Can Advisor Provided Plan Fiduciary and Participant Distribution Services Co-Exist?

- We believe that the additional fee disclosures required by 408(b)2 and 404(a) will put increased pressure on margins for all service providers, including plan advisors and consultants.

- IRA Rollovers may help plan advisors diversify their revenue sources and maintain margins, but are fraught with current and proposed regulatory hurdles.

- Plan advisors conflicted from soliciting rollover business can, and should, offer distribution education and execution as part of their service offering, and may do so without running afoul of the current or proposed regulatory landscape.

- Plan advisors who want to expand their practice to capture the rollover opportunity will find fierce competition from “retail” advisors and must carefully consider staffing requirements, marketing initiatives and the delivery of a client engagement model appropriate for individual investors.
Part One: Current Regulatory and Legal Environment

Two existing Department of Labor (DOL) rulings provide guidance on rendering investment advice regarding distributions and IRA Rollovers:

- **Interpretive Bulletin 96-1** – Under IB 96-1, the DOL set forth its guidelines for determining the line between information and advice. This bulletin allows a series of educational activities that will not give rise to rendering investment advice.

- **Advisory Opinion 2005-23A** – Under Advisory Opinion 2005-23A, the DOL gives guidance on what an Advisor can do if:
  - already acting in the role of a fiduciary for a plan
  - not already acting in the role of a fiduciary for a plan.

**Analysis of Interpretive Bulletin 96-1**

Under IB 96-1 (IB), an Advisor can provide a litany of services that do not cross the investment advice threshold. The interpretive bulletin points out, in effect, a series of safe harbors under ERISA for plan sponsors, service providers, and Advisors. The IB sets forth four specific categories of investment information and materials:

1. **Plan Information** - information and materials that inform a participant or beneficiary about the benefits of plan participation and increasing plan contributions, the impact of preretirement withdrawals on the participant’s ultimate retirement income, the terms and operation of the plan, and information on the plan’s investment alternatives - descriptions of investment objectives and strategies, philosophies, risk and return characteristics, historical return information, or prospectuses.

2. **General Financial and Investment Information** - information and materials that inform a participant or beneficiary about: general financial and investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment; historic differences in rates of return between different asset classes based on standard market indices; effects of inflation; estimating future retirement income needs; determining investment time horizons; and assessing risk tolerance.

3. **Asset Allocation Models** - information and materials that are made available to all participants or beneficiaries – in the form of pie charts, graphs, or case studies – with hypothetical asset allocation portfolios models with different time horizons and risk profiles.

4. **Interactive Investment Materials** - questionnaires, worksheets, software, interactive websites and similar materials that give participants or beneficiaries the ability to estimate future retirement income needs in light of different asset allocation choices.
These safe harbors are designed to ensure that participants and beneficiaries will have the information they need to make their own, informed asset allocation decisions. The DOL clarified that the safe harbor for interactive investment materials would continue to be available even if the asset allocation models generated by the materials take into account a participant’s or beneficiary’s broader non-plan assets, income and investments.

Under the IB, the safe harbor would also be available if participants and beneficiaries receive personal assistance in developing model asset allocations. The IB allows Advisors to provide various categories of information that will not, in and of themselves, constitute “investment advice” irrespective of whether they are provided on an individual or group basis, in writing or orally, or via video, computer software or the internet.

Information in these categories can also be combined. For example, general financial and investment information on estimating future retirement income needs, determining investment time horizons and assessing risk tolerance may be combined with interactive investment materials in order to allow participants and beneficiaries to relate these retirement planning concepts to their personal situations.

The primary objective of the Bulletin was to draw a distinction between investment education and investment advice. Hence IB 96-1 focuses on educational activities relating to investment decision-making.

The DOL had three messages it wanted educational service providers to emphasize that participants should:

- Participate in the plan as soon as they are eligible.
- Maximize contributions to the plan.
- If participants change jobs, they should refrain from withdrawing their retirement savings in a lump sum, and instead directly transfer or roll over their new plan account into an IRA Rollover.

According to the Bulletin, whether providing particular investment-related information or materials to a participant or beneficiary constitutes the rendering of “investment advice” is a facts and circumstances test - determined by looking at the facts and circumstances of the particular individual plan participant or beneficiary.

To this end, the DOL identified examples of investment-related information and materials, which if provided to plan participants and beneficiaries would not result in the rendering of “investment advice” under ERISA. According to the DOL, providing the four categories of information
and materials to a participant or beneficiary in a participant-directed plan will not constitute the rendering of “investment advice,” irrespective of:

- who provides the information (e.g., plan sponsor, fiduciary, service provider or an Advisor),
- the frequency with which the information is shared, the form in which the information and materials are provided, or
- whether an identified category of information and materials is furnished alone or in combination with other identified categories of information and materials.

The information and materials provided are meant to be relevant but they do not become specific about which investment options are appropriate for a particular participant or beneficiary. Because the information and materials in these categories let the individual participant or beneficiary determine for themselves how the information and asset allocation model relate to their particular situation, it would constitute neither a “recommendation” nor “investment advice” under ERISA.

The DOL states that because the information and asset allocation model do not contain either “advice” or “recommendations”, they would not be considered rendering of “investment advice” for purposes of the DOL definition of a fiduciary under ERISA. The DOL went on to say that this would hold true even if the plan offers only one investment alternative in a particular asset class identified in an asset allocation model. The information provided through these interactive means merely puts participants and beneficiaries in a position to independently design and assess multiple asset allocation models based on hypothetical assumptions, and hence such information would not constitute a “recommendation” and would not constitute “investment advice” under ERISA.

What do the safe harbors outlined in the Bulletin mean for Advisors? The Education and Information safe harbors mean just what they say: Advisors can educate and provide information and, in the end, it is the participants’ investment decision. The same would hold true of the distribution and rollover decision – the Advisor would educate, provide information through any of the means described but leave the actual distribution and rollover decision to the participant. The Advisor would make it part of their business model to document how they approach each participant situation.

Analysis of Advisory Opinion 2005-23A

Advisors who are not currently acting as Fiduciaries for a plan: Under Advisory Opinion 2005-23A, the DOL gives even wider latitude to Advisors who are not already acting as fiduciaries. The DOL states that: “Under this ruling, merely advising a plan participant to take an otherwise permissible plan distribution, even when that advice is combined with a recommendation as to how the distribution should be invested, does not constitute ‘investment advice’ under ERISA.” The investment advice regulation defines when a person is a fiduciary by virtue of providing investment advice with respect to the plan assets. Under this rule, the DOL currently does not view a recommendation to take a distribution as “advice” under ERISA. The DOL’s point of view in this ruling is that any investment recommendation regarding the proceeds
of a distribution would be advice with respect to funds that are no longer assets of the plan and therefore no longer subject to ERISA nor under the DOL's jurisdiction.

**Advisors who are acting as Fiduciaries:** Suppose alternatively that an Advisor is already providing advice to the plan or to the plan participants under a fee for service agreement. Under both the current and the new proposed fiduciary rules, the Advisor is a fiduciary.

**How does this fiduciary status affect the Advisor’s ability to capture rollovers?**

Even without the DOL’s new definition of fiduciary rule change, the same 2005 DOL Advisory Opinion provides in part that: where, an Advisor who is already a plan fiduciary responds to participant questions concerning the advisability of taking a distribution or the investment of amounts withdrawn from the plan, that Advisor as a fiduciary is exercising discretionary authority with respect to the management of the plan and must act prudently and solely in the interest of the participant.

If, for example, the Advisor fiduciary causes the participant to take a distribution and then to invest the proceeds in an IRA account managed by the Advisor fiduciary, the Advisor fiduciary may be viewed as using plan assets in his or her own interest, in violation of ERISA’s self-dealing prohibitions. If so, the Advisor will also be found to have breached the fiduciary duty under ERISA to act solely in the interest of the participants and beneficiaries.

**The Regulatory Outlook**

**New Fiduciary and Investment Advice Rules:** In October 2010, the DOL issued a proposed fiduciary rule aimed at making it easier to find Advisors to be “rendering investment advice for a fee.” This means Advisors including brokers can be found to be fiduciaries even when they intend to merely play a sales role. The DOL seeks to cast a much wider net by proposing to redefine a fiduciary rendering investment advice under ERISA as a person who gives investment advice for a direct or indirect fee,

1. by providing the requisite type of advice: appraisals or fairness opinions about the value of securities; recommendations on investing in, purchasing, holding, or selling securities; or the management of securities; and

2. by meeting one of the following conditions:
   - Represents to a plan, participant or beneficiary that they are acting as an ERISA fiduciary;
   - Is already an ERISA fiduciary to the plan by virtue of having any discretionary authority or control over the management or disposition of plan assets, or the administration of the plan;
   - Is an investment adviser under the Investment Advisers Act of 1940; or
   - Meets the following test:
<table>
<thead>
<tr>
<th>Current Five-Part Test</th>
<th>New Proposed Test</th>
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<tr>
<td>Renders Investment Advice</td>
<td>Same</td>
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<tr>
<td>On a regular basis</td>
<td>One time is enough</td>
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<td>Pursuant to a mutual agreement</td>
<td>Same</td>
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<tr>
<td>Intended to be the primary basis</td>
<td>May be considered</td>
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<td>Advice is individualized</td>
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**Impact:** It will be much easier for an Advisor to be inadvertently found to be a fiduciary under this ERISA rule. It also creates ambiguity around whether advising participants about plan distributions and Rollovers is a fiduciary act. Senator Tom Harkin, D-Iowa, chairman of the Committee on Health, Education, Labor and Pensions (“HELP”), urged the DOL to hold retirement plan advisors to the highest fiduciary standards. In a letter to the DOL, he offered the following comment: “‘Investment advice’ should be construed broadly to include recommendations regarding plan distributions, the management of standards, securities, investment manager selection, and asset allocation.”

This extension of the investment advice framework to plan distributions and rollovers obviously threatens the existing Advisor business models that seek to provide plan participants with investment advice for the purpose of developing a long term relationship with the participant and eventually capturing rollovers. The ability to build IRA Rollover business has been a main reason that Advisors and firms provide participant investment advice.

**Now, the DOL has created some uncertainty as to whether rendering investment advice to a participant under the new fiduciary definition will preclude an Advisor from doing the participant’s IRA Rollover.**

Regardless of what the DOL decides to do, if an Advisor merely educates the participant about rollovers and lets the participant make the decision about whether to take a distribution and where to set up the IRA rollover, the Advisor is not rendering investment advice for a fee. The Advisor who is only providing education and information can capture the rollover business. Thus, the newly proposed fiduciary rule change clearly gives the benefit to Advisors who are educators and direct marketers. At the same time the proposed rule disadvantages Advisors who already act as fiduciaries.

**New Retirement Plan and IRA Investment Advice Rule:** Newly proposed DOL investment advice rules apply to both retirement plans and IRAs. Under the new DOL regulation re-issued in March 2010, Advisors will only be able to offer investment advice in one of two ways:

- **level fee arrangement** - Advisors must disclose fees and acknowledge in writing that they are fiduciaries;
- **Or a certified computer model** – Unlike the Proposed Bush rule, Advisors will not be able to stray from that computer generated advice.
Impact: The newly proposed DOL investment advice rules now apply to both retirement plans and IRAs. As a fiduciary under ERISA, an Advisor must act solely in the interests of participants and beneficiaries. Advisors receiving 12b-1 compensation that varies by asset class will not be able to offer participants nor IRA holders investment advice due to the prohibited conflict of interest under ERISA – the Advisor may make more money if participants invest in equity vs. fixed income or money market funds. If so this is self-dealing and a clear conflict of interest under ERISA's fiduciary rules. So these new investment advice rule changes will disadvantage the 12b-1 business model and will favor those RIAs and other Advisors who are already acting as fiduciaries and charging level fees.

Together, the new Fiduciary Definition and the new Plan and IRA Investment Advice rules will change the fiduciary landscape - no advisor will be immune to these changes. Advisors providing advice to retail clients who also have IRAs will need to offer advice under this level fee rule or use a certified computer model. These rules affect every Advisor. We see a few possibilities that may happen: the large broker dealer firms may allow every Advisor in the firm to become a fiduciary and offer IRA clients investment advice for a fee or they may instead create an IRA product that will incorporate standardized advice provided by the firm itself for a level fee.

Part Two: Practice Management Considerations

Once an advisor makes a determination as to what is permitted from a regulatory perspective, the next step is to decide how, if at all, IRA rollovers may fit into his business model. Advisors who are serving in a fiduciary capacity and have been advised by their firm’s legal counsel not to proactively solicit rollovers, or those who have little interest in working with individual clients, should consider adding distribution counseling and execution to their existing plan sponsor deliverables. These services may greatly enhance the Advisor’s value to his plan relationships while not running afoul of any fiduciary restrictions.

Distribution Education and Execution

One possibility is to augment traditional participant educational seminars with targeted pre-retirement and distribution planning workshops. These workshops should be appropriate for employees within 5 years of retirement and would qualify as “education” under DOL IB 96-1. In addition to educating employees about the mechanics of rollovers, other topics that may be covered include: pre-mature distributions and possible exceptions to the 10% penalty; Social Security retirement benefit planning and options surrounding other employer-sponsored benefits such as pension distributions and retiree health care, if applicable. At a minimum, providing this education will add value to plan sponsor relationships and will help justify Advisor fees. For Advisors who have the ability to engage in a fee-for-service arrangement, offering these programs may even provide an additional source of revenue.

Another possibility is to partner with an outside rollover platform that can administer much of the work migrating distribution-eligible participants out of the plan and into an IRA. These providers often have electronic linkages to record-keepers and IRA providers that can facilitate rollovers when a participant retires or otherwise terminates employment. If no such linkage
exists, the participants can still be accommodated albeit through a more manual process. When combined with an automatic rollover provision for terminated employees with balances less than $5,000, these arrangements may offer the plan sponsor cost savings in the following ways:

- Since average account balance often drives record-keeping costs, eliminating these lower balances may result in lower total costs;
- Eliminating small balances may keep the number of eligible participants under 100 lives, thus avoiding the need for an independent annual plan audit; and
- Passing along the responsibility of communicating with terminated employees will save the employer’s benefit department time and effort.

Even for employees with balances greater than $5,000 who are not subject to the automatic rollover provisions, these arrangements can offer a professional a simple way for retired and terminated employees to transition to an IRA at no additional cost to the plan sponsor, and with little to no engagement from the plan advisor.

Before selecting a rollover platform, however, Advisors should also investigate the rollover capabilities of their plan sponsor’s record-keeping provider. Some providers have built rollover products that offer robust services and competitive pricing for distribution-eligible plan participants. Also, when using an outside rollover platform plan sponsors will be required to share confidential employee information with the third-party, a requirement both the sponsor and advisor must be comfortable with.

For participants with larger balances who may require the attention of a full-service advisor, it may be helpful for 401(k) advisors to simply make a referral to another advisor who has the experience and expertise working with individual clients.

Whether a plan participant is referred to an outside rollover platform, the record-keeper’s IRA rollover service center or another advisor, we suggest plan advisors acting in a fiduciary capacity should not accept any revenue sharing unless expressly permitted by their firm’s compliance and legal departments.

Building a Private Client Practice

While access to a plan’s participants offers 401(k) Advisors a competitive advantage in the marketplace, many experienced and proficient Advisors who specialize in individual retirement planning may prove to be fierce competitors. Careful thought and consideration early in the process, combined with consultation with peers and other industry experts, will increase the chances for a successful launch of this new enterprise. To begin, there are three primary considerations: assessing current and future staffing needs; rebranding of the practice and building a client engagement model.

Staffing. One of the first considerations is whether the practice, as currently constituted, has the capacity to proactively and successfully capitalize on the rollover opportunity. Additionally, are there practice members who have the prerequisite experience and expertise to advise
individual clients regarding their rollover transaction in addition to their broader retirement needs and objectives? If not, there are two options: hire or partner.

Hiring new practice members, particularly to join a well-organized and effective team is never an easy decision. In addition to the necessary technical skill-set, compatible personalities, demeanors and value-systems are equally if not more important. A competitive compensation structure is also paramount for attracting the right talent and offering ample opportunity for growth. Alternatively, partnering with a wealth management expert with a proven track-record of attracting and retaining clients transitioning to retirement may also prove a viable solution. While the plan advisor and individual advisor practices may operate separately, the plan sponsor and participants will view all advisors as one team. Diligence and thoroughness are the keys throughout the interview and reference process to ensure a good match.

**Rebranding.** The next step is to consider how to rebrand the practice. For years, plan sponsors, participants, industry associates, centers of influence and the local community have formed an expectation of the services a prominent and successful 401(k) Advisor and team offers. Care must be taken to carefully amend the value proposition to include serving the individual planning needs of participants. In addition to updating marketing materials and other collateral, plan sponsors should be given an opportunity to voice their opinions on how they view terminated plan participants. Their response will help Advisors decide how best to position the subject of working with employees on an individual basis. After hearing directly from plan sponsors, Advisors may be given more liberties with certain plans, while being limited to unsolicited inquires with others.

It also may be helpful or even desirable for Advisors to set a minimum net worth or rollover amount before transitioning a participant to a client, but have a professional and systematic solution in place for those participants who do not meet these thresholds. Plan sponsors may not appreciate certain participants being cast-aside or ignored solely based on their plan balance. A partnership with an outside rollover platform or an agreement with the plan’s existing record-keeper who offers a proprietary rollover solution will in many cases help segment plan participants and provide referrals to the appropriate party.

A critical part of the new branding and marketing strategy is to ensure participants know to contact the plan Advisor, or his delegate, regarding their rollover. These communications need to be made early and often. Many plan Advisors make the mistake of beginning the discussion when participants are near or at retirement. By this time, several of these rollover-eligible participants will have already sought assistance and chosen their new provider. When the participant calls the plan record-keeper with rollover instructions, a last-minute referral can be made to the plan Advisor, but the opportunity will be very difficult to salvage.

**Engagement Model.** The third element is to build a client engagement model. In other words, when meeting with a plan participant regarding a rollover opportunity, what would the experience look like? While there are a number of approaches, there are four main components: discovery, planning, investing and monitoring.
- **Discovery.** Client discovery involves helping the client articulate his goals and objectives. While this may sound easy, it often can be extremely difficult and Advisors who have mastered this element have a clear advantage over their competitors. Initially, it may be helpful to take time and review the many client interview and fact-finding guides that are available to find one which is comfortable. While they vary, the two common elements will be a series of hard or quantitative questions that ask about income needs, income sources, assets and liabilities and soft or qualitative questions that dive deep into an individual's priorities, interests, hobbies and values.

- **Planning.** Based on the information gathered, it is now the Advisor’s job to draft and present a plan that clearly illustrates how a plan participant will use his rollover and other resources to meet his stated goals and objectives. For many retirement-ready participants, a common concern is generating sufficient cash flow to fulfill their lifestyle needs while minimizing the chances of depleting their accounts. Other considerations may include the optimal age to begin taking Social Security benefits and who to name as their IRA rollover beneficiary. Younger participants may need to be shown the adverse tax implications of taking an early taxable distribution from their 401(k) plan or whether a Roth IRA conversion is an appropriate strategy.

- **Investing.** After the plan is presented, the third step is to construct a portfolio that is designed to generate a sufficient rate of return over time but does not exceed the individual's tolerance for risk. Risk is a very difficult metric to quantify because often an individual's appetite for risk will vary, depending upon his most recent experiences or influence of the current market environment. Tools that are used with 401(k) plans such as Investment Policy Statements can be a valuable device to educate individuals about their portfolios, set expectations and provide a guide-post in times of uncertainty.

- **Monitoring.** Once the rollover is executed and the proceeds invested, the final step is ongoing monitoring. After the plan is in place, there may be unexpected market movements or tax law changes. Other times, individuals may experience changing family circumstances or renewed priorities. All of these events are reasons to revisit and revise the individual’s plan, if appropriate. Advisors should be especially diligent with respect to certain behaviors such as excessive spending immediately following retirement. These actions, if not corrected, can hamper the ability to generate sufficient cash flow during the latter years of retirement.
Janus Can Help

Janus has cultivated a deep understanding of the complexities and needs of the retirement marketplace and 401(k) advisor. Our Retirement Specialists, with an average of 15 years industry experience, have coached and supported advisors regarding the regulatory environment, practice management and marketing campaigns. If you would like to discuss strategies that may be appropriate for your practice with our specialists, please contact your Janus Director at 1-877-33JANUS (52687)

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