DOL fiduciary final rule

Five issues for insurers to consider

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About the authors

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Matt serves as KPMG's U.S. Insurance Advisory leader responsible for developing and executing client strategies aimed to improve core operations, customer satisfaction, and back-office functions. He has over 15 years of experience with KPMG providing assurance and advisory services to a broad range of insurance and wealth management clients based in the Americas, Europe, Asia-Pacific, and Middle East. Matt is a member of the Global and U.S. Insurance Leadership and U.S. Financial Service Leadership teams.

Forward

With management, board members, lawyers, customer-facing personnel, and risk/compliance personnel at insurers preparing to adopt the Department of Labor's (DOL) final "fiduciary rule" on standards for retirement investment advice, we believe now is the time to examine fundamental issues that could determine how insurers can take strategic and tactical steps to succeed in the segment—or exit it.

The focus of this brief is to offer considerations to assist insurers and wealth managers to weigh issues on how to proceed with the assessment of this new rule, which underscores how much consumer-protection ideology is shaping legislation and rulemaking affecting financial services in the United States.

When we look back on this time a few years from now, we may very well view this rule defining a "fiduciary"—under the Employee Retirement Income Security Act (ERISA)—as one of the most important declarations affecting the viability of insurers that made investment-product sales and advice a key generator of their growth plans.

Overview of key elements in the rule

The rule sets two deadlines (one in April 2017, the other January 2018) that will add urgency for insurers and wealth managers to reach well-informed decisions that almost certainly will broadly affect them—from market exit/entry, go-to-market strategies, operating model changes, and compliance operations to technology platform reconfigurations /and adding or jettisoning talent.

The final rule—issued after 3,000 comment letters were received—requires requirement advisers to place clients' best interest first by providing impartial plan advice. Adviser compensation, another important topic of the ruling, also must not motivate them to sell one product over another. While the rule allows the sale of certain commission-based products, they must be sold under the "best interest contract exemption (BICE)," which requires advisers to receive a signed contract from clients and their organizations to adhere to an enhanced risk and compliance set of policies and procedures. The contract must contain language that the adviser is providing a client with advice that is in their interest. Advisers will be assessed against the BICE beginning January 1, 2018.

The BICE rule contains a provision where advisers' clients can agree to product based commission-based through "negative consent" by not responding to correspondence from advisers who provide details of the BICE requirement. That said, commission plans will still be reviewed in the grander scheme across all retirement products and services, ensuring agents are not able to "game the system."

Further, the BICE demands firms adopt practices and procedures that disallow conflicts of interest. And, it grants grandfathering of existing investments held by investors, which was a point of contention during the six years of commentary (much from insurers) leading up to the final rule.

One surprise in the final rule was the stipulation that advisers would need to sign contracts agreeing that they are accountable as fiduciaries before selling indexed annuities. In its original language, indexed annuities were not included in the BICE and thus might actually increase in popularity compared to variable annuity products, which were originally included in the rule.

Links:

- DOL final rule
- DOL factsheet on the rule
- DOL chart illustrating the changes it made to the rule after the comment period

"We anticipate life insurers, annuity providers, and financial advisers will likely face some downward pressure on revenues and upward pressure on expenses as a result of the new rules. The potential still exists for the financial services industry lobbyists to litigate the new DOL rules, but we would anticipate this only extends the time frame for implementation."

Barclays equity analyst

Source: "Reaction to the Labor Department's Fiduciary Rule," *The Wall Street Journal*, April 6, 2016

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Assessing and strategically responding to the fiduciary rule

Determining the rule's impact requires immediate consideration of fundamental questions about whether adhering to the rule would make it worth an insurance and or wealth management company staying in the business of offering retirement investment products.

In addition to being in compliance with the new rule, there are other considerations for insurance and wealth management companies to weigh. Many will see compliance costs increase, there could be an adverse impact on their revenue model due to the potential of a reduction of participation by clients (due to increased compensation costs for low level of account activities), and there are issues associated with potential oversight by the Securities and Exchange Commission.

Taken together, these and other factors may require some insurers and wealth managers now in the business of offering retirement products to rethink their strategy. Given those realities, we've developed a short list of questions for insurers to consider as the new marketplace takes shape.

Can we accurately assess the impact of the DOL ruling on our customers and operations?

Firms will need to examine their target markets, book of business, agent force, compensation structure, marketing abilities, compliance-function, and legal-department capabilities, and then ask two questions: How big of an impact would the rule have on the business today? Does the organization possess the kind of clients where the rule's requirements would decrease participation rates and would the fee requirement result in significantly decreasing the book of business?

An important step in this assessment is developing plans to discuss the rule with existing clients. Many will have read quite a bit about the rule, and there are sure to be plenty of questions. Being able to clearly answer such questions will mean that many (and perhaps most) insurers will need to create education programs inside their organizations to prepare officers, agents, and others for questions that will be raised by existing and new clients.

The assessment issue will impact all sizes of insurance operations, whether it is a shop involved with low-investment-level retail customers who do not execute many transactions, or the insurer is primarily in the annuity business where it would most likely take the BICE, or the business is a large organization where client-facing personnel are registered investment advisers and already are held to the fiduciary standard.

The question is the same: What is your confidence level regarding your ability to thoroughly and accurately assess the impact of the rule on your business?

Is the size of the prize enough to keep insurers in the game?

In the months leading up to the publication of the DOL fiduciary rule on April 6, insurers across the country "began creating task forces to build target operating models designed to determine how to survive in the environment we're now in," said Michael Herman, a KPMG Advisory principal, who is working with insurers and wealth managers to assess options and create strategies in response to the rule.

For many companies, Herman said, the rule raises a few basic questions: "Do we want to be in the business or don't we? Are we going to put in place this set of compliance processes to monitor ourselves, and will that require a whole new systems refresh? And, do we want to bring in a whole new layer of people to get this done?"

For Herman, insurers, and other financial services businesses affected by the rule, the one issue that needs to be addressed is "whether the size of the prize is worth the additional investment."

With costs expected to rise, Standard and Poor's (S&P) analysts recently raised the issue of whether insurers will be able to respond to the new demands and at the same time "maintain their current competitive positions, profitability, and financial risk profiles."[1] S&P analysts said the agency anticipated potential rating implications in the future, based on responses and adaptation to the rule.[2]

"When we study the situation," Herman said, ''we tend to come back to a few questions regarding the ability to measure the size of the prize: Is the market big enough for the business to make money? What are the costs for an infrastructure for compliance? Can the business accurately come up with a headcount needed for compliance work before deciding to move forward? How will the company model the potential risk?"

Is the market ready for you?

With some insurers already deciding to exit the business in order to concentrate on other insurance products, buyers of those business assets must be certain that the market accepts them as a retirement product provider.

"We think there are opportunities for insurers to acquire asset management and wealth management businesses that will be available in the near future. But, we also believe some insurers may not be adequately prepared, and they will need assistance across the board."

Matthew McCorry,
National Advisery Insurance Leader, KPMG

"The opportunity might be there, but the market might not be ready to accept them," said Matthew McCorry, KPMG's National Advisory Insurance Leader. "Becoming an established provider requires much more than simply being able to bring these products to the market. Building a brand that is accepted is a complex process."

Brand building takes much more than money, marketing, and advertising. It demands having the right products, the right people, the right services, and the right service capabilities.

– *"It's been estimated that there are currently $1.7 trillion worth of IRA assets that hold products requiring (BICE) contract exemptions to a fiduciary standard."*

– Wall Street Dodged a Bullet on the Retirement Fiduciary Rule, Fortune magazine, April 6, 2016

– *"S&P analysts estimate that variable and fixed index annuities are a $190 billion annual business for insurers."*

– New DOL rule will force insurers to adapt, Life HealthPro.com. April 8, 2016

[1] "New DOL Rule Will Force Insurers to Adapt," LifeHealthPro.com, April 8, 2016

[2] Ibid

“We think there are opportunities for insurers to acquire asset management and wealth management businesses that will be available in the near future,” McCorry said. “But, we also believe some insurers may not be adequately prepared, and they will need assistance across the board.” He added that businesses that are considering buying will need to move quickly because of the very fluid nature of the market, given the pending deadlines and the scope of preparation work.

Can we get there with our current talent?

There are a number of critical assessment considerations relating to talent—both real and virtual.

As we mentioned above in the section on assessing the impact on the operation, insurers’ clients will almost certainly seek answers to questions, and they will demand straight, complete, and uncomplicated answers.

They will want to understand whether they will realize value or risk losing value when the rule change goes in effect. Some of the success in this endeavor will hinge on communication skills of agents, which, in turn, will depend on agents’ understanding of the intricacies of the rule. If they have not already begun them, in-house education programs should immediately be ramped up for the staff. The organization’s future may depend on it.

We expect many insurers, brokerages, advisors, and asset/wealth management organizations to use robo-advisory platforms. Insurers and others will need to have specifically defined plans that lay out the role those platforms will play in distribution and how they will be connected across accounts.

How will we create our agent transition plans?

If an insurance company’s advisory team is going to accept fiduciary status for their distribution, it will need to determine how it will structure the transition in order to limit disruption. The goal will be to try to make certain that the business has enough “feet on the street” to meet the strategic objective of the business.

Organizations will need to spend a considerable amount of time on change-management activities, such as providing explicit details about the new programs that will need to be installed, identifying the benefits, and providing clear and tangible examples of what is in it for agents. Perhaps most important, agents will need access to services that will help them with the transition every step along the way.

“Agents may be resistant, so the organization will need to help agents understand the change; show them how they will win,” Herman said. “One of the messages we deliver in situations like this is that when any change-management program is being explained to a sales force, the organization has to have very specific details on how the sales people can take advantage of the current situation. They all want to know what’s in it for them.”

In this developing situation, where change could significantly affect agents, we believe the message should focus on the benefits of taking a consumer-oriented, asset-oriented approach—instead of the more traditional product-oriented approach.

We think that if the business can develop a logical and uncomplicated message that lays out the short-, medium-, and long-term benefits, agents—and the business—should win in this game.

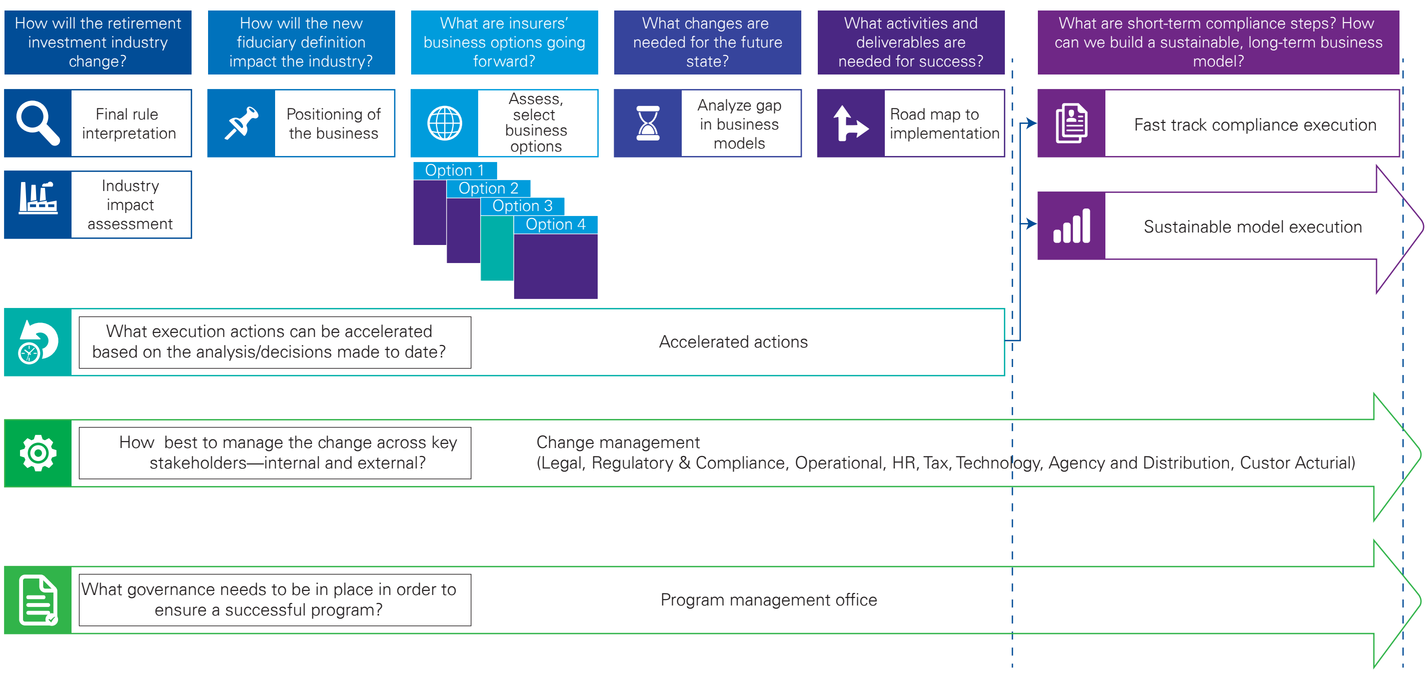
How KPMG can help

By taking a deliberate approach that assesses how the fiduciary rule will change the retirement investment industry, we can then assist insurance organizations with a retirement investment business understand the changes it may need to institute going forward.

Insurers will need to identify options and then take a deeper dive into whether the options can work within the existing business model, or whether minimal or significant model changes will need to be made.

By working toward the identification of an insurance company's future state with respect to retirement investment offerings, KPMG can assist in highlighting the short-term actions and long-term strategies the business will need to build a road map that can sustain the business.

Road map to help insurers identify, assess, and implement a strategic response to the DOL fiduciary rule



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