BY DONALD B. TRONE

To Prepare for the DOL Fiduciary Rules, You Need to Think BIG

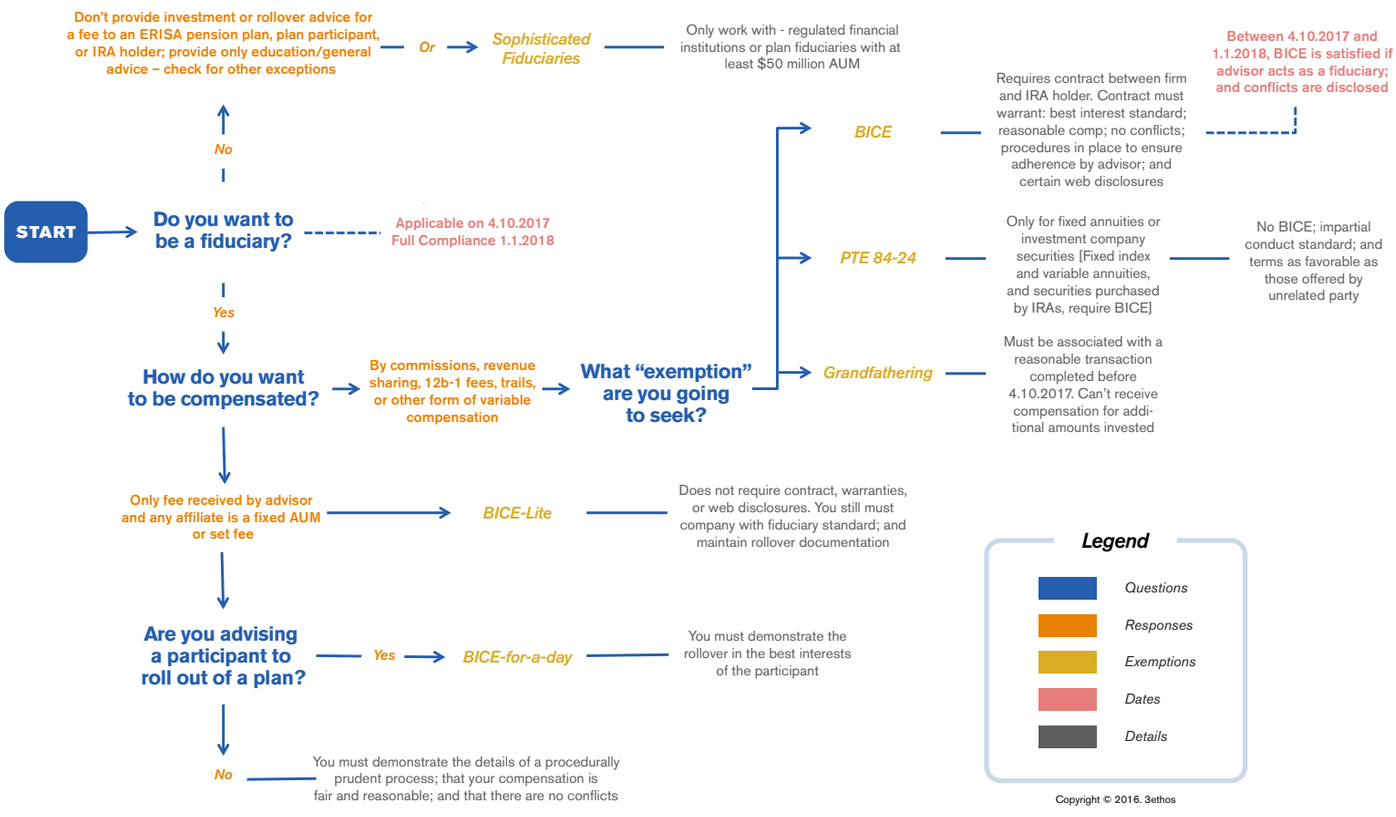
The best way to prepare for the new rules is to consider a behavioral governance framework.

The new DOL conflict-of-interest rules are complex, and the liability associated with serving retirement investors is going to increase dramatically. To illustrate, I enlisted the help of Erin Cho, a partner at the Groom Law Group, to help produce a flowchart (see below) of the different decisions you'll have to navigate.

The purpose of providing this flowchart is to demonstrate that the primary focus of the new DOL rules is on client engagement — literally what you need to demonstrate before you can begin providing retirement planning services to a client. We can be certain that attorneys will soon settle in on appropriate client forms, agreements and contracts to comply with the new engagement rules. As such, I don't believe the rules themselves are the biggest source of liability.

Instead, liability is going to arise from whether you can demonstrate that you have properly employed generally accepted fiduciary best practices. These 80 words from the DOL's new rules are what you need to worry about:

You must act… with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the

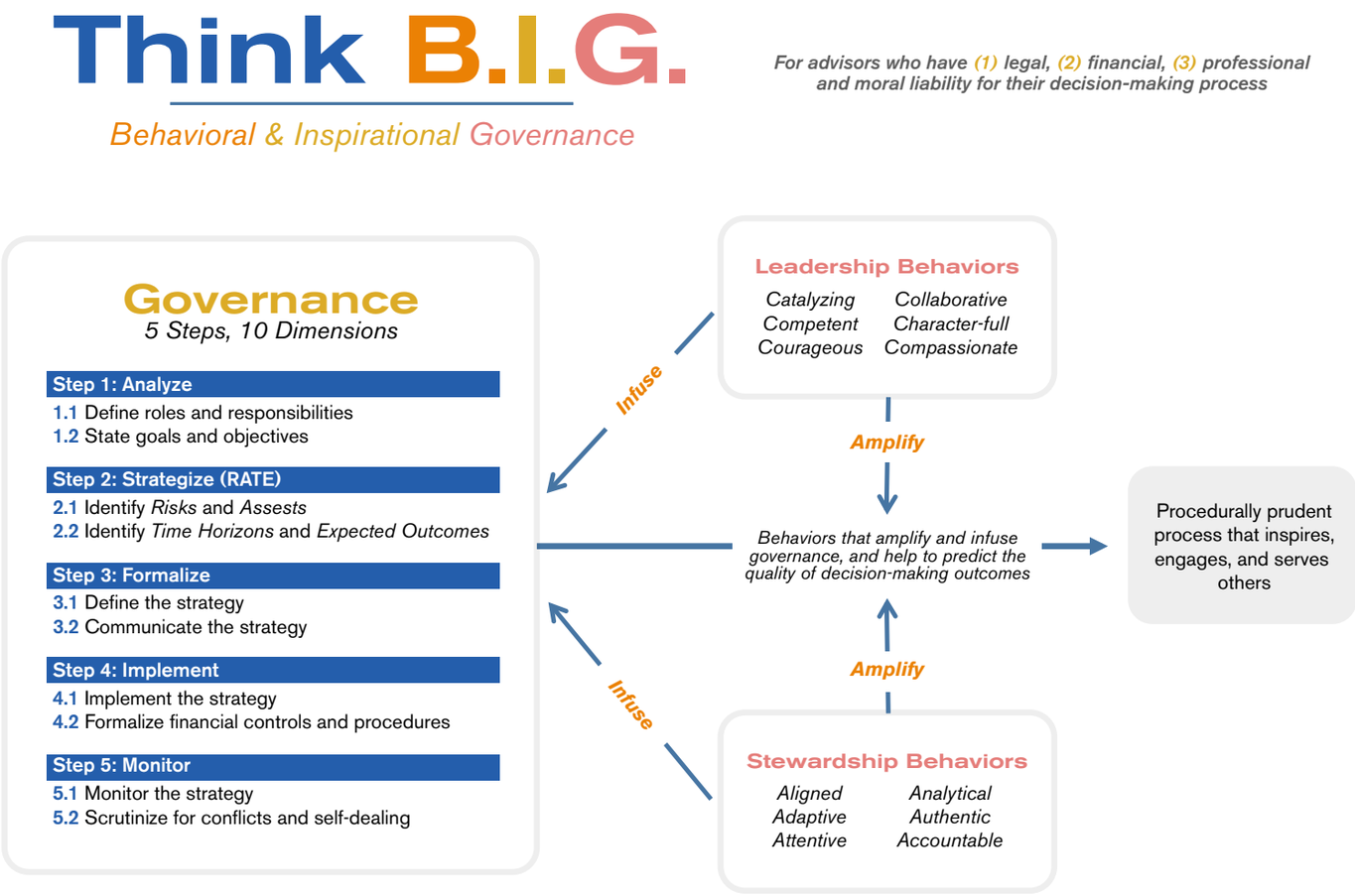


investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Advisor, Financial Institution or any Affiliate, Related Entity, or other party.

The fact that you can produce a properly executed "Best Interest Contract" that complies with the new client engagement rules won't be good enough.

When you find yourself sitting in the witness chair, the plaintiff attorney will likely ask you the following questions:

- What process did you follow to determine the availability of other retirement assets?
- Did you use a holistic household planning process? If so, what are the details of that process?
- Did you ask the client about serious health issues that may require a drawdown of retirement assets?
- Did you ask the client about trusts tied to the retirement assets, or legacy objectives?
- How did you determine the client's risk tolerance?
- What investment time horizons were taken into consideration?
- Did you use an asset allocation model? If so, what is the expertise of the firm that developed the model and the capital markets inputs?
- What modeled rate of return was used to determine the adequacy and appropriateness of the client's asset allocation?
- Was the client involved with the development of their retirement strategy? What steps did you take to ensure the client was making informed decisions?
- Did you prepare a written retirement strategy statement (RSS)? Did the RSS outline the inputs to the strategy; the steps that would be taken to implement the strategy; and the process that would be followed to monitor the strategy?
- What kind of due diligence process did you follow to select the investment or insurance options to implement the RSS? Was the due diligence process consistently applied?
- What steps did you take to control and account for the client's fees and expenses? Did you inform the client of every party that was compensated from the client's portfolio, and did you demonstrate that the compensation was fair and reasonable for the services rendered?
- How often do you benchmark industry fees and expenses?
- How often did you monitor the



client's retirement strategy? What process did you follow to determine whether an investment or insurance option needed to be replaced or placed on a watch list?

- What is your process for rebalancing the client's retirement strategy?
- Do you have a code of ethics or code of conduct? What steps do you take to scrutinize for conflicts and self-dealing?
- What kind of formal training have you undergone to serve as a fiduciary?
- How often do you assess the effectiveness of your practice?

Get the picture? And keep in mind, you'll be expected to demonstrate this level of procedural prudence even for the retirement investor who has an account balance of $25,000 — the median balance for IRA accounts.

Depressing, isn't it?

Well, it doesn't have to be that way. Just because the DOL doesn't know what they're doing doesn't mean we have to respond in kind. I suggest that the best way to prepare for the DOL's new conflict-of-interest rules is to consider a behavioral governance framework.

Behavioral governance is the newest branch of the behavioral finance tree. It was Warren Cormier, one of the co-founders of RAND's Behavioral Finance Forum, who pointed out that our research on leadership and stewardship behaviors seemed to parallel elements of behavioral finance. The major difference: Behavioral finance is focused on the decision-making process of individual savers, while behavioral governance is focused on individuals who have legal, financial, professional or moral liability for their decision-making process.

Specific to your practice, behavioral governance is focused on the behaviors that infuse, amplify and help predict the quality of outcomes associated with your fiduciary decision-making process.

'BIG' Framework

A behavioral governance framework is portrayed in the second chart. When giving a speech or conducting training, we use the catchier term, "Behavioral & Inspirational Governance," or BIG — as in, think BIG!

> "Liability is going to arise from whether you can demonstrate that you have properly employed generally accepted fiduciary best practices."

The left-hand section of the framework is governance, consisting of five steps and two dimensions per step. The dimensions define the details of each step. All of the plaintiff attorney's questions listed above can be mapped back to these five steps.

The five-step governance section is slimmed down from the 27 fiduciary practices first published by the Foundation for Fiduciary Studies in 2003. The Foundation's practices were designed primarily for trustees and investment committees and would be very difficult to apply to individual retirement savers with account balances of less than $360,000. In contrast, the five-step framework makes it possible to apply a fiduciary standard to much smaller accounts.

The six leadership and six stewardship behaviors to the right of the governance section represent the specific behaviors that infuse and amplify the five-step process. In other words, for you to improve the quality of outcomes associated with the five-step process, there are certain behaviors that you need to exhibit. We could also say that to help reduce liability associated with your decision-making process, there are certain leadership and stewardship behaviors that you need to exhibit to a retirement investor.

There are other collateral benefits associated with thinking BIG:

- The framework is universal and can be applied to any industry sector and domain — corporate, not-for-profit, government and military. Imagine sharing with your clients a framework for managing their assets, and then explaining that the same framework could be used by the client to manage a division, a department, a company, a board of directors or an investment committee.
- The framework is simple and intuitive. It does not include any legal or regulatory terms. One mistake we have all made is to try to teach clients the arcane vocabulary associated with a fiduciary standard and portfolio management.
- Most importantly, the BIG framework will help you to inspire, engage and more effectively serve your clients. Behavioral governance provides a point of inspiration, which is in stark contrast to the negativity associated with the new DOL rules.

It will probably be years until there is sufficient evidence to prove that the new DOL rules have caused more harm than good. In the meantime, you can do better by adopting a behavioral governance framework that satisfies the DOL's *de minimis* standards while at the same time providing you a framework for building a more inspiring and successful practice.

Opinions expressed are those of the author, and do not necessarily reflect the views of NAPA or its members.

» Don Trone, GFS® is one of three co-founders of 3ethos. 3ethos provides training and conducts original research on the interrelationships between leadership, stewardship and governance.