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COMPLIANCE & ETHICS FORUM FOR LIFE INSURERS

DOL Fiduciary Standard - What it Means for Life Insurers

Guest Webinar by PricewaterhouseCoopers LLP

March 15, 2016

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~ Leading the Way ~

Agenda

- CEFLI's Antitrust Policy.
- Review of Hot Topics in the Life Insurance Industry.
- Q & A.

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Department of Labor Fiduciary Rule: Compliance Webcast

March 15, 2016

-DRAFT-FOR DISCUSSION PURPOSES ONLY

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Agenda

- Overview of the DoL Fiduciary Rule
- DoL Fiduciary Rule Impacts and Industry Perspectives
- Compliance and the DoL Fiduciary Rule
  - Products
  - Customers
  - Agents
  - Ongoing

With You Today

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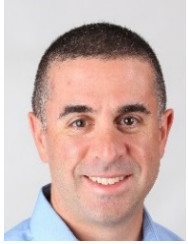

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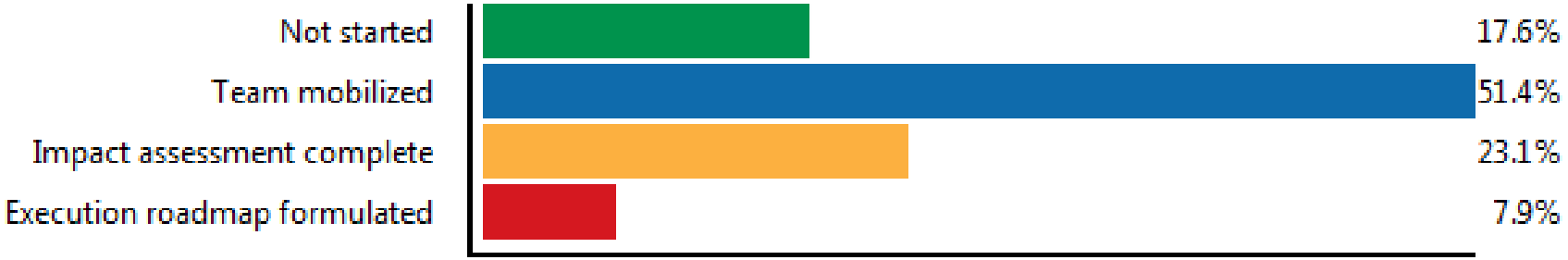
Overview of the DoL Fiduciary Rule

Polling Question #1

Which of the following best describes your company's preparedness for the Proposed Rule?



DoL Fiduciary Rule and Why It Matters

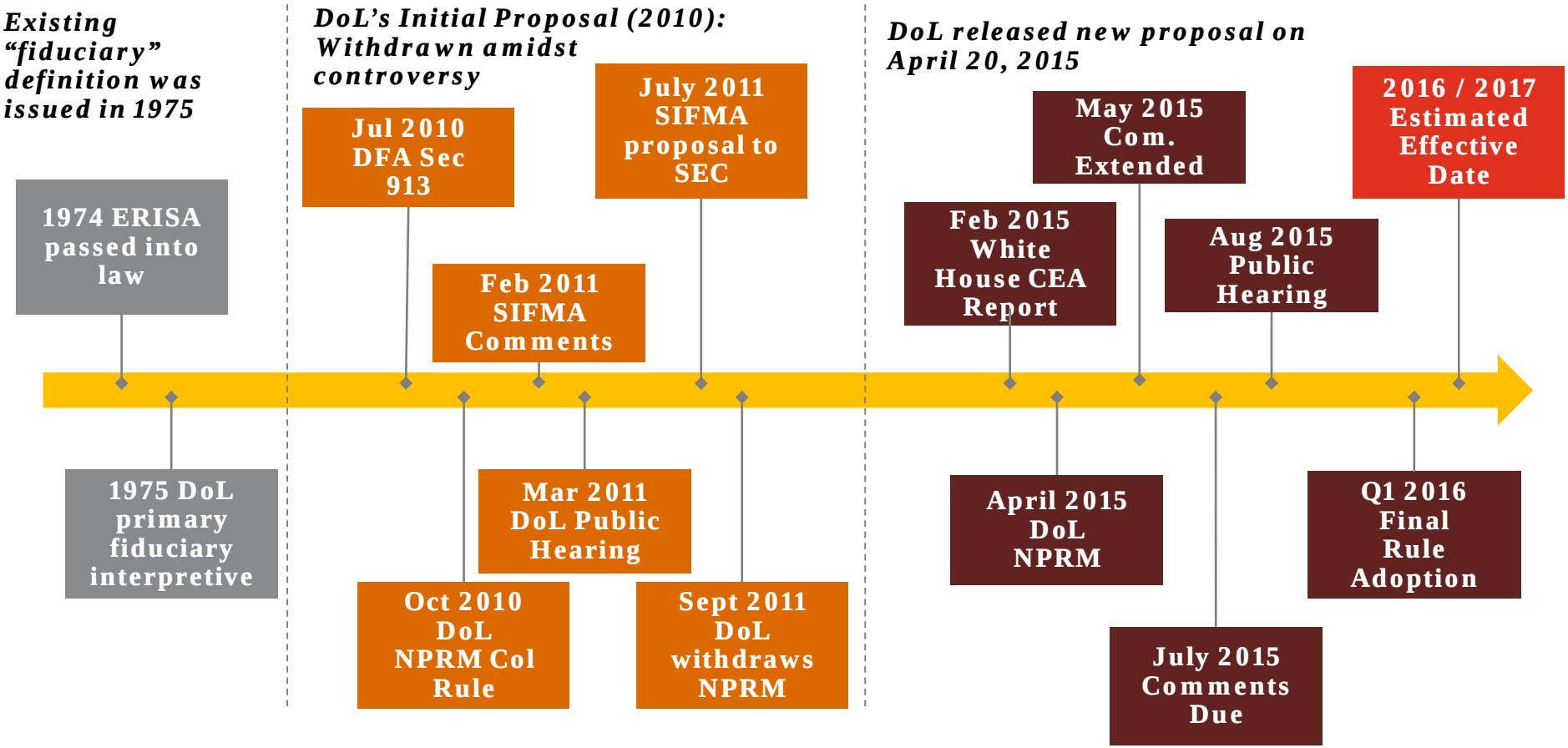
The Rule

- The Department of Labor (DoL) has proposed a complex regulation that would apply to financial professionals who provide investment advice to participants or sponsors of retirement savings plans, including 401(k) plans and IRAs.
- Under the newly expanded definition of investment advice within the DoL Fiduciary Proposal, ERISA and the Internal Revenue Code imposes fiduciary status on anyone providing advice regarding assets of an ERISA plan or IRA.

The "so what"

- The DoL Fiduciary Rule is set to fundamentally alter the entire financial services ecosystem and competitive landscape for US broker-dealers, asset and wealth managers, and insurance companies.
- Adjusting to this new landscape involves a number of strategic choices in addition to a major increase in the burden of compliance.
- We expect the DoL to finalize the Rule within the next month, with the proposal's core framework largely intact.

History of the Department of Labor



DoL Fiduciary Rule Timeline

2015		2016			2017
H1	H2	H1		H2	H1
DoL Fiduciary re-proposal released (April 14, 2015)	**Written comments and public hearings (Jul-Aug 2015)**	**DoL Rule sent to OMB (January 29, 2016)**	**Final DoL Rule anticipated (Mar 2016)**	**Additional DoL guidance anticipated (Q3 2016)**	**DoL compliance anticipated effective date (Jan 2017)**
			Today (Mar 2016)	**US Presidential Election (Nov 2016)**	

- The Final Rule will be effective 60 days after its publication in the Federal Register
- Requirements of Final Rule will become applicable ~8 months after publication in the Federal Register

DoL Fiduciary Rule

- The DoL has long had a concern that people choosing to roll over assets from an employer sponsored pension plan to an IRA are not being well advised and, as a result, are investing in products which are not the most appropriate for their needs and are unnecessarily expensive.
- Central to the DoL concern is what they perceive as a lack of transparency around the standard under which an advisor is providing advice and how he / she is being compensated. This is not surprising since advisors operate under multiple standards with a majority of asset flows falling under a "suitability" rather than Fiduciary Standard.
- The DoL's proposed solution is to expand the definition of a fiduciary under ERISA and the Internal Revenue Code (the "Code") to impose fiduciary status on anyone providing advice regarding assets of an ERISA plan or IRA – specifically including advice on rollover of assets to an IRA.
- Becoming a fiduciary would impose duties of loyalty, prudence, disclosure and monitoring but would also have a very fundamental impact on advisor compensation.
- Specifically, "ERISA and the Code generally prohibit fiduciaries from receiving payments from third parties and from acting on conflicts of interest, including using their authority to affect or increase their own compensation, in connection with transactions involving a plan or IRA."

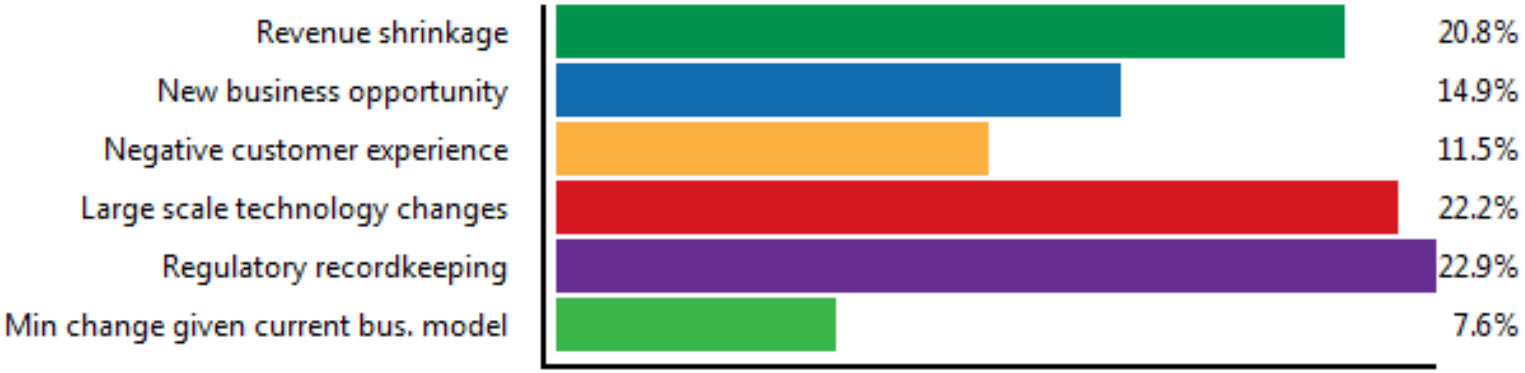
DoL Fiduciary Rule

- Under the Proposed Rule, an individual will be considered a fiduciary if he or she provides "investment advice" by providing investment or investment management recommendations and he or she acknowledges the fiduciary nature of the advice or acts pursuant to an understanding that the advice is individualized to or specifically directed to a retirement investor.
- Those who provide fiduciary investment advice (i.e., recommendation to move or not move money from an ERISA-qualified product) will face limits on receiving commission-based (as opposed to flat fee) compensation.
- Under ERISA, a fiduciary may not receive "conflicted compensation." This includes fees and compensation common in the retail market, such as brokerage or insurance commissions, 12b–1 fees and revenue sharing payments, (which) fall within these prohibitions when received by fiduciaries as a result of transactions involving advice to the plan participants and beneficiaries. The proposed regulatory package includes a proposed exemption to allow brokers to continue to receive this type of compensation (as long as the requirements of the exemption are satisfied).

DoL Fiduciary Rule Impacts and Industry Perspectives

Polling Question #2

Which of the following will be the biggest impact to your business?



Perspectives and Reactions from the Industry

How will the Rule impact manufacturers and distributors?

How will the Rule affect Compliance?

How can I best prepare for the final release?

Overarching Themes to the Financial Services Ecosystem and Industry Players

Consolidation	• Consolidation of businesses with market players leaving the retirement business
Compensation	• Significant restructuring of compensation arrangements and product fee structures
Distribution	• Distribution channel changes imminent due to restrictions on compensation and permissible asset class
Increased costs	• Cost increases to business lines, compliance, technology and operations
New compliance requirements	• Compliance with new requirements, training and ongoing monitoring
Disclosures	• Point of sale, annual and website disclosures

What are other industry participants doing to prepare for the release of the Final Rule?

- Baseline assessment
- Reviewing business model
- Determining potential impact
- Scenario planning
- “No regrets” actions
- Implementation plans and contingency plans

Preparing for The Rule

*PwC conducted an initial assessment of the Proposed Rule and identified three main options for **compliance**:*

1

Brokerage Model Conforming with the Best Interest Contract (BIC) Exemption

- *Disclosure requirements*: Disclosure must be provided to customers at the time they purchase new investments and must include key information
- *Contract requirements*: Signed contract between the financial advisor, financial institution, and investor must indicate the fiduciary status of the advisor and describe the fiduciary compliance program

2

Advisory Model

- Change to a flat fee for advisory services
- *Note* that the Advisory Model is a committed flat fee and as such the compensation model must change

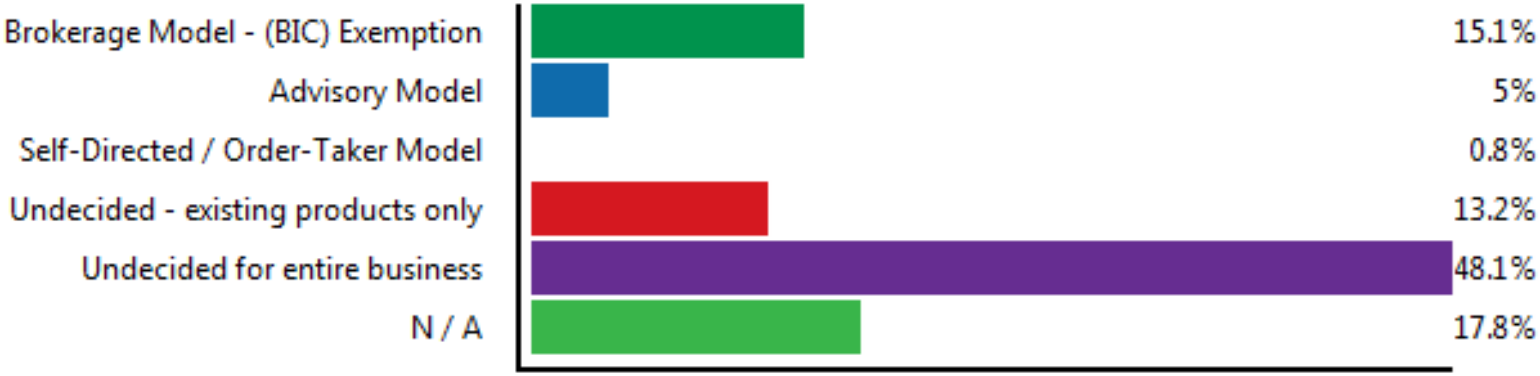
3

Self-Directed / Order-Taker Model

- Maintain current fee structure, but rely on directed orders from consumers

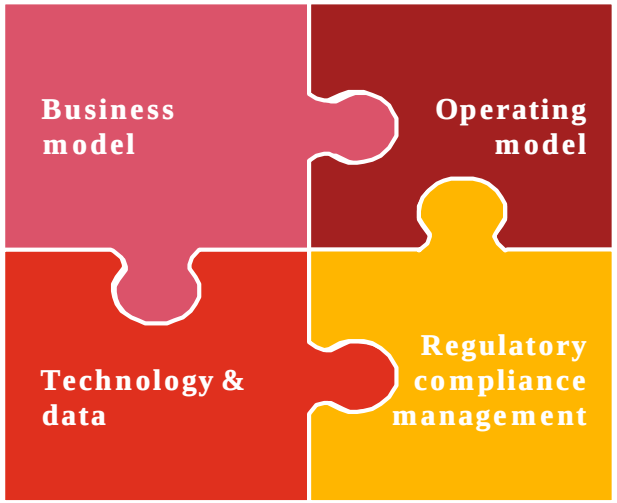
Polling Question #3

Are you planning to use one of the following models?



Compliance and the DoL Fiduciary Rule

Major Areas of Impact



Regulatory Compliance Management Considerations

Products	***Customers***	***Brokers / Agents***
• Product Development and New Product Approvals • Distribution Channels • Marketing Materials & Communications	• Contracting • Disclosures • Customer Education / Communication	• Compensation Models
Ongoing Surveillance Data capture and Record Retention and Management Training and Education		

Impact on Compliance – Products

Product Development and New Product Approvals

Regulatory Details and Impacts

- Under the Proposed Rule, products will have more nuanced and detailed requirements.
- Certain products, such as Variable Annuities, will be significantly affected by the Proposed Rule.
- Products will have to be changed to either allow for "reasonable" commission-based compensation under the BIC exemption, or be changed to a fee-based compensation structure.
- Certain advisors will have to shift their attention away from some commission-based products to fee-based products.

Compliance Impact

- Determine Compliance's role in the new product development and approval process
- Provide perspective and compliance guidance during new product rationalization, for proprietary and non-proprietary products
- Determine if new policies should be written, and identify key policies that will require review or potential overhaul
- If utilizing the BIC exemption, determine how new product development will be monitored on an ongoing basis to ensure that commissions received are "reasonable" under the Final Rule

Impact on Compliance – Products

Distribution Channels

Regulatory Details and Impacts

- Although the Proposed Rule does not create specific requirements for distribution channels, the proposed changes to compensation models may affect distribution through:
  - An increase in an advisory model, with more distribution of third party products to put clients in products that are in their best interest,
  - A potential decrease in advice / sales to investors with moderate to low assets under management, since increased advisory fees may potentially reduce access to distribution by these investors,
  - A potential increase in individual activity and robo-advising.

Compliance Impact

- Support determination of distribution channels for new products
- Provide guidance on and monitor products from third parties for financial performance, sufficient risk mitigation, and availability of accompanying disclosures and data
- Determine approach to monitor online interactions with clients to ensure that fiduciary advice is properly rendered
- Support the development and execution of field training and education on compensation models during the distribution process

Impact on Compliance – Products

Marketing Materials & Communications

Regulatory Details and Impacts

- The Proposed Rule will have an effect on the way that advisors and firms communicate with customers, including increased disclosure requirements and specific rules around investor education.
- A major deviation from the ERISA definition of a fiduciary under the Proposed Rule is the removal of required on-going advice in order to be a fiduciary. Under the Proposed Rule, even one time or ad-hoc advice can trigger the Fiduciary Standard.
  - This could have a potential "chilling" effect on the willingness of advisors to interact with customers before formalizing the relationship.

Compliance Impact

- Review existing marketing materials to ensure they have been updated to include appropriate language, in line with the Final Rule
- Consider applicability of communication channels and develop strategies to update those channels
- Provide applicable supervision of the disclosure process and distribution of information
- Evaluate and monitor the client onboarding process to prevent the rendering of unintended fiduciary advice

Impact on Compliance – Customers

Contracting

Regulatory Details and Impacts

- Under the BIC exemption, parties must enter into a tri-party contract (advisor, financial institution, investor).
- The contract must include applicable requirements, such as acknowledgement of fiduciary status, certain warranties, impartial conduct standards, accounts covered and limitations / conflicts of interest.
- Firms cannot limit liability or preclude investors from enforcing the contract through class actions.

Compliance Impact

- Review existing templates and model contracts, ensuring applicable exemption provisions have been included appropriately if the organization is adopting the brokerage model conforming to requirements
- Determine Compliance's role within the reflowed contract process and determine key interactions with other internal stakeholders (e.g., Legal) and ensure that record retention and archiving requirements are included in the enhanced process
- Provide guidance and input to Operations and Legal on the re-papering process for existing clients, such as reviewing accompanying communications to manage risk
- Work with other second and third line of defense (e.g., Internal Audit) teams to develop or enhance the contract monitoring and testing approach; consider enhancing test scripts, conducting frequent testing following implementation, etc.

Impact on Compliance – Customers

Disclosures

Regulatory Details and Impacts

- Companies that conform with the BIC exemption must make certain disclosures in tri-party contracts, including conflicts of interest, the customer's right to information on fees, information on how the advisor is compensated, and the website address to access further information and disclosures.
- Advisors must also make disclosures for transactions, such as one, five, and ten year cost projections of fees the customer will pay if he / she purchases the given product, annual disclosures about the investment and related fees, and website disclosures on compensation.

Compliance Impact

- Review and update disclosure templates for compliance with the Final Rule
- Review drafted disclosures for accuracy of included information and completeness, including website information
- Determine if pre-existing contracts will require new disclosures or additional client communications and ensure updated disclosures are appropriately flowed into the contract re-papering process
- Oversee and work with Operations on applicable dissemination of disclosure information (e.g., ensure that annual disclosures are properly distributed)
- Maintain an archive of disclosure information so that customers making information requests can receive materials in a timely manner

Impact on Compliance – Customers

Customer Education / Communication

Regulatory Details and Impacts

- The Proposed Rule provides a new definition of what is now considered investment advice.
- The Proposed Rule provides carve outs, including one for investment education and applies to:
  - General financial / retirement information, asset allocation models, interactive investment materials and general plan information,
  - Education for both plan and IRA clients.
- Education must not recommend specific investment products or asset classes.

Compliance Impact

- Ensure customer communications and websites are updated to clearly provide transparency on the Fiduciary Standard and actions that can be taken if customers believe the investment advice they are provided does not appear to meet the Fiduciary Standard
- If applying the carve out, ensure that investment education and clear examples are documented in policies and pushed into applicable policies and procedures (e.g., scripts)
- Work with Operations teams to identify various channels to communicate with clients (e.g., website, call center, agents, marketing materials, etc.) and determine where process updates or additional training may be required

Impact on Compliance – Brokers / Agents

Compensation Models

Regulatory Details and Impacts

- The Proposed Rule will have varying effects on current compensation models, from minimal impact to requiring a complete overhaul. Commission based accounts will no longer be permissible in their current state, and will require either the use of the BIC exemption or change to another model.
- Some potential models and alternatives that companies are currently considering are:
  - Conform to BIC Exemption,
  - Utilize the Prohibited Transaction Exemption,
  - Switch to an Advisory Model (wrap fees),
  - Switch to the Self-Directed / Order-Taker Model.

Compliance Impact

- Understand current compensation and fee models (e.g., administrative fees, sales charge / load, management fees / investment advisory fees, warp fee, 12b-1 fees, broker-assisted commissions, redemptions fees, custodial fees, trail commissions)
- For existing products and customer profiles, work with business lines to provide guidance on compensation structures and options under the Final Rule
- Determine approach to ensure that advisors / employees are acting within the boundaries of the selected model (e.g., not giving advice in the Order-Taker Model)

Impact on Compliance – Ongoing

Surveillance

Regulatory Details and Impacts

- Though the Proposed Rule provides no formal requirements around surveillance, given the breadth and complexity of the Proposed Rule, it is essential that organizations consider ways to enhance capabilities for monitoring applicable data and stakeholder activities / communications that are impacted by the Fiduciary Standard.

Compliance Impact

- Determine appropriate data to collect (for distributors) or provide (for manufacturers), such as customer information, annuity characteristic, CDSC on an annuity, underlying investments, etc.) that contribute to appropriate Fiduciary Standard surveillance, as well as if data analytics solutions can be leveraged
- Evaluate manual surveillance conducted throughout the organization
- Determine opportunities for surveillance areas that may already have gaps and develop plans to remediate that are in line with the Fiduciary Standard
- Consider additional technology solutions that could assist Compliance and the broader organization to provide monitoring and oversight of areas affected by the Final Rule (e.g., email communications, contract language, etc.)

Impact on Compliance – Ongoing

Record Retention and Management

Regulatory Details and Impacts

- To reduce litigation and reputational risk, companies will need to deliberately and effectively document interactions and transactions between advisors and customers.
  - After a recommendation, transaction, or mere conversation, an advisor may need to show:
    - Knowledge of investment products and the market,
    - Knowledge of the clients circumstances,
    - Rationale for product recommendations.

Compliance Impact

- Draft templates to gather information during client interactions, such as current financial information, future retirement goals, etc.
- Work with Operations to develop an efficient and effective means of disseminating product and market information to advisors in real-time
- Work with Operations and provide oversight on the papering process to capture advisor-clients interactions, including advice rendered and resulting transactions
- Ensure record retention and management policies are updated for compliance with the Final Rule and ensure training is completed for affected stakeholders

Impact on Compliance – Ongoing

Training and Education

Regulatory Details and Impacts

- Though the Proposed Rule provides no formal requirements around ongoing training and education, given the breadth and complexity of the Proposed Rule, it is essential organizations consider ways to keep employees and distributors educated on the requirements, particularly those who interact with customers.

Compliance Impact

- Identify key stakeholders (e.g., those who provide investment advice) to be trained on what it means to be a fiduciary and provide investment advice under the Final Rule
- Work with applicable learning and development teams to build multi-channel trainings that provide education to affected resources and are customized for their role / daily responsibilities
- Develop approach to work with affiliated broker-dealers and agents to reinforce the Fiduciary Standard and regulatory implications
- Consider enhanced monitoring of functions with higher potential to provide investment advice, such as call center employees, and develop enhanced documentation to reduce risk and support compliance (e.g., scripting)

Polling Question #4

What is your biggest concern regarding the Final Rule?

Next Steps

Many organizations are standing up program teams to prepare for the Final Rule, ensuring that decisions related to business models are risk-based and comprehensive and execution is consistent throughout the organization.

1 Impact assessment & Execution roadmapping

2 Execution phase

Steering committee

Program management office

Resources & time commitment

- Business:
  - Retirement brokerage
  - Advisory
  - Self-directed
- Field management/operations
- IT
- Finance
- Risk
- Legal
- Compliance
- Client solutions

Resources & time commitment

- Business:
  - Retirement brokerage
  - Advisory
  - Self-directed
- Products:
  - Annuities, capital markets, ETFs, insurance, IRAs, mutual funds, UITs, etc.)
- Field management/operations
- IT
- Risk
- Legal
- Compliance
- Client solutions
- FA training

Thank You

Questions/Answers

We'd love to hear from you.

For any questions or comments regarding this presentation, please contact:

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