



Minding the Gaps:

HELPING PEOPLE MOVE TO WHERE THEY NEED TO BE

Summer Conference

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THE HOUSEHOLD BALANCE SHEETSM VIEW AND THE NEW DOL FIDUCIARY RULE

INTRODUCTION

- Agenda
 - Household Balance SheetSM
 - Advisor use of balance sheet
 - Traditional ERISA Prudence
 - New Best Interest Standard

THE RIIA[®] HOUSEHOLD BALANCE SHEETSM

- Sophisticated net worth statement
- Captures and classifies household resources
 - Financial Capital: savings and investments
 - Human Capital: future earnings
 - Social Capital: Social Security benefits and pensions
 - Liabilities: all future expenses
- Projections and present value calculations generally based on 30 year horizon

HOUSEHOLD BALANCE SHEETSM AS ANALYTICAL TOOL

- Human Capital (*i.e.*, future earnings) decreases over time
- Floor: Liabilities remaining after subtracting Human Capital and Social Capital
 - Financial Capital must equal/exceed Floor to reach goals
 - Excess of Financial Capital over Floor
 - Mathematical measurement of risk
 - Delineates investable assets
- Balance sheet facilitates planning for all purposes (*e.g.*, risk management and cash flow optimization) not just investment planning

DATA INPUTS FOR HOUSEHOLD BALANCE SHEETSM

- **Human Capital:** Earnings from employment and hobbies
- **Financial Capital:** 401(k) and other DC plans; IRAs; HSAs; Keoghs; annuities; checking & savings accounts; money market funds; CDs; Mutual funds; trusts; educational accounts
- **Social Capital:** Soc. Security; pensions; trust income & bequests
- **Other Assets:** Primary residence; other real estate; business ownerships; art
- **Essential Expenses:** Food; shelter; clothing; health-care; utilities; insurance and taxes
- **Discretionary Expenses:** Vacations; entertainment; hobbies & gifts
- **Debt:** Home mortgage & equity loans, school loans, credit card debt, vehicle loans, alimony and other financial obligations
- **Desired Legacies**

IMPACT OF NEW DOL FIDUCIARY RULE

- ERISA Title I
 - Prudent man standard of care for fiduciaries
 - Prohibition of fiduciary self-dealing and conflicts of interest by fiduciaries
 - NA to IRAs or sole proprietor plans
- ERISA Title II / Internal Revenue Code
 - Excise tax imposed on prohibited transactions by fiduciaries
 - Generally applicable to all retirement vehicles
- New DOL fiduciary rule significantly expands scope of investment advice fiduciary definition

OLD FIDUCIARY DEFINITION

- Fiduciary Status
 - Covers person who provides “investment advice” relating to plan assets for compensation
 - Not a fiduciary if no investment advice is given
- 5-Prong Definition for “Investment Advice”
 - Making investment recommendations
 - On regular basis
 - Mutual understanding
 - Primary basis for plan’s decisions
 - Individualized to plan’s needs

NEW INVESTMENT ADVICE DEFINITION

- Required Context for Investment Advice
 - Advisor acknowledges it is acting as a fiduciary under ERISA or IRC, or
 - Written or unwritten understanding that advice is based on particular investment needs of client, or
 - Advice is directed to specific person(s) regarding advisability of a particular investment decision
- Required Nature of Investment Advice
 - Advisor makes a “recommendation” for a fee or other direct or indirect compensation

“RECOMMENDATION” DEFINED

- Covered Recommendations to Plan/IRA
 - On advisability of investing in property, or
 - Relating to management of property including:
 - IPS, strategies, portfolio composition
 - Selection of other persons to provide advice
 - Selection of account (brokerage vs. advisory)
 - Transfers or rollovers from Plan/IRA
- “Recommendation”
 - Reasonably viewed as suggestion to engage in particular course of action (*i.e.*, call to action)

PROHIBITION OF VARIABLE COMPENSATION AND THE BICE

- Prohibited transaction rules bar fiduciary advisors from receiving variable compensation
 - Variable compensation is remuneration that varies on the basis of the product in which plan assets are invested
 - E.g., commissions
 - Variable compensation creates conflict of interest by giving advisor an incentive to steer retirement client to higher paying investment
- Exemption from prohibited transaction rules needed in order to receive variable compensation
 - Best Interest Contract Exemption is a new exemption included under DOL Fiduciary Rule

BICE AND THE BEST INTEREST STANDARD OF CARE

- New Best Interest standard
 - Condition for receiving variable compensation under BICE
 - Three elements:
 - Prudence
 - Recommendations based on retirement client's investment objectives, risk tolerance and financial circumstances and needs
 - Without regard to advisor's interests, financial or otherwise
- BICE operational requirements
 - written compliance policies and procedures mitigating conflicts

FINRA SUITABILITY AND THE BEST INTEREST STANDARD OF CARE

- FINRA suitability questionnaire may fall short of BICE standard of care
 - Most FINRA questionnaires are limited in scope
 - Fail to meet information gathering standard
- ERISA prudence and BICE standards require basing advice on retirement investor's investment objectives, risk tolerance, circumstances and needs
- Information must be obtained before rendering advice
- Inadequate information indicates potential failure to give adequate consideration to client's needs

USING HOUSEHOLD BALANCE SHEETSM TO MEET BEST INTEREST STANDARD OF CARE

- Advantages of Household Balance SheetSM:
 - Represents complete financial picture of client's needs / objectives
 - Qualifies as client information gathering and financial planning tool consistent with ERISA prudence
 - Input process provides key information
 - Allows advisors to give appropriate consideration to client's needs / objectives and all other relevant information in creating a retirement plan and making investment recommendations

HOUSEHOLD BALANCE SHEETSM AND BICE COMPLIANCE POLICY

- Under BICE, advisory firms must adopt written compliance policies / procedures mitigating conflicts
 - Content of policies/procedures is flexible
 - Mandatory use of Household Balance SheetSM could be included in policies/procedures
- Household Balance SheetSM can help in formulation of investment recommendations
- Requiring recommendations to be based on Household Balance SheetSM would be consistent with Best Interest standard under BICE

RIA USE OF HOUSEHOLD BALANCE SHEETSM TO MEET FIDUCIARY STANDARDS

- RIAs might not receive variable compensation but will still need the BICE for rollover recommendations
 - Qualifying under BICE means meeting new Best Interest standard
- Non-rollover advice from RIAs to ERISA clients must meet related ERISA Prudence standard
- Household Balance SheetSM methodology meets ERISA Prudence and BICE Best Interest standards

IMPORTANT INFORMATION

This presentation is intended for general informational purposes only, and it does not constitute legal, tax or investment advice from The Wagner Law Group. Financial advisors and other plan service providers should consult with their own legal counsel to understand the nature and scope of their responsibilities under ERISA and other applicable law.

The Household Balance SheetSM View and the New DOL Fiduciary Rule

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