



How the Retirement Income Style Awareness (RISA[®]) Informs Retirement Income Recommendations

Executive Summary



Regulatory guidance that is frequently changing presents a challenge for financial professionals (FPs) and Financial Institutions. Documentable, repeatable processes are becoming increasingly critical to protecting the perceived integrity, as well as to minimizing legal liability associated with the provision of all forms of financial advice.



Retirement Income Style Awareness (RISA®) is a new framework for understanding an investor's preferred retirement income sourcing style.



As part of a proposed methodical process for making retirement strategy recommendations specific to a given client's needs, RISA provides financial professionals and their overseeing Financial Institutions with a consistent, repeatable, documentable, and empirically supported framework for retirement income recommendations being made in a client's best interests.



RISA® can form the backbone of a prudent process for retirement income recommendations performed by a financial professional.

RISA[®] and Regulatory Requirements

Regulatory guidance that is frequently changing presents a challenge for financial professionals (FPs) and Financial Institutions in making appropriate recommendations and creates similar challenges for Financial Institutions responsible for overseeing those recommendations. Documentable, repeatable processes are becoming increasingly critical to protect the perceived integrity of all forms of financial advice, as well as to minimize the legal liability associated with its provision. According to fiduciary education firm Fi360:

“*The timeless principles that underlie the fiduciary standard, such as loyalty and care, provide the basis for trustworthy conduct by those who are entrusted with other peoples’ money. Fiduciary laws and regulations serve to define the details of prudent investment processes. Those prudent processes make adherence to the core fiduciary principles practical and reliable... By following a structured process based on ... [Fi360’s practices], the fiduciary can be confident that critical components of an investment strategy are properly implemented and followed.*⁽¹⁾

As part of a proposed methodical process for making retirement strategy recommendations specific to a client’s needs, Retirement Income Style Awareness (RISA[®]) provides FPs and their overseeing Financial Institutions with a consistent, repeatable, documentable, and empirically supported framework for retirement income recommendations being made in a client’s best interests. For more information on the RISA profile framework, please visit <https://risaprofile.com/>

We posit that RISA[®] is helpful in satisfying regulatory requirements in the following ways:

Regulation Best Interest

Department of Labor Rollover Fiduciary Rule

Investment Advisers Act of 1940

States’ Best Interests Laws

1 - https://www.fi360.com/uploads/media/handbook_advisors_2019.pdf, “Prudent Practices for Investment Advisors: DEFINING A GLOBAL FIDUCIARY STANDARD OF EXCELLENCE FOR PROFESSIONALS WHO PROVIDE INVESTMENT ADVICE, INCLUDING FINANCIAL ADVISORS, BROKER-CONSULTANTS, TRUST OFFICERS, FINANCIAL PLANNERS, AND FIDUCIARY ADVISORS”, p.7.

Regulation Best Interest:

In June 2019, the Securities and Exchange Commission (SEC) adopted, effective in June 2020, Regulation Best Interest (“Reg BI”), in an effort to enhance significantly the quality and transparency of relationships between broker-dealers and investment advisers (together, “firms”) and retail investors. Reg BI establishes a new standard of conduct for broker-dealers when making a recommendation of any securities transaction or investment strategy to a retail customer. According to Groom Law Group, “Reg BI provides for a new standard of conduct that is not an explicit fiduciary standard as some have advocated, but as the SEC points out the standard does draw upon certain fiduciary concepts, particularly those found in the Advisers Act. The intent of the SEC was to create a “fiduciary-like” standard for governing firm and representative conduct, while accommodating and preserving the broker-dealer model, which SEC noted is largely transaction-based.”⁽²⁾

A Broker Dealer can document an appropriate client match to an annuity, structured product, or other product types through an empirically validated retirement income framework. The RISA® framework utilizes a standardized questionnaire to assess how individuals prefer to source retirement income from strategies that have the attributes of the products in question.

2 - <https://www.groom.com/resources/sec-adopts-regulation-best-interest-and-related-rules/>

Investment Advisers Act of 1940:

RIAs, as fiduciaries, need to objectively evaluate a universe of retirement solutions, and finding effective strategies for efficient income generation is getting more and more challenging in the current low-rate environment. Investing through retirement, when investors need to draw income from the portfolio, brings about a different set of risk factors than does investing for accumulation. In retirement, the investor cannot rely on their income from working, instead needing to use savings to cover spending needs, spending shocks, while facing uncertainty about how long the spending must last (longevity risk).

There are many credible retirement income strategies, and the starting point for any individual, and any FP that serves that individual, is to identify a strategy that closely aligns with how they prefer to source retirement income. Some fee-only “fiduciary” advisors take an actively anti-annuity stance. We feel that unwillingness to consider the consumer’s preference for how they wish to source retirement income is a questionable practice for a fiduciary. Annuities are the only retail product category that effectively solves length-of-life risk, which is a material concern for the majority of retirees. Universally deploying a specific retirement income strategy for everyone, such as drawing a sustainable withdrawal from an investment portfolio (i.e., a total returns-based approach), may result in a fiduciary making recommendations that may NOT necessarily be in a client’s best interests.

Since many RIAs maintain an assets under management or investment-centric business model, they initiate client relationships with an investment portfolio in mind. Accordingly, many RIAs use a risk tolerance questionnaire (RTQ) early in their relationship with their client to determine a client’s asset allocation mix. However, the RTQ framework presupposes the client’s preferred retirement income strategy as a total return approach. This retirement income approach advocates for drawing an expected sustainable amount from an investment portfolio. RTQs, however, fail to identify concerns many retirees experience around the possibility of outliving their assets, unknown health care expenses as they age, and addressing unknown spending shocks.

RTQs result in recommendations that are implemented as if all retirees willingly embrace a total returns-based approach to retirement income planning. As a true fiduciary, an RIA must first decide what retirement income strategy the client wishes to pursue based on personal preferences. This decision should occur well before the asset allocation decision. Fiduciaries advising upon retirement portfolios should consider the client’s preferences for the attributes of their retirement income streams in making strategy recommendations. RISA helps RIAs accomplish this objective by framing solution recommendations under the main retirement income strategies espoused by organizations like the Financial Planning Association, such as time segmentation, total return, and a flooring approach.

Department of Labor Rollover Fiduciary Rule:

On December 18, 2020, the Department of Labor (DOL) adopted Prohibited Transaction Exemption (PTE) 2020-02, Improving Investment Advice for Workers & Retirees, a new PTE under the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code of 1986 (the "Code") for investment advice fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs).

Investment advice fiduciaries who rely on the exemption must render advice that is in their plan and IRA customers' best interest in order to receive compensation that would otherwise be prohibited in the absence of an exemption. This includes the receipt of commissions, 12b-1 fees, revenue sharing, and mark-ups and mark-downs in certain principal transactions. The exemption expressly covers prohibited transactions resulting from both rollover advice and advice on how to invest assets within a plan or IRA. In the preamble to this exemption, the Department of Labor (DOL) reinterpreted ERISA's five part test ⁽³⁾ for when one is making a fiduciary rollover recommendation, applying it to a broader swath of transactions. As a result, many more financial institutions and investment professionals will become fiduciaries for their recommendations to retirement investors than had previously been the case and, therefore, will need the protection provided by a PTE.

According to prominent ERISA attorney Fred Reish, "PTE 2020-02 requires that the IRA investor be given a written statement of the 'specific reasons' why the IRA transfer is in the investor's best interest. In light of the language in the preamble, it would be advisable to include services in the analysis and the reasons why the rollover is in the best interest of the IRA investor" ⁽⁴⁾. The key, according again to Mr. Reish, is that "the added value be based on that particular participant and not a generic or hypothetical participant. As a word of warning, when the examinations begin a year or two from now, expect the first question to be: 'How do you justify the added costs of the IRA in making the rollover recommendation?' In other words, what value is being provided to that investor, based on his or her particular needs, that offsets the increased costs? The answer should be the same as the 'specific reasons' given to the participant in writing at the time of the recommendation." ⁽⁵⁾

3 - <https://www.morganlewis.com/pubs/2020/08/dol-take-three-five-part-test-officially-reinstated-proposed-investment-advice-exemption>

4 - <https://fredreish.com/best-interest-standard-of-care-for-advisors-70/>

5 - <https://fredreish.com/best-interest-standard-of-care-for-advisors-71/>

Department of Labor Rollover Fiduciary Rule (cont.):

Historically, FPs have often cited "Defined Contribution (DC) plan does not contain annuities", which would be true for rollovers from 93% of DC plans ⁽⁶⁾, as reason for recommending a rollover, irrespective of whether an annuity forms part of the FP's recommended portfolio. As Mr. Reish's analysis implies, this will no longer be acceptable conduct for rollover recommendations. In order to qualify for PTE 2020-02, FPs, and the Financial Institution that serves as co-fiduciary with the FP, will need to provide substantiation for the specific reasons a rollover was recommended for a specific client and for the product selection performed by the FP for that client.

We contend that, for the same reasons as suggested above regarding Reg BI, RISA® results can provide appropriate reasoning for a recommendation to roll over, so as to gain access to those products that match the consumer's preferences, if not available in plan.

Under PTE 2020-02, Financial Institutions and agents are both fiduciaries. There is another available PTE for fixed insurance sales, made after the ERISA five-part test is satisfied, in PTE84-24. When PTE84-24 is used by agents, neither insurance manufacturers nor distributors are regarded as fiduciaries. Following the February 1, 2022 effective date, many insurers are requiring independent fixed product distributors to attest to meeting PTE84-24. However, there is much speculation brewing that this PTE could be amended to be as stringent as is 2020-02. If this occurs, it is unclear what form of Financial Institution would come to oversee the sales of indexed annuity products made by independent agents. Might bigger Insurance Marketing Organizations (IMOs) choose to provide regulatory oversight for fixed insurance product sellers? If so, a consumer's RISA® profile can substantiate why a recommendation for rollover was made and provide greater comfort to a newly formed Financial Institution in overseeing fixed insurance product introductions.

6 - <https://www.shrm.org/hr-today/trends-and-forecasting/research-and-surveys/pages/benefits19.aspx>

States' Best Interests Laws:

With respect to sales of fixed insurance products, many states are implementing best interest protections based on model National Association of Insurance Commissioners (NAIC) guidance that is intended to align with federal Regulation Best Interest guidelines. For the same reasons that RISA can be useful for substantiating recommendations made in a client's best interests under Reg BI, it can be similarly helpful in addressing States' best interests requirements.

Given this regulatory landscape, the need for a systematic, process-driven approach for identifying retirement income sourcing preferences is warranted. The RISA® meets the needs of an increasing number of retirement investors, as well as regulators' higher expectations for an empirically based approach for recommendations that are being made in the best interests of a client. The RISA® framework helps consumers, FPs and supervisory organizations feel safer in making and accepting retirement income recommendations.

Conclusion:

The RISA addresses the above-mentioned regulatory concerns in an unprecedented manner. It does so by assessing client retirement income preferences and assisting the FP in making a product recommendation(s) that matches the client's preferred retirement income strategy. Unlike RTQs, the RISA® incorporates multiple retirement income strategies into an empirically validated framework. The table below provides a concise view of the RISA® and its potential for risk-mitigation for an FP and their overseer under current regulatory standards. For more information, please visit our website at www.risaprofile.com

Govt. Regulation	Does the RISA® address pertinent risks for the FP and their overseer?
Regulation Best Interest	✓
Investment Advisers Act of 1940	✓
Department of Labor Rollover Rule-PTE 2020-02	✓
Department of Labor Rollover, Rule-PTE84-24	✓
States Best Interests Laws	✓



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