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The Increasingly Regulated World of IRA Rollovers . . . and What to Do About It

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Capturing Rollovers

With the aging of the baby boomers in a defined contribution world, the importance—and the amounts—of retirement assets being rolled over to IRAs will be increasing dramatically.

Unfortunately, the regulation of distributions and rollovers is not well defined and there are misunderstandings about what advisers can and cannot do.

The DOL and IRA Rollovers

The Department of Labor’s 2005 guidance on “capturing rollovers” from retirement plans was the first step in regulating advisory services for distributions and rollovers.

Those concerns have been compounded by the DOL’s proposal to expand the definition of fiduciary advice.

The DOL and IRA Rollovers

In addition, the GAO's recent report: "401(k) PLANS: Labor and IRS Could Improve the Rollover Process for Participants," has heightened the awareness of conflicts of interest in the rollover process and increased the likelihood of greater regulation of IRA rollovers.

Note: GAO review of recordkeeper practices.

The DOL and IRA Rollovers

Unfortunately, the DOL's guidance has been misconstrued as possibly restricting rollover services by advisers for the plans that they serve.

It does not prohibit the capturing of rollovers . . . by fiduciary or non-fiduciary advisers.

Instead, it highlights certain issues for advisers who serve as fiduciaries to retirement plans.

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Impact on Non-Fiduciary Advisers

When advisers are *not* acting as fiduciaries to plans, . . .

they may capture IRA rollovers from plans, and may assist in the investment of those rollovers, without concern about ERISA's fiduciary or prohibited transaction rules.

However, FINRA and the SEC are also looking at rollover practices for advisers.

FINRA Report on Conflicts of Interest

Why?

Customer liquidity events and suitability monitoring:

Firms monitor the suitability of registered representatives' recommendations around ***key liquidity events in an investor's lifecycle where the impact of those recommendations may be particularly significant****, for example,* ***at the point where an investor rolls over his pension or 401(k)****.* [Emphasis added.]

FINRA Regulatory Notice 13-45

The IRA Rollover Decision

A recommendation to roll over plan assets to an IRA rather than keeping assets in a ***previous employer's plan*** *or rolling over to* ***a new employer's plan*** *should reflect* ***consideration of various factors****, the importance of which will depend on an investor's individual needs and circumstances.*

continued . . .

FINRA Regulatory Notice 13-45

- *Investment Options.*
- *Fees and Expenses.*
- *Services.*
- *Penalty-Free Withdrawals.*
- *Protection from Creditors and Legal Judgments.*
- *Required Minimum Distributions*
- *Employer Stock*

. . . the list is not exhaustive.

FINRA Regulatory Notice 13-45

. . . must consider ***the customer's investment profile, including:***

- ***the customer's age;***
- ***other investments'***
- ***financial situation and needs;***
- ***tax status;***
- ***investment objectives;***
- ***investment experience;***
- ***investment time horizon;***
- ***liquidity needs;***
- ***risk tolerance****;*

and . . . any other information the customer may disclose . . . . [Emphasis added.]

FINRA Examination Priorities

In 2014, reviewing firm rollover practices will be an examination priority, and staff will ***examine firms' marketing materials and supervision*** *in this area. FINRA will also* ***evaluate securities recommendations made in rollover scenarios*** *to determine whether they comply with suitability standards in FINRA Rule 2111.* [Emphasis added.]

Note: Also in SEC 2014 Examination Priorities.

FINRA Examination Priorities

In 2014, FINRA examiners will continue to focus on how firms engage with these ***senior investors****, especially with respect to suitability determinations as well as disclosures and communications.*

FINRA will also examine firms' policies and procedures to identify and address situations where issues of diminished capacity may be present. [Emphasis added.]

FINRA

The IRA Rollover: 10 Tips to Making a Sound Decision

The largest source of IRA contributions comes from individuals who move their money from their employer-sponsored retirement plans such as 401(k) and 403(b) plans when they leave a job, according to the Employee Benefit Research Institute.

If you are considering rolling over money from an employer plan into an IRA—or if you have been in contact with a financial professional to do so—follow these tips to decide whether an IRA rollover is right for you.

1. **Evaluate your transfer options**. You generally have four choices. You can usually keep some or all your savings in your former employer's plan (check with your benefits office to see what the company's policy is). You can transfer assets to your new employer's plan, if allowed (again, check with the benefits or human resources office). You can roll over your plan assets into an IRA. Or you can cash out your balance. There are pros and cons to each, but cashing out your account is rarely a good idea for younger individuals. If you are under age 59½, the IRS generally will consider your payout an early distribution, meaning you could owe a 10 percent early withdrawal penalty on top of federal and applicable state and local taxes.

. . . .

Impact on Fiduciary Advisers

When advisers serve plans (or participants) as fiduciaries, there is some concern because of the DOL guidance and its lack of clarity.

If a fiduciary adviser intends to offer rollover services, a conservative approach should be considered.

Legal Background—Fiduciaries

In DOL AO 2005-23A, the DOL said that, ***if an adviser was already a fiduciary to the plan***:

- a recommendation to take a distribution and/or to roll over to an IRA;
- advice on how to invest the funds in the IRA; or
- answering questions about these matters;

could be subject to ERISA's **fiduciary responsibility** and **prohibited transaction** rules.

Legal Background

In effect, the DOL is taking the position that a fiduciary adviser—has such influence over participants' thinking that the adviser has expanded its authority to encompass distributions, rollovers and IRA investing.

While it is possible that, in an individual case, a fiduciary adviser could exercise undue influence over participant's decision to take a distribution and roll into an IRA with the adviser, that would be highly unusual.

Steps for Fiduciary Advisers

Fiduciary advisers who want to provide services for distributions and rollovers should consider:

- educational materials for plan distributions and rollovers;
- descriptive materials concerning retirement investment services for the IRAs;
- disclosure materials for “compensation” for the adviser and for costs; and
- disclosures of conflicts of interest.

Steps for Advisers

The descriptive materials concerning distributions could include discussions of the advantages and disadvantages of:

- leaving the money in the current plan;
- transferring it to the plan of their new employer;
- taking a taxable distribution;
- rolling into an IRA of their choice; or
- working with the adviser to identify and use a suitable IRA provider.

Steps for Advisers

A conservative approach could also provide written disclosures of fees and expenses for the IRA and its investments, as well as the adviser's compensation.

For those advisers, these disclosures should be made prior to the participant making a decision about using the adviser.

- Note: Similar to 408(b)(2).

Steps for Advisers

Under a conservative approach, an adviser should obtain written acknowledgments that a participant made the decision to work with the adviser of his own free will and was not influenced by the adviser's status as a fiduciary.

That approach could also acknowledge that the participant made the decision to take a distribution—without consulting the adviser.

Steps for Advisers

Issues that may attract DOL attention:

- recommendations that participants take distributions (and particularly in-service distributions).
- discussions that favor one form of holding retirement assets over another (*e.g.*, IRA rollovers over leaving money in the plan).
- recommendations that result in high or hidden costs or compensation of the adviser.
- recommendations that result in conflicts of interest.

Steps for Advisers

Other considerations:

- Capturing rollovers for existing wealth management clients.
- Charging fees for IRA at plan levels.
- Capturing rollovers for sophisticated investors.
- Charging a set fee for financial planning and wealth management.

Parting Thoughts and Questions . . .

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