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Capturing Plan Rollovers

What advisors should do now in light of increased scrutiny by the DOL and recommendations in a 2013 GAO report on rollovers.

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As the Baby Boomer generation nears (or reaches) retirement age, many have to make decisions about their DC plan options when they retire, including weighing the pros and cons of IRA rollovers. Advisors — both registered investment advisers and registered representatives of broker-dealers — can help plan participants with these decisions, but they need to understand the current regulatory environment surrounding retirement plan distributions and IRA rollovers.

This article provides an overview of our conclusions and recommendations for advisors. We'll discuss the current Department of Labor (DOL) guidance, the impact of last year's Government Accountability Office report on IRA rollover practices in the DC plan industry on the advisor's role, and specific steps advisors should take now to manage their risk in light of this regulatory environment.

DOL GUIDANCE

The issue of whether an advisor's rollover recommendation to a plan participant subjects the advisor to ERISA fiduciary standards was addressed in 2005 by the DOL in Advisory Opinion 2005-23A. In that Opinion, the DOL drew a distinction between rollover recommendations made by a financial advisor versus recommendations made by an investment adviser.

Before proceeding, let's define our terms:

- By *financial advisor,* we mean an advisor to the plan who is not a fiduciary. This could include advisors who provide services to the plan (but not plan-level investment advice), such as a registered representative of a broker-dealer who provides brokerage services or a registered investment adviser

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who only provides education or benchmarking services; and advisors who receive and respond to plan participant inquiries (but do not provide participant-level investment advice).

- We use the term *investment adviser* to refer to a fiduciary to the plan who is providing plan-level and/or participant-level investment advice.

In the case of a non-fiduciary financial advisor, the DOL concluded that a recommendation to make an IRA rollover does not subject the advisor to ERISA fiduciary standards even if the advice is combined with a recommendation as to how the distribution should be invested. In reaching this conclusion, the DOL noted that funds rolled over to an IRA are no longer "plan assets."

To the surprise of many, the DOL then went on to say that in the case of a fiduciary investment adviser, making a recommendation to take a distribution, advising on how to invest the funds in the IRA or even merely responding to questions concerning the advisability of taking a distribution amounts to an exercise of "discretionary authority respecting the management of the plan." As such, the investment adviser is subject to ERISA's fiduciary responsibility rules and prohibitions on self-dealing. Curiously, the DOL did not base its conclusion on investment advice (the ERISA Section 3(21)(A)(ii) fiduciary definition), but rather on plan management (the ERISA Section 3(21)(A)(i) fiduciary definition).

Tip for Advisors: If you provide only non-fiduciary services to a plan such as brokerage or participant investment education, your service agreement should state clearly that you are not acting in a fiduciary role. This will help make clear that you can capture rollovers without having to deal with these ERISA complications.

The DOL's analysis casts a broad net. By concluding that even the mere act of answering participant questions constitutes an act of fiduciary "plan management" when it is done by an investment adviser (but not when it is done by a non-fiduciary financial advisor), the DOL departs from well-established law that requires fiduciary status to be determined separately on a "facts and circumstances" basis for each task performed.

The DOL's analysis also suggests that under all circumstances, an investment adviser's role as a plan-level fiduciary would invariably influence participants in their distribution decisions even if the investment adviser does not provide participant-level advice. This does not seem to follow logically. In the case of a plan-level fiduciary who is also providing participant-level investment advice, it is reasonable to conclude that participants will likely be influenced by that status and rely on the investment adviser's recommendation to make an IRA rollover. On the other hand, if the investment adviser serves only as a plan-level fiduciary, it is less likely that participants would be influenced by this status, and holding such an adviser to ERISA fiduciary standards when he or she merely answers questions about plan distributions seems highly questionable.

The DOL has continued to focus on this issue, addressing it in the preambles to both the 2009 and 2010 proposed fiduciary investment advice regulations. In the 2009 proposed regulation, the DOL repeated the conclusion it reached in the 2005 Opinion; in the 2010 proposed regulation the DOL hinted at expanding its interpretation to encompass all advisors who give recommendations as to plan distributions (regardless of whether they are plan-level fiduciaries).

THE GAO REPORT

With the issuance of the GAO rollover report in 2013, there is now even greater emphasis on this issue. The report focuses on how participant rollovers are handled, and in particular, the lack of complete information and possible misinformation provided to participants. While the GAO report focuses on practices of record keepers, it contains good lessons for advisers as well.

The GAO reviewed the current practices of plan providers and their rollover services and found that even though plan participants have at least four options when retirement occurs, the current marketplace favors only one: IRA rollover distributions. Assuming that a participant is not forced to take a cash-out distribution under the plan because of the small size of his or her account, these four options are:

- leaving plan monies in the plan;
- cashing out the distribution;
- rolling over funds to a new employer's plan; or
- rolling over funds to an IRA.

In addition to its finding that the processing of plan-to-plan rollovers is often inefficient, the GAO report concluded that participants are not provided with adequate information about these options, the fees and expenses associated with each and the financial interests of service providers that assist participants with their distribution decisions.

Steps Investment Advisers Can Take to Manage Their Risk

Advisors who are *fiduciaries* to the plan (who we refer to as "investment advisers") can provide information to participants about their IRA rollover services without violating ERISA's fiduciary or prohibited transaction rules, provided that certain practices are followed and certain documents are maintained:

- An unbiased, educational description of their rollover program
- A participant form acknowledging receipt of the description and the voluntary nature of the participant's decision
- A checklist to assist plan sponsor clients in developing a disclosure as to the participant's distribution options at retirement

An investment adviser who makes a recommendation to take a distribution and/or make a rollover to an IRA, or who advises on investing in an IRA, where the IRA pays compensation to the investment adviser (sometimes referred to as "capturing rollovers" or "cross-selling") could be subject to both ERISA's fiduciary responsibility and prohibited transaction rules if these safeguards are not observed.

Advisors *who are not fiduciaries* to the plan (who we refer to as "financial advisors") can capture IRA rollovers from plans and assist in the investment of those rollovers without violating ERISA's fiduciary or prohibited transactions rules.

Based upon these findings, the GAO report included a number of recommendations to the DOL and the IRS, including:

- issuing clarification of the circumstances that will cause a service provider who assists participants with their distribution decisions to be an ERISA fiduciary;
- requiring service providers to clearly disclose their financial interests in participant decisions and describe the conditions that subject them to ERISA fiduciary and other regulatory responsibilities, such as SEC standards; and
- requiring plan sponsors to provide a summary to a separating participant of his or her four options and the key factors that the participant may wish to consider in comparing investment options.

The GAO report will probably influence the DOL's regulation governing when a party is considered to be providing investment advice as an ERISA fiduciary, which the DOL says it expects to re-propose in August 2014. Generally speaking, we expect that the re-proposal of the fiduciary advice regulation will expand the scope of when (and under what circumstances) an investment adviser will be deemed to be providing investment advice "for a fee or other compensation" and therefore acting in a fiduciary capacity.

More specifically, the findings in the GAO report will probably encourage the DOL to address whether an investment adviser's recommendation to a plan participant to take a plan distribution and roll it over to an IRA subjects the adviser to ERISA's fiduciary and prohibited transaction rules.

ACTION ITEMS FOR INVESTMENT ADVISERS

The GAO report offers a glimpse of the requirements that are ahead in structuring IRA rollover programs. While investment advisers await this guidance, there are steps they can take now to address the DOL's concerns. Following is a discussion of documents that investment advisers can develop and a description of several factors that investment advisers should consider in structuring their rollover programs.

Rollover Program Brochure

Investment advisers should develop a brochure of their IRA services that is designed to educate participants. It should be unbiased, and should not contain language that encourages the participant to make the IRA rollover. That could be viewed as possible prohibited "self-dealing" by a plan fiduciary, since the investment adviser will receive compensation on account of the IRA rollover.

The format should be similar to that described in DOL guidelines pertaining to investment education, since providing only investment "education" is not a fiduciary act. This brochure should contain descriptions of the investment adviser's services, investment strategies, fees, the role of the investment adviser and considerations in selecting an IRA provider. These materials should not encourage participants to take distributions from the plan.

Participant Acknowledgements

The decision to take a distribution and/or IRA rollover lies with the participant. Therefore, the investment adviser should obtain a written acknowledgement that the participant made the decision to work with the investment adviser and was not influenced by the investment adviser's status as a plan fiduciary.

Investment advisers should also consider providing the participant with a disclosure about the fees and expenses of the IRA and its investments, as well as the investment adviser's services, compensation and fiduciary status (under securities law or other applicable law). As a best practice, we recommend that investment advisers include the same information in this disclosure (regarding the IRA) that is required under ERISA Section 408(b)(2). These disclosures should be made prior to the participant making a decision and the investment adviser should consider obtaining the participant's signed acknowledgement of receipt.

Tip for Advisors: Receiving these signed acknowledgments is particularly crucial where the investment adviser stands to receive greater compensation if the funds are rolled over to the IRA than if they were left in the plan. We address the issue of advisory fees below.

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Plan Sponsor Checklist for Disclosure About Retirement Options

Based upon the recommendations in the GAO report, plan sponsor clients should consider developing a participant disclosure describing the participant's options at retirement. Investment advisers can assist plan sponsor clients by developing a checklist of the information to be contained in the disclosure. This information should be structured in an educational, nontechnical and unbiased way, and should include a description of each of the following options and the general advantages and disadvantages of each:

- leaving the retirement monies in the current employer plan (unless the participant is forced to take a cash-out distribution under the plan due to the small size of his plan account balance);
- transferring the retirement monies to the new employer plan;
- taking a distribution;
- rolling the retirement monies into an IRA program of the investment adviser; and
- rolling the retirement monies into another IRA program that the investment adviser does not provide services to.

The checklist should include information about the investment choices and fees associated with the IRA and the current employer plan and, in cases where a participant is changing jobs, a reminder that it is the participant's responsibility to examine the investment choices and fees in the successor employer's plan. The checklist should also include a description of the tax implications of each distribution option including, for instance, the possible tax disadvantages of taking a plan distribution where the payment includes employer stock.

Tip for Advisors: When creating a checklist for plan sponsors, investment advisers need to be careful to accurately describe the advantages of their IRA rollover programs (and the other options) in a way that does not rise to the level of fiduciary "advice" – this will protect both the investment adviser and its plan sponsor clients. Precise language is crucial here.

CONSIDERATIONS IN STRUCTURING THE IRA PROGRAM

In operating an IRA rollover program, there are two points that investment advisers should keep in mind. First, expect that any fees and expenses associated with an IRA may be closely scrutinized. While the DOL has not issued guidance on this topic and it has not been litigated, some observers believe that capturing rollovers would not give rise to prohibited self-dealing by an investment adviser as long as the fees payable to the adviser (and its affiliates) under the IRA are no higher than those under the plan. This issue is not well-settled, but even to the extent this belief is correct, it may be a moot point in some cases because it is often impossible for an investment adviser to provide services under an IRA at as low a rate as those services can be provided to a much larger employer plan. In any event, investment advisers should be aware of the possible fee scrutiny and proceed cautiously.

Second, even if a participant's plan benefits are rolled over to an IRA (and are no longer ERISA "plan assets"), the assets are nonetheless retirement savings that should be invested prudently taking into account the participant's life expectancy, individual risk tolerance, other sources of retirement income and other relevant facts and circumstances. This generally contemplates that some appropriate portion of the assets be maintained in asset preservation vehicles.

Tip for Advisors: All financial advisors and investment advisers should see that asset allocation decisions are made in light of all relevant facts and circumstances, and that retirement assets are otherwise prudently managed. Registered investment advisers should also keep in mind that they are subject to fiduciary standards under securities law that are similar to those under ERISA.

CONCLUSION

Investment advisers should take steps now to mitigate the risk that their cross-selling efforts could be deemed as violating ERISA's fiduciary conduct standards or prohibitions on self-dealing by fiduciaries. Because of the lack of detailed guidance on this topic, investment advisers should err on the side of being conservative. Our recommendations are designed to accomplish this, but they are not the exclusive means by which investment advisers can protect themselves from potential ERISA violations. PC

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