WEEKLY ECONOMIC COMMENTARY

This Week's Economic Review and Outlook

June 2016

Our roads to success may have twists and turns and ups and downs; together we can navigate a course and enjoy the scenery along the way.

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In This Issue

Weekly Economic Commentary | Week of June 6, 2016

KEY TAKEAWAYS

- The latest Beige Book suggests that the U.S. economy is still growing near its long-term trend.
- Oil production continues to weigh on economic conditions in the energy-producing states.
- Main Street has remained broadly optimistic, although pessimism is running high in the energy-producing states.

BEIGE BOOK: WINDOW ON MAIN STREET

BEIGE BOOK SUGGESTS CONTINUED MODEST ECONOMIC GROWTH

The latest Beige Book suggests that the U.S. economy is still growing near its long-term trend, and that the drag from a stronger dollar and weaker energy prices is fading. However, oil production--which has continued to decline despite the run-up in oil prices from the mid-$20 per barrel range in January 2016 to near $50 today--is weighing on economic conditions in the energy-producing states. In addition, our analysis of the Beige Book confirms that there continues to be some spillover of weakness from the energy and manufacturing sectors to other parts of the economy. Comments in the Beige Book also continue to indicate that some upward pressure on wages is beginning to emerge; but the wage pressures are not accelerating quickly, which should keep the Federal Reserve (Fed) from raising interest rates aggressively this year.

Overall, the Beige Book described the economy as expanding at a "modest or moderate" pace in 7 of the 12 districts, about the same as in recent editions of the Beige Book. In general, optimism regarding the economic outlook far outweighed pessimism throughout the Beige Book, as it has for the past two years or so, but pessimism continues to run high in the energy-producing regions of the U.S.

The Beige Book is a qualitative assessment of the U.S. economy and each of the 12 Fed districts individually. We believe the Beige Book is best interpreted by measuring how the descriptors change over time. The latest edition of the Fed's Beige Book was released Wednesday, June 1, 2016, ahead of the June 14-15Federal Open Market Committee (FOMC) meeting, the fourth Fed policy meeting of 2016. The qualitative inputs for the June 2016 Beige Book were collected from mid-April through May 23, 2016. Thus, they captured Main Street's reaction to:

- A period of relative calm in U.S. and global financial markets
- Rising oil prices but falling oil production
- Falling odds of a summer Fed rate hike in early May that gave way to rising odds of a summer hike by late May, which sent the dollar on a round trip--weaker at first before rallying in the past month or so
- Economic and inflation data for February, March, April, and May 2016 that disappointed from February through early May and then began to exceed expectations over the rest of the month
- Increased discussion in the financial media about rising inflation and rising wages in the U.S.

SENTIMENT SNAPSHOT

To evaluate the sentiment behind the entire Beige Book collage of data, we created our proprietary Beige Book Barometer (BBB) [Figure 1]. In June 2016, the barometer ticked down to just +44 after the +73 reading in April 2016. At +44, the June 2016 reading was still above the +39 reading in March 2016, but is now back at the low end of the range it has been in since early 2012.

Here in 2016, although oil prices have rebounded more than 80% off the February 2016 lows, oil production has continued to fall, and the continued weakness in the oil patch has weighed on the overall barometer.

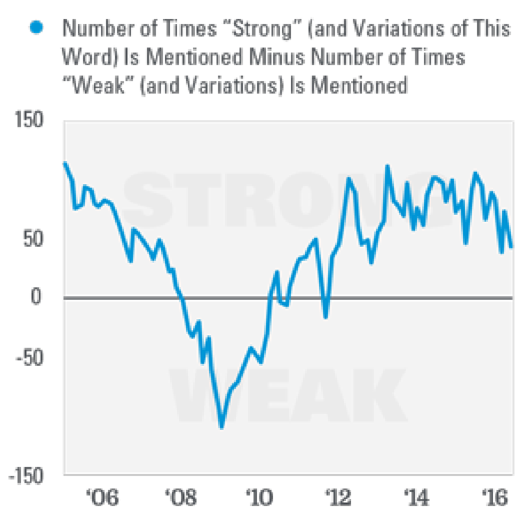
However, most of the decline in the BBB since its 2015 peak has come in the non-energy-producing districts of the U.S., suggesting that there has been some spillover from lower oil prices and lower oil production to other parts of the economy.

HOW THEY WORK
BEIGE BOOK AND BEIGE BOOK BAROMETER

The **Beige Book** compiles qualitative observations made by community bankers and business owners about economic (labor market, prices, wages, housing, nonresidential construction, tourism, manufacturing) and banking (loan demand, loan quality, lending conditions) conditions in each of the 12 Fed districts (Boston, New York, Philadelphia, Kansas City, etc.). This local color that makes up each Beige Book is compiled by 1 of the 12 regional Fed districts on a rotating basis — the report is much more "Main Street" than "Wall Street" focused. It provides an excellent window into economic activity around the nation using plain, everyday language. The report is prepared eight times per year, ahead of each of the eight Federal Open Market Committee (FOMC) meetings. The next FOMC meeting is June 14 – 15, 2016.

The **Beige Book Barometer** is a diffusion index that measures the number of times the word "strong" or its variations appear in the Beige Book less the number of times the word "weak" or its variations appear. When the Beige Book Barometer is declining, it suggests that the economy is deteriorating. When the Beige Book Barometer is rising, it suggests that the economy is improving.

1 THE BEIGE BOOK BAROMETER DROPPED IN JUNE, NOW BACK AT THE LOW END OF ITS RANGE SINCE EARLY 2012



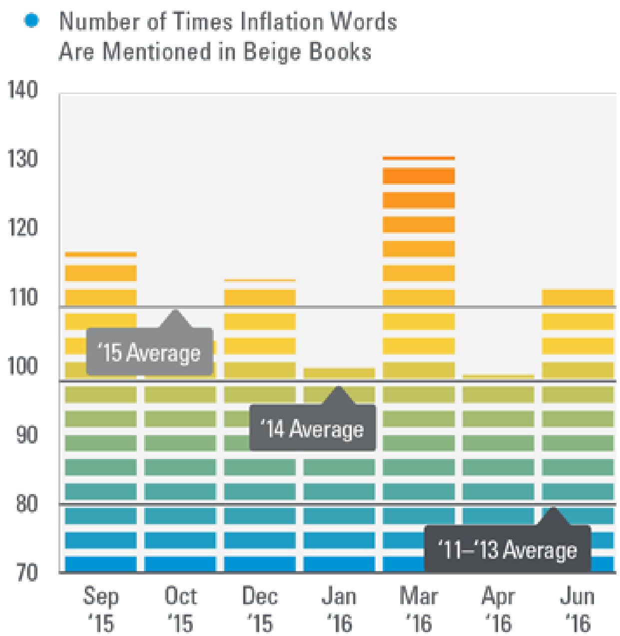
Source: LPL Research, Federal Reserve Board 06/01/16

WATCHING WAGES & INFLATION

Now that the Fed has initiated its first rate hike cycle since 2006, FOMC members and market participants, who are trying to gauge what the Fed may do next, will be watching inflation closely. Each Beige Book provides an economy-wide assessment of wages and prices. The June 2016 Beige Book noted that "wages grew modestly since the last report, with increases concentrated in areas of labor tightness," and "employment grew modestly since the last report, but tight labor markets were widely noted in most districts."

We monitor wage pressures via the data in Figure 2, which show the recent trend in the number of wage/inflation words in the Beige Book. We counted the number of times the words "wage," "skilled," "shortage," "widespread," and "rising" appeared in recent editions of the Beige Book. In June, these words appeared 117 times, up from the 104 in April and the 2016 low of 100 in January. These words appeared, on average, 109 times per Beige Book in 2015. In all of 2014--when deflation, not inflation, was a concern--those words appeared an average of just 98 times per Beige Book; so, after a brief drift back toward deflation worries in the January 2016 edition (100 mentions), the latest Beige Book shows a pickup in the number of inflation words. For reference, during 2011-13, also a period when heightened risk of deflation was evident, inflation words appeared 80 times per Beige Book on average.

2 INFLATION WORDS TICKED UP AGAIN IN JUNE 2016



Source: LPL Research, Federal Reserve Board 06/01/16

COMMENTS ON OIL & ENERGY WAY DOWN

Oil and energy received a total of 87 mentions in the March 2016 Beige Book, the highest reading since at least the start of 2014; but just two Beige Books later, here in June, the mentions of oil and energy dropped to 53, the lowest since the start of 2014. This drop in mentions of oil and energy came as oil prices rose nearly 30% but oil production continued to decline. For context, energy and oil had only around 40-45 mentions per Beige Book in 2011-14 and 64 per Beige Book in 2015 [Figure 3]. So far in 2016, oil prices have averaged around $38 per barrel, more than 20% below the average price in 2015 ($49 per barrel), which, in turn, was 48% below the 2014 average price of $92 per barrel.

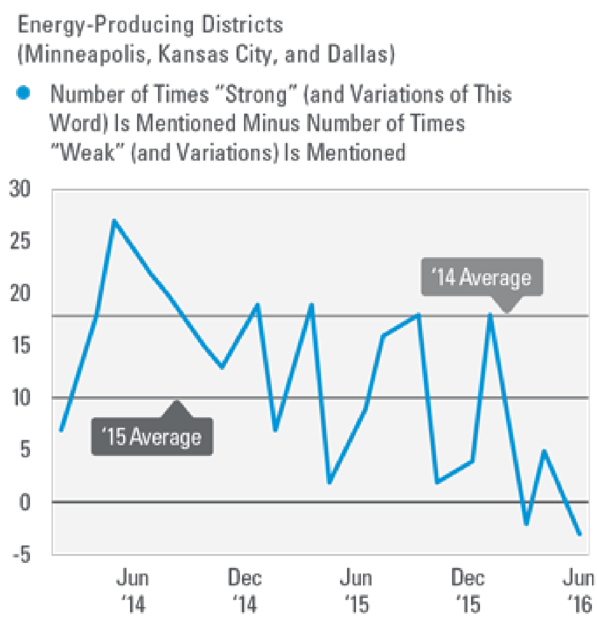
3 AFTER HITTING A HIGH IN MARCH, ENERGY/OIL MENTIONS DROPPED DOWN TO LOWEST SINCE EARLY 2014

	Weather	China	Energy/ Oil	Strong Dollar
June '16	16	3	53	2
Apr '16	18	2	70	3
Mar '16	17	3	87	6
Jan '16	26	2	71	16
Dec '15	16	6	65	16
Oct '15	4	7	56	15
Sep '15	7	11	56	14
'15 Avg	22	4	64	13
'14 Avg	40	2	43	1
'11–'13 Avg	14	2	46	0

Source: LPL Research, Federal Reserve Board 06/01/16

To better gauge the impact of lower oil prices on the economy, we constructed a separate Beige Book Barometer [Figure 4] for the three Fed districts with the most energy-related economic activity (Minneapolis, Kansas City, and Dallas). During 2014, the Beige Book Barometer in the energy-related Fed districts averaged +18. In the 8 Beige Books released in 2015, the barometer in the energy-related districts was just +10, a clear deceleration in activity. In January 2016, the reading bounced back up to +18, but it cratered to -2 in March, and bounced to +5 in April as oil rallied off the early 2016 lows. But in June, our barometer for oil-producing states plunged to an all-time low of -5, indicating that oil production may be a better indicator of sentiment in the oil patch than oil prices.

4 AFTER MANY UPS AND DOWNS SO FAR IN 2016, THE BAROMETER FOR ENERGY-PRODUCING STATES PLUNGED TO AN ALL-TIME LOW



Source: LPL Research, Federal Reserve Board 06/01/16

FADING CONCERNS/RISING CONCERNS

In the early part of 2016, uncertainty around fiscal policy and the Affordable Care Act continued to fade as concerns, but those concerns were replaced by fears of a stronger dollar, weaker energy prices, and uncertainty surrounding China. In the latest Beige Book, the concerns around the dollar, China, and oil have faded; in addition, there weren't any mentions of concerns about the upcoming U.S. presidential election or the June 23, 2016, "Brexit" vote on whether the U.K. will remain in the European Union. China had just 3 mentions in the latest Beige Book, well below the 8 China mentions per Beige Book in the late summer and fall of 2015. China averaged only 2 mentions per Beige Book from 2011-14. As we noted in the Weekly Economic Commentary, "China Challenge," while the Chinese economy has been slowing for more than five years, the news media and U.S. financial markets have only recently seemed to have taken note. In the latest Beige Book, 2 of the 3 China mentions were in a negative context.

The concerns about a stronger dollar eased substantially in the latest Beige Book, as the value of the U.S. dollar versus the currencies of its major trading partners generally moved lower over the first five months of 2016. There were only 2 mentions of "strong dollar" in June--down from the 15-20 mentions per Beige Book from September 2015 through January 2016. The 2 mentions in June were the fewest since the March 2015 report. To put these readings in context, the strong dollar was mentioned, on average, 13 times per Beige Book in 2015, but just once per Beige Book in 2014 and early 2015, and got virtually no mentions in 2011-13. Since the big run-up in the dollar between late 2014 and early 2015, the dollar has received, on average, 20 mentions per Beige Book. At current levels in the second quarter of 2016, the dollar is down 2-3% from a year ago, after rising 15-20% year over year throughout most of 2015. If it holds these levels, the dollar could be a modest tailwind for commodity prices, exports, manufacturing, and overseas earnings over the remainder of 2016.

OPTIMISM STILL RULES

In the June 2016 Beige Book, the word "optimism" (or its related words) appeared 17 times, whereas the word "pessimism" appeared just 2 times [Figure 5]. In the 12 Beige Books released since early 2015, optimism appeared, on average, 19 times per Beige Book, while the word pessimism has appeared a total of just 15 times, with 11 of the 15 mentions coming in the Dallas and Kansas City districts, who were commenting on the outlook for the oil and gas sector.

5 OPTIMISM CONTINUES TO RUN HIGH ON MAIN STREET

Mentions per Beige Book in:	Optimism	Pessimism
June '16	17	2
Apr '16	14	1
Mar '16	14	4
Jan '16	17	3
Dec '15	20	0
Oct '15	15	1
Sep '15	22	1
'15	21	1
'14	30	0
'13	25	1
'09	9	5
'07	10	1

Source: LPL Research, Federal Reserve Board 06/01/16

As reassuring as it is to see that Main Street can remain optimistic despite the flow of bad news, the large number of optimistic comments in the Beige Book is not the start of a new trend: In the 8 Beige Books released in 2014, the word "optimism" appeared, on average, 30 times. In 2013, "optimism" appeared, on average, 25 times per Beige Book. In the 8 Beige Books released in 2009, during some of the worst of the financial crisis and Great Recession, the word "optimism" appeared, on average, just 9 times.

Concerns that today's economic and market environment is similar to the onset of the Great Recession and the stock market peak in late 2007 also appear to be misplaced. In the 8 Beige Books released in 2007, the word "optimism" appeared, on average, just 10 times per edition--a far cry from the 30 times per edition in the 8 Beige Books released in all of 2014, the 21 times per edition in 2015 and the 16 per Beige Book so far in 2016.

IMPORTANT DISCLOSURES

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Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market.

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.
Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, will be subject to greater volatility than investing more broadly across many sectors and companies.

Investing in foreign and emerging markets securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

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Tracking #1- 503834 (Exp. 06/17)

Weekly Market Commentary | Week of June 6, 2016

KEY TAKEAWAYS

- This week we take a look at the "GAAP gap," the gap between reported and operating earnings.
- The gap today is largely energy driven, and we see little in earnings data that might indicate a broader market downturn.
- Analysis of prior periods with similar gaps reveals these gaps were largely reactions to downturns, not precursors to them.

A LOOK AT THE GAAP GAP

This week we take a look at what we call the "GAAP gap." Currently, a wide gap exists between reported earnings and operating earnings for S&P 500 companies. We first introduced this topic briefly in our first quarter 2016 earnings preview commentary after the financial media began to focus on it as a potential bearish indicator. Some have tried to make a cause-effect relationship between this earnings divergence and bear markets, a connection we find extremely weak. Here we dig a little deeper into this issue and make the case that it should not be of much concern to investors.

CONSIDER THE SOURCE

Different sources such as FactSet, Bloomberg, Standard & Poor's, and others have different calculations than Thomson Reuters for S&P 500 earnings, based on various methodologies and different interpretations of what constitutes operating earnings.

OPERATING VS. GAAP EARNINGS

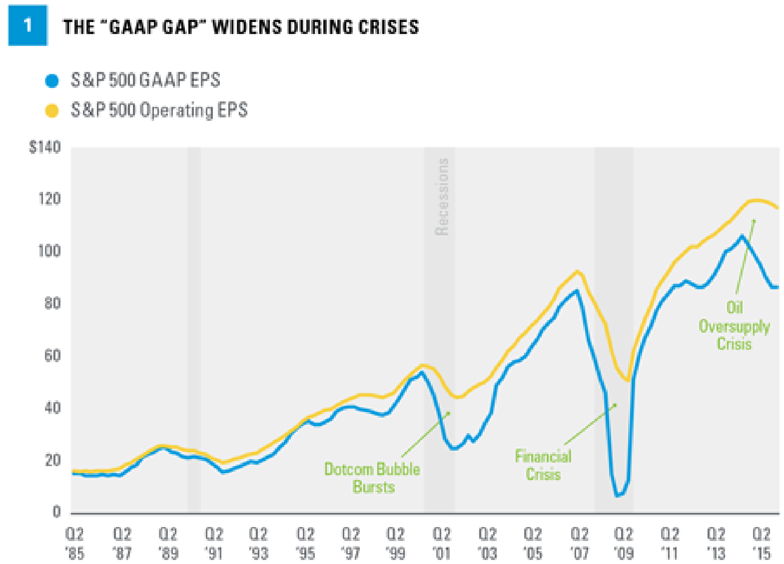
Operating earnings represent earnings from recurring operations. Isolating earnings from recurring operations (essentially a company's core business) facilitates better forecasting and provides valuable information to assess the long-term value of a company or group of companies. The more transparency, the better, so knowing of all factors impacting earnings is desirable.

GAAP earnings are based on generally accepted accounting principles (GAAP), a corporate profit measure that follows widely accepted accounting rules and includes all items, regardless of how those profits (or losses) were generated. For example, GAAP earnings include asset write-downs and one-time charges such as restructurings, divestitures, and acquisitions. These factors are important for investors to consider, but they can make forecasting more difficult.

SHOULD WE WORRY ABOUT THE GAAP GAP?

The large gap between operating earnings and GAAP earnings, shown in Figure 1, has received a lot of attention from the financial media in recent months. Some have expressed the opinion that the size of the gap between these two earnings measures, 26% in the most recent four quarter period, is a signal of bigger earnings troubles ahead. We do not think so.

The biggest reason for the latest gap, which reached 27% in 2015, has been the energy downturn, which led to significant downward adjustments to valuations of oil and gas assets. The drop in energy sector earnings had nothing to do with accounting or earnings quality, and everything to do with the sharp drop in oil prices (largely a supply problem, with some help from the strong U.S. dollar). With crude oil prices near $50 per barrel and the S&P 500 within 2% of its all-time high, the market has looked past the earnings discrepancy, which is still 19% as of the end of the first quarter of 2016, as we think it should.



Source: LPL Research, FactSet, Thomson Reuters, Standard & Poor's 06/03/16

GAAP = generally accepted accounting principles

EPS = earnings per share

The S&P 500 is an unmanaged index which cannot be invested into directly. Past performance is no guarantee of future results.

HISTORICAL PERSPECTIVE

Similar gaps were observed during the tech crash in the early 2000s and the financial crisis during 2008-09. These periods witnessed sharp asset devaluations (similar to the devaluation of energy properties). During the internet bubble and subsequent accounting crisis (think Enron/Worldcom), the gap between the operating measure and GAAP earnings got as high as 40%. But the widening gap provided little warning. During the first quarter of 2000, near the stock market bubble highs, the gap was just 4%. By the time the gap peaked, the 2001 recession was over and the bear market well underway.

The gap did widen significantly ahead of the October 2002 stock market lows during the Enron/Worldcom crisis. However, we have a hard time interpreting this concentrated accounting fraud situation, which is focused on a small handful of companies, with any warning we might try to find in current earnings data. This period is not very comparable.

The financial crisis, like the tech bubble and today's energy downturn, was also concentrated largely in one sector. The gap reached an extreme level during the fourth quarter of 2008, peaking at more than 80% in mid-2009 just after the stock market bottomed. But the gap did not meaningfully narrow until the end of 2009, and by then the S&P 500 had already rallied nearly 70% off of its lows. Not a great market timing tool.

Beyond the concentration in one sector, we see little parallel between today's earnings gap and the one during the financial crisis, which had much more to do with the excess leverage and bad loans than earnings quality. Poor earnings quality may have exacerbated the problem later, but the widening earnings gap was a symptom of a long illness.

FALSE SIGNALS

One piece of evidence to suggest that a widening gap between these earnings measures is not a precursor of a market downturn is that the gap widened to above-average levels in 2012, ahead of the powerful 2013 stock market rally when the S&P 500 rose 30%; and 2014 was another double-digit year for the S&P 500.

A jump in the gap in late 1991 was another false signal, as 1992 and 1993 were both solid years for stocks after a nearly 30% gain for the S&P 500 in 1991. We do not have many periods for comparison, but we have enough to be skeptical of the current earnings gap as a signal of major market weakness ahead.

Bottom line, these periods of divergent earnings measures have had clear causes that have been unrelated to the causes of the market downturns. They reflect reactions to downturns, not precursors of them. We continue to expect an earnings rebound in the second half of the year and for the earnings gap to narrow as the energy sector continues to heal.

CONCLUSION

We do not believe market participants should worry about the gap between GAAP earnings and operating earnings. The gap today is largely energy driven and not indicative of a broader earnings quality problem, in our view. Analysis of prior periods with similar gaps reveals these gaps were largely reactions to downturns, not precursors of them. We see little in the earnings data across the broad market that might lead to a broader market downturn.

We would continue to focus on fundamental and market indicators that have historically provided better early warning signs that the economic cycle was nearing its end, such as those we highlight in our Recession Watch Dashboard.

Please see our "Corporate Beige Book" edition of the *Weekly Market Commentary* and our "Earnings Recession" Thought Leadership report for more on earnings. Look for much more on this topic in our upcoming *Midyear Outlook* publication.

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All investing involves risk including loss of principal.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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Tracking #1-503959 (Exp. 06/17)

Summer Is Heating Up | June 2016

Dear Valued Investor:

June 2016 is full of major market events, which may go a long way toward determining the direction of the stock market for the rest of the year. Although for some, the approach of summer means it's time to slow down and plan vacations, the markets and global economies are doing anything but that. As we approach the midpoint of this year and the kick-off to summer, events are ramping up--not slowing down--making this a good time for a check-in and look ahead.

The month of June starts off with an OPEC (Organization of the Petroleum Exporting Countries) meeting and the monthly jobs report, followed by policy meetings for the Federal Reserve (Fed), European Central Bank, and Bank of Japan, as well as the anticipated "Brexit" vote on whether the U.K. will remain in the European Union. These events could be viewed as opportunities to provide clarity and potential resolution to issues that have been years in the making. The path of the Fed's rate hike campaign could ramp up and place us firmly in the midst of a rate normalization cycle. We have endured a volatile two years for oil prices--another OPEC meeting may provide important confirmation that we are entering a period of greater stability. And after overcoming past threats, such as Greece, the EU may face the first country to exit after its more than 20 years in existence as the U.K. goes to the polls. How the U.S. and global economies react to these events will be watched closely by all market participants.

For the OPEC meeting, the market's expectations are low and a production freeze seems unlikely, so any movement toward restraining supply could push oil prices higher. Although not much action is expected out of this meeting, with oil prices ranging from as high as over $100 per barrel in June 2014 down to $26 per barrel in February 2016, it still warrants close attention.

Concerning central banks overseas, major policy shifts at their June meetings are not expected, but a challenging growth environment in both the Eurozone and Japan suggests further loosening of monetary policy may be ahead in the coming months. Fiscal policy will also be on watch, such as Japan's recent decision to push a scheduled sales tax increase all the way back to October 2019.

The markets will be particularly focused on the June 14-15 Federal Open Market Committee (FOMC) meeting. The market may still be underestimating the probability of an early summer rate hike and another by year-end--the LPL Research base case and a potential source of near-term volatility. After years of low interest rates, the second hike will reaffirm that we are finally normalizing rates. Thus, the outcome of this meeting (or the following one in July) could be the turning point here, as we watch how the U.S. economy and market participants can handle this shift.

Last but not least, should the British people vote to leave the EU, it may be seen as a lack of confidence in the second-largest economic region worldwide, which may spark other anti-EU movements across the continent, drag down economic activity in the U.K., or weaken London's place as a global financial center. It could also lead to a spike in financial market volatility. The latest polls, however, do show "remain" ahead of "exit."

All in all, we are in for a busy month in June. Instead of easing into a low-key summer, we will be watching these events and the impact they may have. Coupled with the age of the economic cycle and election-related uncertainty, stocks may experience continued volatility over the summer. Although these ups and downs can make for a bumpy ride, we expect a dip may be an opportunity to buy. As LPL Research prepares its market outlook for the remainder of the year, the continued expectation is for the S&P 500 to deliver mid-single-digit gains for the year and end 2016 slightly above current levels.*

As always, if you have questions, I encourage you to contact me.

**Historically since WWII, the average annual gain on stocks has been 7-9%. Thus, our forecast is roughly in-line with average stock market growth. We forecast a mid-single digit gain, including dividends, for U.S. stocks in 2016 as measured by the S&P 500. This gain is derived from earnings per share (EPS) for S&P 500 companies assuming mid-to-high-single-digit earnings gains, and a largely stable price-to-earnings ratio. Earnings gains are supported by our expectation of improved global economic growth and stable profit margins in 2016.*

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College Planning -- It's About More Than Money

Applying well in advance of the deadlines can boost your child's chances of getting accepted to the school of his or her choice and receiving a favorable financial aid package.

Choosing a way to save for your child's education expenses may be your family's first college planning decision, but it certainly won't be the last. From making that first deposit, to selecting a college, to choosing a course of study, you and your child will be making choices that can have a financial impact for years to come.

How Will You Save Enough?

Starting to save for college when your child is young may give you the best chance for accumulating a significant amount of money. Section 529 plans -- prepaid tuition plans designed to lock in today's tuition rates at eligible institutions -- and college savings plans, which permit contributions to an investment account set up to pay qualified education expenses, are popular tax-favored options. [1]Coverdell Education Savings Accounts also offer tax advantages, although contribution limits are relatively low.[2] Custodial accounts set up under the Uniform Gifts to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA) are another option to consider.

The Financial Aid Game

By the time college gets close, your family's life may seem to be ruled by deadlines. There are different deadlines for college applications, scholarship applications, and the FAFSA (Free Application for Federal Student Aid) submissions. Applying well in advance of the deadlines can boost your child's chances of getting accepted to the school of his or her choice and receiving a favorable financial aid package. If you wait too long, spots may already be filled and aid money given to students who applied earlier.

Dissecting Aid Packages

Typically, aid packages consist of grants, loans, work study, and an expected family contribution. When reviewing aid offers, compare apples to apples. Start with the cost of tuition at each school. Then look at how much of the aid package consists of loans that will have to be repaid. Make sure non-tuition costs, such as room and board, books, equipment, transportation, and fees, are included in the school's cost estimates. It's a good idea to do your own cost estimate and use that as your basis for comparing offers.

The Right Fit

As important as it is, money shouldn't be the only criterion used when choosing a college. Lower cost of attendance or generous financial aid is most valuable if the college is a good fit for your child's abilities, personality, and goals. Choosing the wrong college could cost a bundle in lost opportunities if your child is unhappy or doesn't feel sufficiently challenged by the curriculum.

Look Toward the Future

A college education is an investment in the future, so parents may want to discuss choosing a course of study that will lead to a career. Talk to your child about the importance of preparing for life beyond college by obtaining the practical skills and knowledge needed to land a job after graduation. By planning ahead, your child may turn his or her interests into a successful career.

[1]*Certain benefits may not be available unless specific requirements (e.g., residency) are met. There also may be restrictions on the timing of distributions and how they may be used.*

[2]*Internal Revenue Service. The annual contribution limit is $2,000. Taxpayers with modified adjusted gross incomes (MAGIs) of more than $220,000 (for married couples filing a joint tax return) and $110,000 (for singles) may not contribute. For most taxpayers, MAGI is the adjusted gross income as figured on their federal income tax return.*

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The DOL Revisits Conflict of Interest Rules

According to the DOL's definition, "a person is a fiduciary if he or she receives compensation for providing advice with the understanding that it is based on a particular need of the person being advised or that it is directed to a specific plan sponsor, plan participant, or IRA owner."

Over the past several decades, there has been a significant shift in the retirement savings landscape away from employer-sponsored defined benefit pension plans to defined contribution plans, such as 401(k)s. At the same time, there has been widespread growth in assets in IRAs and annuities.

One consequence of this change, according to the U.S. Department of Labor -- the governmental body that oversees pensions and other retirement accounts -- is the increased need for sound investment advice for workers and their families.

The DOL says its so-called "conflict of interest" rules are intended to require that all who provide retirement investment advice to employer-sponsored plans and IRAs abide by a "fiduciary" standard -- putting their clients' best interest before their own profit.

Originally proposed more than a year ago, the "final" rules -- introduced in April 2016 -- have been revised to reflect input from consumer advocates, industry stakeholders, and others. Following are some of the key takeaways from the DOL's final regulatory package.

The Role of the Fiduciary

According to the DOL's definition, "a person is a fiduciary if he or she receives compensation for providing advice with the understanding that it is based on a particular need of the person being advised or that it is directed to a specific plan sponsor, plan participant, or IRA owner. Such decisions can include, but are not limited to, what assets to purchase or sell and whether to roll over from an employment-based plan to an IRA.[1] In this capacity, a fiduciary could be a broker, registered investment adviser, or other type of adviser.

The Best Interest Contract Exemption

The DOL's final rules include a provision called the Best Interest Contract Exemption (BICE). This exemption is intended to allow firms to continue to use certain compensation methods provided that they "commit to putting their client's best interest first, adopt anti-conflict policies and procedures, and disclose any conflicts of interest that could affect their best judgment as a fiduciary rendering advice" -- among other conditions.[2]

How does the BICE affect you? The contract provisions of the BICE are slated to go into effect January 1, 2018. At that time, IRA clients entering into a new advisory relationship should expect to sign the contract either before or at the time that a new recommended transaction is executed. IRA clients already working with an investment adviser as of January 1, 2018, may receive a notice from their adviser describing their new rights, but they should not be required to take any action unless they object to the terms of the notice.

Clients receiving advice about investments in an employer-sponsored retirement plan should receive the same general protections and disclosure, but should not expect to receive a contract to sign.

Education vs. Advice

The DOL's final rules clarify its position that education about retirement savings is beneficial to plan sponsors, plan participants, and IRA owners. As such, the DOL said that plan sponsors and service providers can offer investment education without becoming investment advice fiduciaries.

Further, the DOL stated that communications from plans that identify specific investment alternatives can be considered "education" and not a "recommendation" because plans have a fiduciary who is responsible for making sure the investment offerings in the plan are prudent. Since there is no such responsible fiduciary in the IRA context, references to specific investment alternatives are treated as fiduciary recommendations and not merely education.

Time to Get on Board

The new regulations are expected to take effect in the spring of 2017 (at the earliest) to allow all affected parties to adapt to and incorporate the changes.

To learn more about the new regulations and how they may affect you, visit the Department of Labor website.

United States Department of Labor, "FAQs About Conflicts of Interest Rulemaking."

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