2016 INVESTMENT MANAGEMENT CONFERENCE

ERISA Developments

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TOPICS

- Changing Retirement Landscape
  - New DOL fiduciary regulation
  - Litigation
- Risks for Investment Managers

Changing Retirement Landscape

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RETIREMENT LANDSCAPE IS UNDERGOING DRAMATIC CHANGES

Traditional defined benefit pension plans	401(k) plans	IRAs
~$2.8T in assets	~$6.8T in assets	~$7.4T in assets
Beginning to wane as plans are closed, frozen, and terminated	Experiencing growth	Experiencing growth but may stagnate under the new DOL fiduciary regulation

Causes include:

- New DOL fiduciary regulation
- Litigation

Source: Investment Company Institute www.ici.org/research/stats/retirement/ret_16_q2

NEW DOL FIDUCIARY REGULATION

- In April 2016, the DOL issued a new regulation that redefines “investment advice fiduciary”
- Greatly expands the types of market participants deemed to be ERISA fiduciaries
- Alters key “prohibited transaction” exemptions
- Includes a new Best Interest Contract Exemption
- Many of the requirements are applicable beginning in April 2017

BROAD REACH

- Under the new fiduciary regulation, a fiduciary “recommendation” broadly includes statements that would reasonably be viewed as suggestions to take or refrain from taking a particular course of action
- Content, context, and presentation inform the determination
- The more individually tailored the communication, the more likely it is a “recommendation”
- Fiduciary recommendations must meet a “best interest” standard and raise conflict of interest considerations
- Pivotal Concern: Many activities currently considered to be “promoting” or “marketing” of investment products or services can now be captured as ERISA fiduciary “recommendations”

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INSTITUTIONAL CLIENT APPROACH: SOPHISTICATED FIDUCIARY

- **Rule:** It is not fiduciary investment advice for a party to communicate with a sophisticated, independent fiduciary acting on behalf of a retirement client where there is no expectation of reliance
- **Requirements include:**
  - The party providing the advice knows or reasonably believes the fiduciary is a: (i) bank, (ii) insurance company, (iii) RIA, (iv) broker-dealer, or (v) party that holds or has under management or control at least $50M in assets
  - The party providing the advice informs the fiduciary that it is not providing impartial investment advice or giving advice in a fiduciary capacity
  - The party providing the advice knows or reasonably believes the fiduciary is a fiduciary under ERISA and/or the Internal Revenue Code with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction
  - The party providing the advice knows or reasonably believes the fiduciary is capable of evaluating investment risks independently, both in general and with regard to the particular investment

SOPHISTICATED FIDUCIARY: ACTION STEPS

- Develop and implement a process to promote adherence
- Training
- Add investor representations and investment manager disclosures to fund documents and IMAs
- Consider due diligence on the client's fiduciary

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RETAIL CLIENT APPROACH: BEST INTEREST CONTRACT EXEMPTION

- **Rule**: Permits promotional activities and allows investment advice fiduciaries to receive certain types of compensation that would otherwise be impermissible
- **Requirements Include**:
  - Compliance with "impartial conduct standards"
  - Policies and procedures
  - Disclosures
- "Level fee fiduciaries"
  - Streamlined requirements
  - A level fee is a fee or other compensation that is provided on the basis of a fixed percentage of assets or a set fee that does not vary with the particular investment recommended, rather than a commission or other transaction-based fee

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BIC EXEMPTION: ACTION STEPS

- Develop and implement a process to promote adherence
- Determine whether the streamlined requirements for level fee fiduciaries are available
- Draft model contracts and disclosures
- Identify material conflicts of interest
- Determine whether changes to business models are necessary
- Draft policies and procedures

LITIGATION

- Unlike securities laws, which are primarily based on the concept of full disclosure, ERISA regulates what “fiduciaries” may and may not do and does so in a manner designed to ensure that actions are in the best interests of retirement clients
- ERISA class actions against fiduciaries have focused principally on (i) the soundness of investments, (ii) the reasonableness of compensation received by service providers and (iii) investments in employer stock
- Proliferation of class actions in recent months

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ERISA CLASS ACTIONS

- ERISA class actions have alleged the following:
  - Failure to adequately monitor costs
  - Use of more expensive share classes when less expensive share classes were available
  - Use of proprietary funds that charged excessive fees
  - Use of actively managed funds that charged higher fees than index funds
  - Failure to use collective trusts and separately managed accounts

FOCUS ON PLANS MAINTAINED BY INVESTMENT MANAGERS

- A number of recent complaints target retirement plans maintained by investment managers for their employees alleging it is imprudent to offer proprietary funds

Risks for Investment Managers

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PRINCIPAL RISKS

Risk	Mitigation
Becoming a fiduciary when selling/promoting services to clients (prior to contract engagement or product/service selection)	1. General communications exception 2. Investment education exception 3. “Hire me” concept 4. Sophisticated fiduciary or BIC Exemption
Failure to adjust to new environment of heightened focus on fees/expenses	1. Review internal analytics to ensure appropriate emphasis on fees/ expenses of underlying fund products and manager strategies
Litigation Risk	1. Enhance internal process 2. Learn from current litigation