Can RIA Help Participants with Rollovers

by Fred Reish, Drinker Biddle & Reath LLP

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This article asks, answers and analyzes the important question: “Can registered investment advisers help participants with individual retirement account (IRA) rollovers where the registered investment adviser (RIA) serves as a fiduciary to the plan?”

The answer is “yes” . . . if the RIA—or “adviser”—takes appropriate precautions.

COMMENT FOR fi360: While this article explains those precautions in more detail (and should be read in its entirety before relying on these conclusions), the basic steps are:

- Provide participants with an educational and unbiased description of the distribution alternatives available to participants, for example;
  - leaving their money in their current plan;
  - transferring their account to the plan of a new employer;
  - taking a taxable distribution;
  - rolling the money over to an IRA with help from the adviser; and
  - rolling the money over to another IRA of their choice.

The description should include the important advantages and disadvantages of each alternative.

- Provide participants with a description of the rollover services provided by the adviser, including, for example, a professional and objective description of:
  - The adviser’s services in managing retirement money in an IRA.
  - The adviser’s philosophy about retirement investing, e.g., the balance of capital appreciation and preservation of capital.
  - The adviser’s status as an RIA and fiduciary for the IRA services.
  - The adviser’s compensation for services.

In some regards these descriptions are similar to the ERISA 408(b)(2) disclosures.

- Obtain an acknowledgment by the participant that it was the participant’s decision to take a distribution, to roll over to an IRA, and to work with the adviser; and that the adviser’s status as a fiduciary to the plan did not influence that decision.
History

In 2005, the Department of Labor (DOL) issued Advisory Opinion 2005-23A, which addressed whether the recommendation that a participant take a distribution from his 401(k) plan and roll the money to an IRA was subject to the fiduciary standards and prohibited transaction rules of ERISA. In that guidance, the DOL said that, where a person who is not already a fiduciary to a plan makes a recommendation about distributions and IRA rollovers, the person would not be a fiduciary even if he offered investment advice about the money rolled into the IRA.

However, the DOL went on to say that, if the adviser was already a fiduciary to the plan:

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

could be subject to both ERISA’s fiduciary responsibility and prohibited transaction rules—because, in the view of the DOL, that amounted to the exercise of discretion over the management of the plan. (Interestingly, the DOL’s conclusion was based on “management” — which requires some control — under ERISA §3(21)(A)(i), rather than on investment advice under ERISA §3(21)(A)(ii).) To quote from the DOL:

> Where, however, a plan officer or someone 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 fiduciary is exercising discretionary authority respecting management of the plan and must act prudently and solely in the interest of the participant. Moreover, if, for example, a fiduciary exercises control over plan assets to cause the participant to take a distribution and then to invest the proceeds in an IRA account managed by the fiduciary, the fiduciary may be using plan assets in his or her own interest, in violation of ERISA section 406(b)(1). [Emphasis added.]

**COMMENT FOR fi360:** In effect, the DOL is taking the position that a fiduciary adviser who makes recommendations about distributions, IRA rollovers and investments—or who even answers participant questions in that context—has such control or influence over participants’ thinking that the adviser has expanded its fiduciary role to effectively “manage” distributions, rollovers and IRA investing.

The DOL’s conclusions conflict with well-established law. The conclusion is based on a fiduciary adviser (under ERISA §3(21)(A)(ii)) becoming a “fiduciary manager” under ERISA 3(21)(A)(i). As authority for that proposition, the DOL cites Varity v. Howe, 516 U.S. 489, 502-503 (1996). However, in that case, the fiduciary (that is, the plan sponsor) was already the fiduciary for administering the plan. That is, Varity was already a fiduciary for the purpose of providing information to the participants about a variety of matters, including distributions. As the Court noted, “Varity was both the employer and the benefit plan’s administrator . . .”
With regard to the Varity communications with participants, the Court noted “[W]e believe that the District Court reached the correct legal conclusion, namely, that Varity spoke, in significant part, in its capacity as plan administrator.” Thus, the issue in Varity was not whether a fiduciary for one purpose could become a fiduciary for another. Instead, the issue was whether a fiduciary must, in the performance of the duties it has accepted, be truthful in its communications. At worst, the Varity decision could be viewed as saying that it can be confusing when an employer communicates with its employees about its ERISA benefit programs. Are the communications made in a non-fiduciary employer capacity or as a fiduciary plan administrator?

It appears that the DOL is attempting to extend that holding beyond its meaning . . . and conclude that whenever someone who is a fiduciary for any purpose communicates with participants, the communication can only be viewed as being a fiduciary communication. However, the question of whether a fiduciary for one purpose becomes a fiduciary for another purpose is a facts-and-circumstances test and cannot be generalized. In litigation on these issues, courts require much more than just answering questions. As a result, the DOL’s conclusion may be appropriate for a fiduciary who already has responsibility for distributions and answering questions about distributions (e.g., the 3(16) plan administrator), but it is questionable when applied to a plan’s investment advisers.

**COMMENT FOR fi360:** This position may be particularly difficult for the DOL to assert where the participant is already an advisory client of the RIA (e.g., the RIA is the personal wealth manager for the participant). In that case, it would be almost impossible for the DOL to maintain that the RIA was chosen to handle the IRA rollover because of the RIA’s fiduciary position with the plan.

Similarly, but not to the same degree—it is difficult for the DOL to assert that sophisticated and financially successful corporate officers were unduly influenced by the RIA or its fiduciary status.

Not only does the DOL’s position directly conflict with the Varity analysis, but it is also contrary to well-established legal interpretations, for example:

“[A] person may be an ERISA fiduciary with respect to certain matters but not others, for he has the status only ‘to the extent’ that he has or exercises the described authority or responsibility.” F.H. Krear & Co. v. Nineteen Named Trustees, 810 F.2d 1250, 1259 (2d Cir. 1987).

“We emphasize that our affirmance does not automatically transfer into fiduciaries conscientious or even miscreant professionals, consultants, advisers, or sales representatives who provide necessary services to ERISA plans. This is so even if these persons render advice and play influential roles by virtue of the expertise that they may possess or the capacities in which they act. . . . To be fiduciaries, such persons must exercise discretionary authority and control that amounts to actual decision making power.” Reich v. Lancaster, 55 F.3d 1034, (5th Cir. 1995).

In another words, while it is possible for a service provider, when acting as a fiduciary for one purpose to become a fiduciary for another purpose, that determination
requires a detailed analysis of the facts and circumstances—and is not a per se conclusion as the DOL opinion suggests. Furthermore, the courts usually require compelling facts to reach that conclusion.

**COMMENT FOR fi360:** Theoretically, the analysis is the same regardless of whether the RIA is providing fiduciary investment services to the plan fiduciaries or to the participants. However, as a practical matter, it may be easier for the DOL to assert that a participant adviser has more influence, and perhaps “control,” over the behavior of a participant. As a result, investment advisers for participants should be particularly careful that they do not make “recommendations” about distributions, rollovers and IRA investments.

- On the other hand, in at least some cases, advisers to participants may be able to charge the same advisory fees in IRAs as they do in plans—which would eliminate the primary risk.

Nonetheless, the DOL has stated its position. As a result, a conservative approach is advisable.

**Discussion in the Preamble**

The Preamble for the DOL’s 2009 proposed regulation on fiduciary advice for participants reiterated the DOL’s position in Advisory Opinion 2005-23A:

“When a person is already acting in a fiduciary capacity with respect to the plan, the Department has indicated that recommendations relating to the taking of a distribution or the investment of amounts withdrawn from the plan would constitute the exercise of discretionary authority respecting management of the plan and, therefore must be undertaken prudently and solely in the interest of the participant or beneficiary, consistent with section 404(a)(1). The Department further notes that if, for example, a fiduciary exercises control over plan assets to cause a participant or beneficiary to take a distribution and then to invest the proceeds in an IRA account managed by the fiduciary, the fiduciary may be using plan assets in his or her own interest, in violation of [the prohibited transaction rule in] ERISA section 406(b)(1).” [Emphasis added.]

**COMMENT FOR fi360:** Interestingly, the DOL did not repeat its earlier position that answering questions could cause a fiduciary adviser to be controlling plan assets and distributions. Instead, this more recent discussion focuses on “recommendations.” Nonetheless, the DOL continued to opine that, where a fiduciary makes those recommendations, it is the equivalent of exercising discretionary authority or control over the management of plan assets.

However, there is a difference between unbiased educational materials and “recommendations.”

The importance of clear and unbiased educational materials was highlighted by the March 2013 Report from the Government Accountability Office (GAO) “401(k) PLANS: Labor and IRS Could Improve the Rollover Process for Participants.” In that report, the GAO found that, in many cases, participants were receiving biased and partial or inaccurate information about their distribution and rollover alternatives. The GAO
Plan participants often receive guidance and marketing favoring IRAs when seeking assistance regarding what to do with their 401(k) plan savings when they separate from their employers. GAO found that service providers’ call center representatives encouraged rolling 401(k) plan savings into an IRA even with only minimal knowledge of a caller’s financial situation. Participants may also interpret information about their plans’ service providers’ retail investment products contained in their plans’ educational materials as suggestions to choose those products. Labor’s current requirements do not sufficiently assist participants in understanding the financial interests that service providers may have in participants’ distribution and investment decisions.

In addition to being subject to inefficient rollover processes and the marketing of IRAs, 401(k) plan participants separating from their employers may find it difficult to understand and compare all their distribution options. Information participants currently receive is either too generic and without detail, leaving participants without understanding of the key factors they need to know to make decisions about their savings, or too long and technical, leaving participants overwhelmed and confused. Labor regulations do not ensure that 401(k) plans provide complete and timely information to participants on all their distribution options. Industry experts told GAO that participants could benefit from simplified, concise, and standardized information.

Even before that GAO report, the DOL had expressed concerns about the rollover information being given to participants and the lack of disclosure and transparency.

In 2010, the DOL addressed the broad issue of rollovers again in the preamble to its proposed regulation expanding the definition of fiduciary investment advice. The DOL stated:

The Department notes that it also has taken the position that, as a general matter, a recommendation to a plan participant to take an otherwise permissible plan distribution does not constitute investment advice within the meaning of the current regulation, even when that advice is combined with a recommendation as to how the distribution should be invested. Concerns have been expressed that, as a result of this position, plan participants may not be adequately protected from advisers who provide distribution recommendations that subordinate participants’ interests to the advisers’ own interests. The Department, therefore, is requesting comment on whether and to what extent the final regulation should define the provision of investment advice to encompass recommendations related to taking a plan distribution. [Emphasis added.]

In other words, the DOL is considering, among other things, expanding its interpretation to include non-fiduciary advisors who make recommendations that participants take distributions. It appears the Department is concerned that some participants may be encouraged to take distributions from relatively low-cost retirement plans and roll over their money into high-cost individual retirement accounts and annuities.

The GAO added its voice to these concerns, on page 46 of its report:
Additionally, although Labor has attempted to help plan participants understand the information they are given from providers, current requirements do not sufficiently assist participants in understanding the financial interests that service providers have in the distribution and investment decisions that participants make, nor sufficiently clarify the fiduciary responsibility that providers may have when providing assistance to participants who are in need of guidance. Requiring service providers to clearly disclose their financial interests in participants’ decisions and the extent of their fiduciary obligations can also help participants better understand providers’ roles and assess the guidance or information received from them.

[Emphasis added.]

As a result of those concerns, the GAO made several recommendations to the IRS and DOL for changes. For purposes of this article, the key recommendation was:

Finalize the agency’s initiative to clarify the ERISA definition of fiduciary, and, in doing so, require plan service providers, when assisting participants with distribution options, to disclose any financial interests they may have in the outcome of those decisions in a clear, consistent, and prominent manner; the conditions under which they are subject to any regulatory standards (such as ERISA fiduciary standards, SEC standards, or others) and what those standards mean for the participant.

Based on subsequent comments by Phyllis Borzi, the DOL’s Assistant Secretary for the Employee Benefits Security Administration, it appears that the DOL views the GAO report as an affirmation that plan distributions and rollovers need to be further regulated to limit biased and incomplete information and to expose conflicts of interest and excessive fees and compensation. As a result, it is likely that the DOL will be issuing additional guidance—perhaps in conjunction with the proposed regulation on fiduciary advice expected later this year. Unfortunately, it is impossible to know if the DOL will limit its guidance to requiring new disclosures or if it will attempt to further restrict service providers from helping participants with their distributions and IRA rollovers. Because the future changes are unknown, the best approach for now is to provide rollover services in a way that addresses the DOL concerns.

Analysis

What do these developments mean to RIAs?

First and foremost, RIAs should accept—and adapt to—more regulation of the distribution and rollover process. RIA services in those areas can no longer be informal, but instead must be structured to take into account these changes.
COMMENT FOR fi360: Before discussing those structural steps, though, let’s look at the consequences of the DOL position. First, the DOL believes that, as a fiduciary to the plan, an RIA will become a fiduciary for recommendations to participants about distributions and rollovers. Because of the DOL conclusion, RIAs should address two issues. The first is that an RIA’s recommendations must be prudent. That should not be problematic for retirement plan-focused RIAs, since they are well-versed in the distribution rules, IRA rollovers, and investing money for retirement. As a word of warning, though, in-service distributions will likely be closely scrutinized and, for that reason alone should be avoided.

The second consequence is that the advisory fee charged in the IRA might be higher than the fees paid from the plan, for example, the fees for the plan might be 25 basis points and the fees for the IRA might be 75 basis points. It is possible that the DOL could take the position that the difference between those fees is a prohibited transaction—if the RIA is a fiduciary for recommending the distribution and a rollover IRA, that is, advised by the RIA. Obviously, that issue can be avoided by charging only .25% to the IRA. However, that may not adequately compensate the adviser, since the IRA’s assets will likely be much smaller than the plan’s.

RIAs who cannot “levelize” their fees in IRAs (to the plan level) should consider taking a conservative approach for providing rollover services. The purpose of the conservative approach would be to avoid fiduciary status for purposes of distributions and rollovers. Keep in mind that fiduciary status is a facts-and-circumstances test . . . and unbiased education and information are typically not considered to be fiduciary services.

As a result of the DOL’s concerns and the GAO report and recommendations, advisers should consider developing educational materials for plan distributions and rollovers; disclosure materials concerning services; status (e.g., RIA, fiduciary); and compensation. These disclosure materials could be similar to those provided to ERISA-governed plans for 408(b)(2) purposes. The following are specific suggestions about the disclosure materials:

- The GAO report supports and encourages the distribution of unbiased educational materials to participants. The DOL has accepted that report. Participants should be given information about their distribution alternatives, e.g.:
  - 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.
The materials should describe the most important advantages and disadvantages of each alternative. These materials should specifically discuss the advantages of leaving money in the current retirement plan. These materials should be educational and should not be misleading.

- Provide participants with a description of the rollover services provided by the adviser, including, for example, a professional and objective description of:
  - The adviser’s services in managing retirement money in an IRA.
  - The adviser’s compensation for these services.
  - The adviser’s philosophy about retirement investing, e.g., the balance of capital appreciation and preservation of capital.
  - The adviser’s status as an RIA and fiduciary for the IRA services.

In some regards these descriptions are similar to the ERISA 408(b)(2) disclosures.

- Obtain an acknowledgment by the participant that it was the participant’s decision to take a distribution, to roll over to an IRA, and to work with the adviser; and that the adviser’s status as a fiduciary to the plan did not influence that decision.

These are suggestions . . . not requirements. The key is to have a conservative approach based on information, i.e., disclosures and communications.