RETIREMENT DNA MODIFICATION

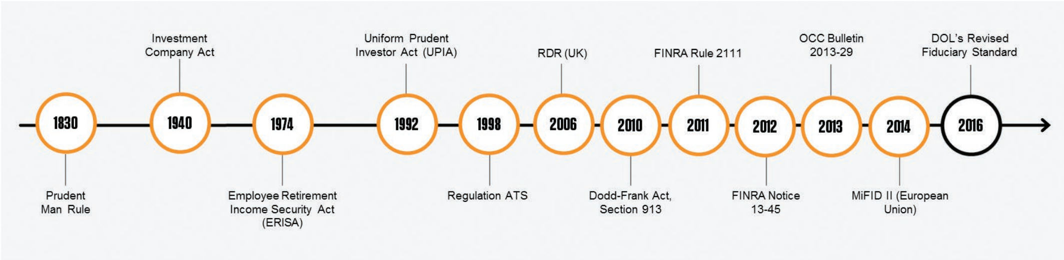
CAPCO

Overview

The Department of Labor's (DoL's) Revised Fiduciary Standard is poised to strike the core DNA of how investment firms and wealth managers will operate going forward. A complete overhaul of ERISA, the Revised Fiduciary Standard puts pressure on Wealth Managers to keep the best interest of the client: investment advice is a fiduciary contract which opens up advisors to legal recourse for non-compliance.

Fiduciary continuum

The Revised Fiduciary Standard adds significant force to the regulatory tsunami currently reshaping financial markets in the U.S. and abroad.



The DoL took a page from international regulatory initiatives (RDR – UK, MiFID II – EU) when devising and shaping the regulation. In turn, this puts pressure on FINRA and the SEC to consider their own revised fiduciary standards beyond the qualified (retirement) landscape – potentially impacting the entire wealth community.

Confluence of factors

A confluence of factors led the DoL's decision to enact this updated standard:

Macroeconomic

- The climate of middle class economics and income inequality, especially since the financial crisis of 2008, has put significant pressure on the DoL and government as a whole to act in the interest of the middle class.
- A continued distrust of financial services through the lens of the general public: recent studies have shown that only 46% of the population had any trust at all, making financial services the least trusted industry in the economy.
- Consumer demographics are shifting as the baby boomer population ages, triggering an unprecedented amount of IRA roll-overs [see growth in retirement]. This epic shift sets the stage for a large number of impacted clients in a space not covered by ERISA.

Evolution of the Industry

- The retirement space has evolved, moving away from DB Plans (e.g. traditional pensions) to DC Plans (e.g. 401k) and Individual Retirement Accounts (IRAs).
- A shift in the environment where financial decision-making and the onus of saving and preparing for retirement is left largely to the individual saver.
- The explosive proliferation of complex investment options over the past 40 years, creating a steep learning curve for individual savers.
- Over the years, there has been shrinkage of commission business in the broker space relative to a growing fee-based and fee-only registered investment advisor (RIA) segment.

Conflicting Standards

- There is a potential conflict of interest due to the fact that the two primary sources of investment advice – brokers and RIAs – **play by two different sets of rules**.
- Economic analysis has suggested that conflicted advice costs the small retirement investor (targeted middle class) "annual losses of about 1 percentage point– or about **$17 billion** per year in total."

International Regulations

Both Retail Distribution Review (RDR) and Markets in Financial Instruments Directive II (MiFID II) created momentum for change in the industry and helped to shape the framework of the rule.

Lessons learned can be applied to:

- Transparency around incentives and revenue sharing agreements
- Investor protection
- Defining investment advice
- Bifurcation of manufacturing and distribution of products

DOL REGULATION

At a glance, financial advisors will be held to a much stricter ERISA fiduciary standard which legally requires them to keep the best interest of the client ahead of their own; the right recommendation vs. simple suitability standard. This provides consumers with meaningful legal recourse when advisors abuse their trust and put their own financial interests first.

There are three major components of the DoL Regulation:

Best Interest Contract

The Best Interest Contract (BICE) is the core tenet of the final DoL rule which sets strict standards on advice provided to clients – the solidification of retirement advice acting as a fiduciary agreement. The BICE will allow firms to continue to set their own compensation practices so long as they, among other things, commit to putting their client's best interest first and disclose any conflicts that may prevent them from doing so. The BICE provides legal recourse to the client in the case of non-compliance.

Prohibited Transaction Exemptions (PTE)

Existing PTEs have not been drastically altered by the DoL Revised Fiduciary Standard, but should be noted as still key in providing nuanced categories of specific transactions under more prescriptive conditions. As an example, PTE 84-24 allows for specific allowance of the sale of fixed annuities in the qualified environment.

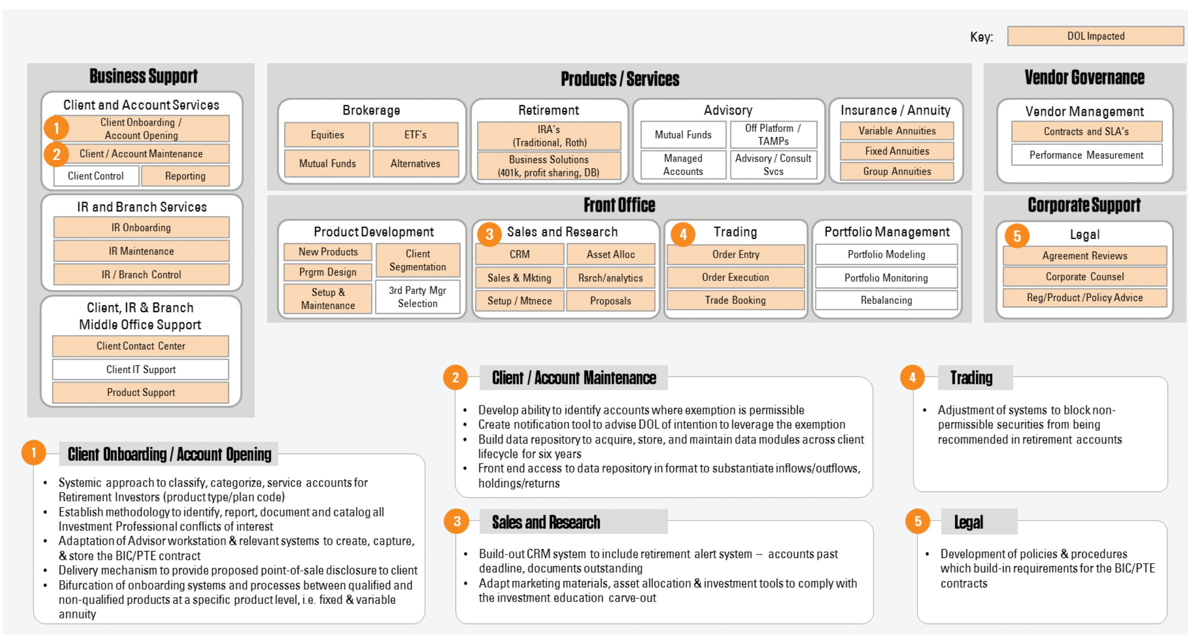
Carve-Outs

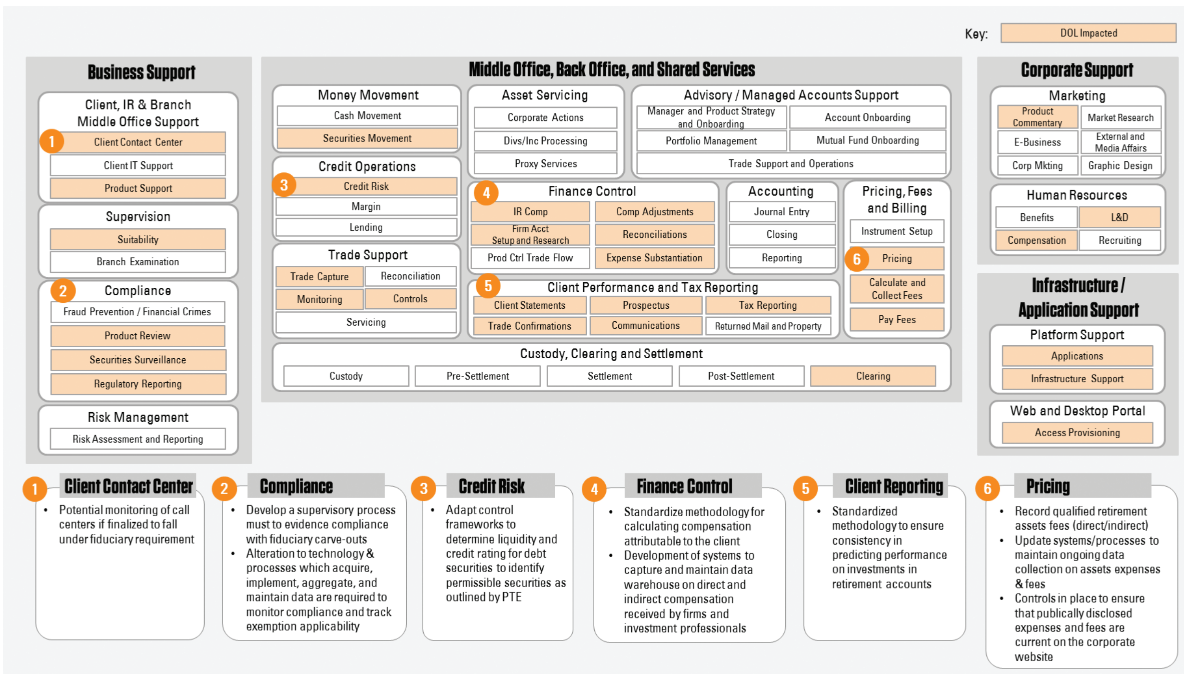
A carve-out relates to certain services that the DoL has recognized which do not constitute fiduciary advice. An example would be the Education Carve-Out which allows for financial advisers to provide significant amounts of educational information and materials to investors without being subject to a fiduciary duty, as long as that information does not contain any specific investment recommendations that the retirement saver can reasonably be expected to act upon.

Failure to abide with the DoL Revised Fiduciary Standard would impact the ability for the firm to compensate their financial advisors utilizing these common practices:

- Commissions
- 12b1 Fees
- Revenue Sharing
- Principal Transactions
- Trails

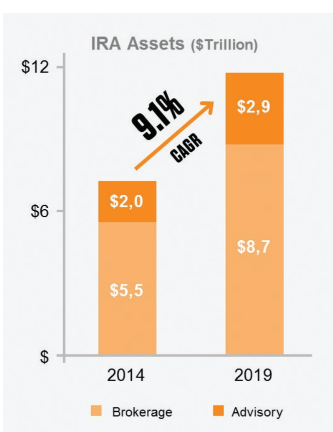
Rule impact to the firm's operating model





Retirement growth projection

Mainly due to aging baby boomers, the shift in demographics is creating an unprecedented amount of defined contribution plan roll-overs, which leads to a greater need for retirement services. As such, IRA assets are poised to grow at 9.1% CAGR over the next five years.



Baby Boomers

- Control 67% of wealth in the U.S. ($28 Trillion)
- Account for roughly 60% of defined contribution plans

Our decision framework

Our decision framework identifies the primary options for firms to follow when faced with the Revised Fiduciary Standard; namely **Comply**, **Adapt** or **Exit**. Based upon the firm's strategy, our decision framework outlines the steps to operationalize the decision and the potential impact to the people, processes and technologies of the firm.

Comply

- Develop in-house
- Develop a turnkey solution
- Outsource the retirement process
- Streamline the retirement product mix
- Refine the compensation structure

Adapt Business Model

- Fee-based
- Self-directed
- Robo-advice

Exit

- Depart from the retirement business

	FIRM RESPONSE	OPERATIONALIZE	IMPACT
COMPLY	BIC/PTE Requirements	Develop in-house Develop a turnkey solution Outsource the retirement process Streamline the retirement product mix Refine compensation structure	People Process Technology
ADAPT	Transition to Alternate Business Model	Transform to: • Fee-based • Self-directed • Robo-advice	
EXIT	Divest Retirement-Related Business Units / Accounts	Depart from the retirement business	

Why Capco

We are a leading global management technology consultancy focused on the financial services industry.

- Founded in 1998
- 24 offices across North America, Europe, India and Asia
- 3,000+ consultants and specialists
- Our consultants have an average of 17 years of industry experience

We offer E2E consulting services to design, build, and operate truly transformational solutions to solve complexity for our clients. Our offerings are deep-seated in process excellence and are rich in both content and methodology. We facilitate the "handshake" between business and technology organizations to deliver solutions that add value.

Strategic Response Options

- Our framework will hone in on areas of focus by proper alignment of retirement business priorities to potential target state capabilities
  - Business Validation
  - Functional Capabilities Mapping
  - Target Operating Model
- We will assess options for compliance with the DOL, based on the Target Operating Model, considering the feasibility, costs, and timeline
  - Develop In House Solutions
  - Deliver a Turnkey Solution
  - Outsource Retirement Functions
- Our detailed response will consider the pros and cons of all potential functional and technical solution options
  - Business Capabilities
  - Technology Blueprints
  - Strategic Response Options

Regulatory Impact Assessment

- Confirm prioritization of key DOL regulation requirements
- Provide understanding of the overall effect of the Revised Fiduciary Standard will have on people, process & technology – who, what, when, why, where is the impact
- Inventory in-flight projects
- Define potential BU impact scenarios based on future regulatory landscape:
  - Best & worst case scenarios
  - Opportunities/challenges
  - Competitive implications
  - P&L and headcount implications
- Quantify alternative benefits through business case analysis

Setup and Execute

- Establish PMO office to act as the Central Nervous System to manage all changes due to DOL Regulation
- Drive the IRA business transformation from DOL regulatory interpretation, strategic planning, & embedding change within the organization
- Assignment of regulatory items to ensure coverage of entire DOL regulation
- Transform retirement blueprint into profitable, compliant functioning business structure
- Establish program governance, stakeholders, steering committee, and frequency for status reporting
- Finalize the design of potential solutions, to include:
  - Business and functional requirements,
  - System hardware and application integration
  - Test plans
- Leverage existing build and test infrastructure with inflight projects
- Develop and integrate applications and services
- Coordinate with stakeholders on field communications, assist with release into production, training and adoption

Key differentiators

- This is not just about DoL regulation. This is a larger conversation on the advisory and retirement business. Capco takes a holistic approach in defining the future DNA of the retirement business with the regulation acting as a change agent creating the opportunity to address larger and more systemic industry issues.
- Provide subject matter expertise, practical retirement industry experience and thought leadership coupled with structured execution and delivery capability.
- Capitalize on the fiduciary expertise and end-to-end solutions to operationalize and proliferate the retirement target operating model.
- Drive the IRA business transformation from DoL regulatory interpretation, strategic planning, crafting complete retirement package and embedding change within the organization.
- Transform customized retirement blueprint into profitable, compliant functioning business structure that effectively competes within the new retirement landscape.

Author:

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Matthew is the Retirement Practice Lead within Capco's Wealth and Investment Management practice. During his 14 year consulting experience, his focus has developed specifically on the DoL Fiduciary Standard making him a recognized thought leader in this space. With senior roles at Citi Private Bank and Merrill Lynch, Matthew has led portfolio advisory teams in the development of custom wealth management strategies, client specific asset allocation, and portfolio construction for High and UHNW individuals. This vast exposure has provide Matthew with unique insights to the complexities of a dynamic financial services landscape, and enables him to bring an innovative approach to solving clients issues.

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ABOUT CAPCO

Capco – an FIS™ company – is a global business and technology consultancy dedicated solely to the financial services industry. We work in this sector only. We recognize and understand the opportunities and the challenges our clients face. We apply focus, insight and determination to consulting, technology and transformation. We overcome complexity. We remove obstacles. We help our clients realize their potential for increasing success. The value we create, the insights we contribute and the skills of our people mean we are more than consultants. We are a true participant in the industry. Together with our clients we are forming the future of finance. We serve our clients from offices in leading financial centers across North America, Europe, Africa and Asia.

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