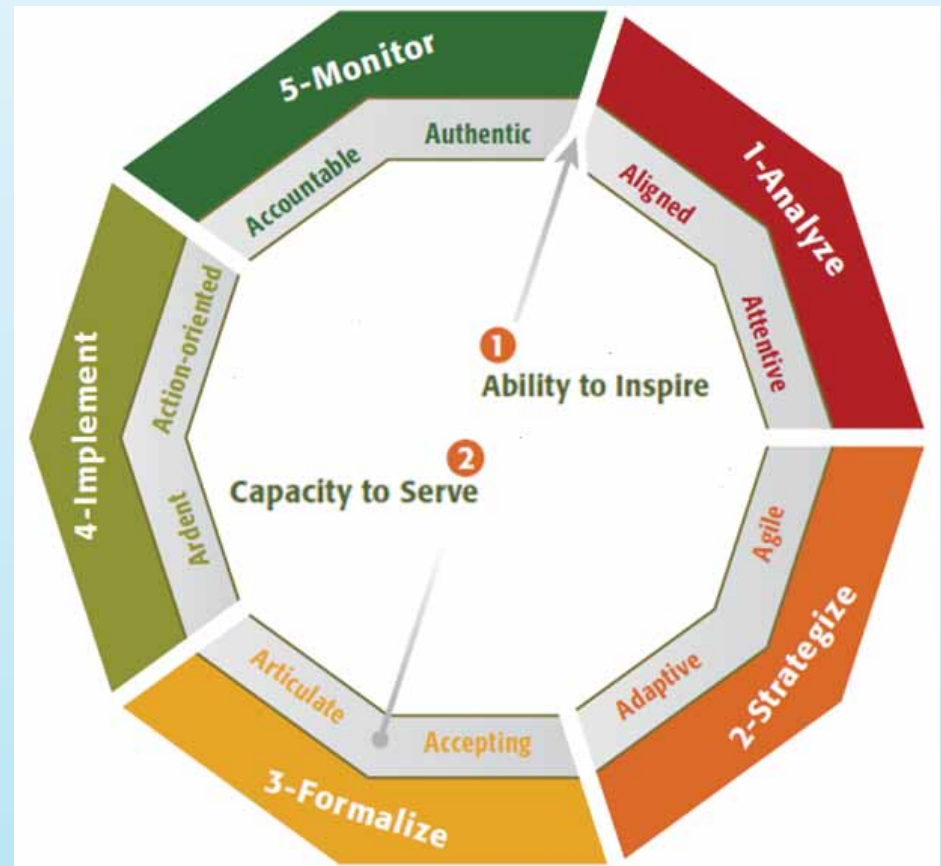
## Investment committees will never “get” a fiduciary process they only use 2 hours every quarter

To broaden and deepen key client relationships, teach institutional clients a leadership framework they can use every day [yet, a framework that still fulfills a fiduciary standard]

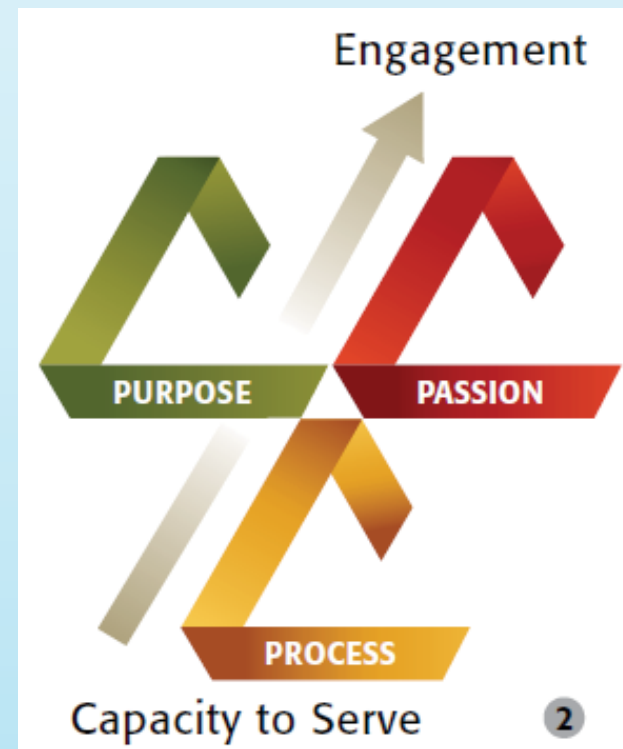
Inner ring:  
**2 Leadership Tenets**

Middle ring:  
**10 Stewardship Attributes**

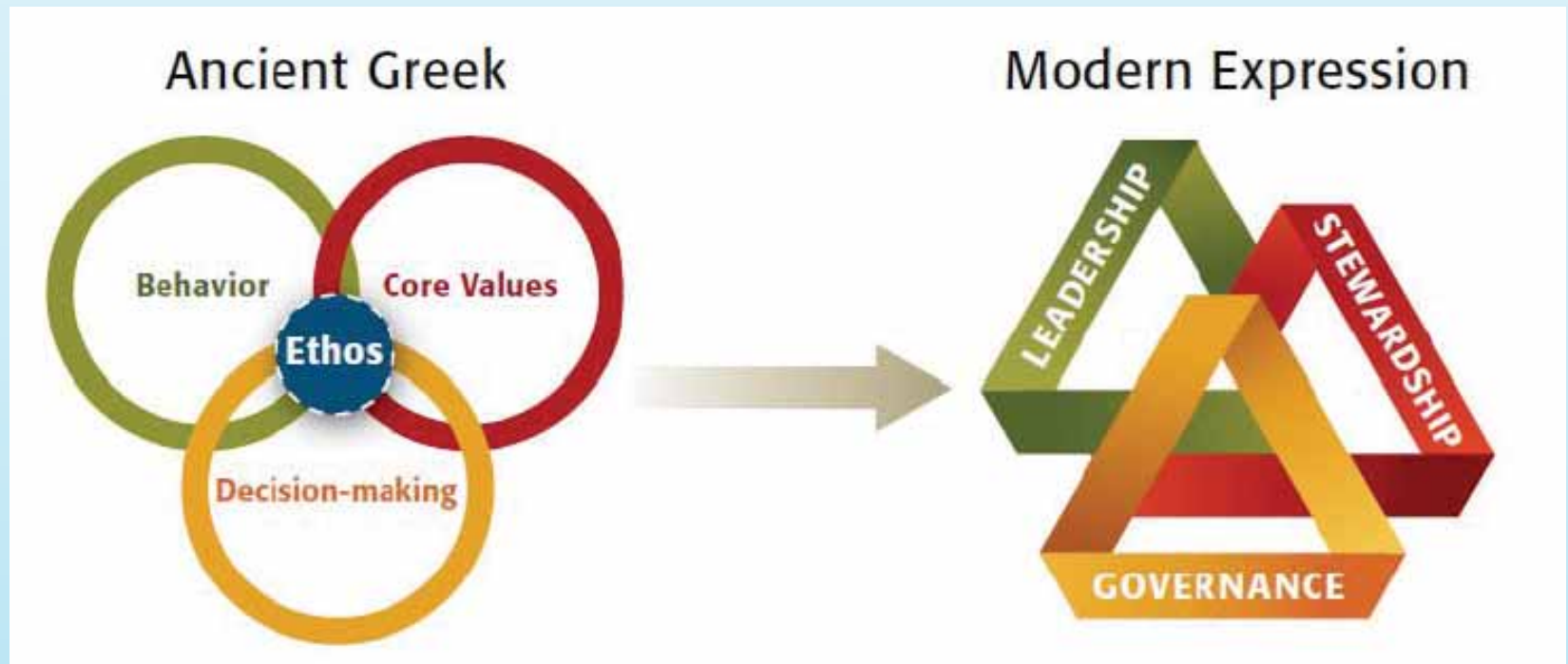
Outer ring:  
**5-step Governance  
[Fiduciary] Process**



## 2 Leadership Tenets



# Ethos





# What do you call a leadership style that integrates with stewardship and governance?



## Ethotic leadership™

The ability to inspire and the capacity to serve others by demonstrating a continuum between leadership, stewardship and governance.