

Drinker Biddle

# Rollovers and IRA Transfers: Navigating Treachurous Waters

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## The Fiduciary Rule: Where Are We Now?

Timeline for the fiduciary rule:

- June 9, 2017: Fiduciary regulation expanding definition of fiduciary advice.
- June 9, 2017: “Transition” requirements for exemptions (e.g., BICE and 84-24).
- July 1, 2019: The final exemption requirements and end of transition rules.
- March 15, 2018: The 5<sup>th</sup> Circuit decision.
- January 1, 2020: Anticipated applicability date for new SEC and DOL rules.

## What Does This Mean?

- Coordination among SEC, DOL and State Insurance Commissioners?
- Uniform definition of fiduciary?
- Uniform standard of care?
- Uniform treatment of conflicts of interest?

For advice to plans and participants, ERISA: prudence; loyalty; and reasonable compensation.

For IRAs, IRC statutory provisions: reasonable compensation.

## Why Does This Matter?

*“Nearly 80 million baby boomers will file for retirement benefits over the next 20 years-an average of 10,000 per day.”*

(Annual Performance Plan for Fiscal Year 2012, U.S. Social Security Administration.)

## Demographic Developments

The research firm Cogent estimates that, **for 2014, \$280 billion was rolled over to IRAs** and, **for 2015, \$382 billion** was in play for the rollover market. (“Investor Rollover Assets in Motion” studies from Cogent Reports.)

In its preamble to the 2016 fiduciary regulation, the DOL noted: *“These rollovers are expected to **approach \$2.4 trillion cumulatively from 2016 through 2020.**”*

# Increase in life expectancy for 65-year-olds

(From Society of Actuaries Report)



## Women

2000

86.4 years

2014

88.8 years

**+2.4 years**



## Men

2000

84.6 years

2014

86.6 years

**+2.0 years**

## The Withdrawal Risk

*“One recent study showed that more than 33% of those interviewed had no idea how much they could safely withdraw and roughly 25% expected to be able to withdraw more than 10% of their retirement savings each year.*

*Given this failure to understand sustainable withdrawal rates, **there is a risk that retirees will exhaust their savings when they are in their late 70’s or 80’s.**” [Emphasis added.]*

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See, Lee Barney, “American All Over the Map on Retirement Drawdown Rates,” Money Management Executive (October 13, 2011).

## Structure of the “New” Fiduciary Rule

- Expansion of definition of fiduciary investment advice includes:
  - Most investment and insurance sales and advice for IRAs, plans and participants.
  - Recommendation of distributions from plans and rollovers to IRAs, as well as transfers of, and withdrawals from, IRAs.
  
- Financial conflict as are prohibited, but exemptions.



## The SEC Prioritizes Rollover Recommendations

In 2015, the SEC issued a National Exam Program Risk Alert entitled the “Retirement-Targeted Industry Reviews and Examinations Initiative (‘ReTIRE’).”

*OCIE, through the National Examination Program (NEP), will conduct examinations of SEC-registered investment advisers and broker-dealers (collectively, registrants) **under the ReTIRE Initiative** that will focus on certain higher-risk areas of registrants’ sales, investment, and oversight processes, **with particular emphasis on select areas where retail investors saving for retirement may be harmed.***

*continued . . .*

## The SEC Prioritizes Rollover Recommendations

Continued . . .

- **Reasonable Basis for Recommendations.** Registrants have important obligations under the federal securities laws and SRO rules (with respect to broker-dealers) **when making recommendations or providing investment advice.**<sup>4</sup> To the extent applicable and required, the staff will assess the actions of registrants and their representatives for consistency with these obligations when: **(i) selecting the type of account;**<sup>5</sup> . . .

*continued . . .*

<sup>5</sup>See FINRA, Rollovers to Individual Retirement Accounts, Regulatory Notice 13-45 (December 2013) (**FINRA Regulatory Notice 13-45**).

## The SEC Prioritizes Rollover Recommendations

Continued . . .

- **Conflicts of Interest** . . . The staff will review registrants' sales and **account selection practices in light of the fees charged, the services provided to investors, and the expenses of such services to evaluate**, . . . whether: (i) . . . and (ii) **material conflicts of interest**, such as compensation structures that may incentivize representatives to make certain recommendations, **are disclosed or otherwise addressed**.

## FINRA Focus on Rollover Recommendations

*In this regard, FINRA will focus on the suitability of firms' and registered representatives' recommendations made to plan participants, including Individual Retirement Account rollover recommendations involving securities transactions.*

Note: Factors to consider.

## Prohibited Transaction Rules

Both ERISA and the Code prohibit **fiduciary advice**:

- that results in receipt of compensation by the “adviser”\* from a party other than the plan; or
- where the “adviser”\* causes himself to receive a benefit (e.g., compensation).

\*“adviser” includes affiliates.

Note: The rollover and transfer prohibited transactions.

## Distribution and Rollover Scenarios

- Unsolicited.
- Education.
- Recommendation.

## The Condition for Transition BICE

For fiduciaries: The financial institution and adviser must comply with the Impartial Conduct Standards . . .

- Best interest standard of care.
- No materially misleading statements.
- Only reasonable compensation.

## The 5<sup>th</sup> Circuit Decision

The 5<sup>th</sup> Circuit Court of Appeals “vacated” the fiduciary regulation and exemptions.

That raises these questions:

- *Who is a fiduciary?*
- *What is the fiduciary standard of care?*
- *What are fiduciary prohibited transactions and are there exemptions?*



## Who is a Fiduciary?

- The “new” fiduciary definition.
- The 5-part test.
- Proposals later this year.

## The 5-Part Test

Old rule definition of fiduciary:

- Recommendations provided for compensation;
- On a regular basis;
- Pursuant to a mutual understanding that;
- The advice will serve as a primary basis for investment decisions; and that
- The advisor will provide individualized advice based on the particular needs of the retirement investor.

## Is It Fiduciary Advice to Recommend A Rollover?

In Advisory Opinion 2005-23A, the DOL asked and answered:

**Question 2:** *Does a recommendation that a participant roll over his or her account balance to an individual retirement account (IRA) to take advantage of investment options not available under the plan constitute investment advice with respect to plan assets?*

**Answer:** *It is the view of the Department that 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" within the meaning of the regulation (29 CFR § 2510-3.21(c)).*

*continued . . .*

## Is It Fiduciary Advice to Recommend A Rollover?

Continued . . .

However, the DOL went on to say:

*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.*

## Recommendations: Best Interest Standard

Investment advice is in the “best interest” of a retirement investor when the fiduciary adviser “*acts with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of **an enterprise of a like character and with like aims, . . .***”

## Recommendations: Best Interest Standard

- What are the “relevant factors” a prudent fiduciary would consider in making a distribution and rollover recommendation?
- What is an enterprise of a like character and with like aims?

## 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.** [Emphasis added.]*

## 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.*



## Recommendations: Best Interest Standard

*. . . based on the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor, . . .*

## Recommendations: Best Interest Standard

*. . . without regard to the financial or other interests of the adviser, Financial Institution or any Affiliate, Related Entity, or other party.*

Note: Duty of loyalty and reasonable compensation.

## BICE Fiduciary Provision

The analysis *“must include consideration of the Retirement Investor’s **alternatives** to a rollover, including leaving the money in his or her current employer’s Plan, if permitted, and...”*

## Distribution Alternatives

The four alternatives generally available to participants:

- Leave the money in the plan;
- Transfer the money to the plan of a successor employer;
- Roll the money over into an IRA.
- Take a taxable distribution.

## BICE Fiduciary Provision

*. . . must take into account **the fees and expenses associated with both the Plan and the IRA;** whether the employer pays for some or all of the plan's administrative expenses; **and the different levels of services and investments available under each option.** . . .*

## Recommendations of Distributions and Rollovers

*[T]he adviser and financial institution must make **diligent and prudent efforts** to obtain information on the existing plan.*

*In general, such information should be **readily available** as a result of DOL regulations mandating plan disclosure of salient information to the plan's participants (see 29 CFR 2550.404a-5).*

Note: Reality clashes with concept.

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DOL Conflict of Interest FAQs (Part I—Exemptions), October 27, 2016.

## Recommendations of Distributions and Rollovers

*If, despite prudent efforts, the financial institution is unable to obtain the necessary information or if the investor is unwilling to provide the information, even **after fair disclosure of its significance**, the financial institution could **rely on alternative data sources**, such as the most recent Form 5500 or reliable benchmarks on typical fees and expenses for the type and size of plan at issue.*

## Recommendations of Distributions and Rollovers

*If the [RIA] relies on such alternative data, it should **explain the data's limitations** and the written documentation should also include an explanation of how the financial institution determined that **the benchmark or other data were reasonable**.*



## Recommendations of Distributions and Rollovers

*Accordingly, any fiduciary seeking to meet the best interest standard as set out in the exemption **would engage in a prudent analysis of these factors and considerations** before recommending that an investor roll over plan assets to an IRA or other investment, . . . [Emphasis added.]*

Note: Good process for DOL, SEC and FINRA.

## The Education Approach to Rollovers

### Compliance Steps for Advisers

- Education on four alternatives: Considerations.
  - Use of brochure
- Education discussions with participant.
- Participant acknowledgment.

## Transfers of IRAs

The issues for transfers of IRAs are similar:

- Unsolicited, education or recommendation.
- For fiduciary recommendations:
  - Investments, services and expenses in current IRA;
  - Investments, services and expenses in proposed IRA;
  - Needs and circumstances of IRA owner.

## Conflicts of Interest

Prohibited transactions are essentially the same as financial conflicts of interest. Under the SEC rules, conflicts of interest should be disclosed on the Form ADV Part 2A (or a compliant brochure).

## Recommendations

- Distributions and rollovers: Approach
  - Education: Documentation
  - Recommendation: Process and services
  
- IRA transfers: Process and services
  
- Update ADV descriptions of material conflicts

# *Questions?*



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