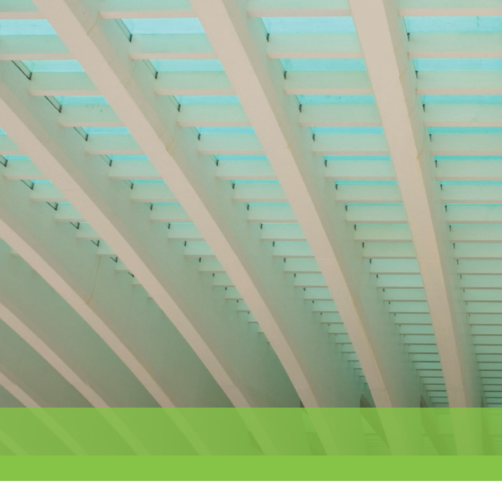

# PURSUING ROLLOVERS IN AN EVOLVING REGULATORY LANDSCAPE

## CONTENTS


INTRODUCTION ............................ 2

DEFINITION OF FIDUCIARY VS. NON-FIDUCIARY ADVISOR SERVICES .... 3

CURRENT REGULATIONS AND THEIR IMPACT ON ROLLOVERS ................ 4

PROPOSED REGULATION ON FIDUCIARY ADVICE ................ 11

CONCLUSIONS AND NEXT STEPS FOR ADVISORS ................ 13

FINAL CONSIDERATIONS FOR ADVISORS ........................... 15

LOOKING FORWARD ................... 16


We understand how important rollovers are to your business. As one of the nation's leading providers of IRAs, rollovers are important to our business too. In fact, McKinsey estimates that rollovers are expected to drive 40% to 50% of net new money for wealth managers through 2015.[1] This is a significant opportunity. And with any opportunity, to be successful, it's important to understand the drivers, as well as potential obstacles.

At the end of 2013, IRA assets totaled $6.5 trillion and accounted for 28% of U.S. retirement assets.[2] This figure is up $1 trillion over 2012, with rollovers from employer-sponsored retirement plans driving much of that growth.[3] The ongoing demographic shift in the U.S. population has triggered this phenomenon, as Baby Boomers seek more in-depth planning to help them feel secure about retirement.

However, against this backdrop, there are regulations that could impede your retirement business. It is important for all of us to understand the current and proposed regulations and the impact they may have on rollovers. With that in mind, Pershing has worked with Fred Reish, a nationally recognized Employee Retirement Income Security Act (ERISA) attorney and retirement plan expert, to provide you with a map to help you navigate the uncertain terrain ahead.

As you begin this journey, the question is not whether you can continue to capture rollovers, but what you need to consider in doing so.

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# INTRODUCTION

## Who should read this?

If you are an advisor who provides services to retirement plans or retirement plan participants and seeks guidance on capturing rollovers to grow your business, you should read this whitepaper. Advisors who understand the implications of the current and proposed regulatory guidance are well-situated to benefit from the changing landscape and provide valuable services to job changers and retirees.

## What are the opportunities and issues?

The Baby Boomers are aging in a defined contribution world. Their impending retirements suggest that trillions[4] of dollars will continue to move from retirement plans into rollover IRAs at an increasing rate. Advisors at broker-dealers and registered investment advisor (RIA) firms will help manage most of that money.

At the same time, retirement plan distributions and IRA rollovers are becoming more regulated. For example, the Department of Labor (DOL), Financial Industry Regulatory Authority® (FINRA®), the Internal Revenue Service and even the U.S. Tax Court have provided guidance on fiduciary, rollover and other IRA issues. More is expected from the DOL in the near future. Both FINRA and the Securities and Exchange Commission (SEC) have included IRA rollover practices in their examination priorities. In addition, the Government Accountability Office (GAO) and Congress have expressed concerns about distributions, rollovers and retirement investing. It is important for advisors to understand this complex regulatory environment.

This paper provides an overview of the current regulatory environment and the anticipated developments pertaining to capturing rollovers. It then discusses the regulatory guidance and steps for advisors to consider in light of those rules. This paper concludes with possible changes to the DOL fiduciary advice regulation and the impact on advisors.

# DEFINITION OF FIDUCIARY VS. NON-FIDUCIARY ADVISOR SERVICES

With respect to employer-sponsored retirement plans, the DOL guidance distinguishes between advisors who are acting as fiduciaries to a plan and those who are not. As a result, the definitions of fiduciary and non-fiduciary advisor services are critical to understanding the DOL view of the rollover process.

## What does it mean to be a fiduciary?

ERISA closely regulates the conduct of "fiduciaries," since they have enhanced responsibility for the investments, servicing and retirement benefits of participants. As a result, if an advisor becomes a fiduciary, he is subject to the fiduciary standard (the "prudent man rule") and to restrictions on dealings with plans (the fiduciary prohibited transaction rules).

While most fiduciaries have control or discretion over plan investments and operation, there is one category of fiduciary that just gives advice. A fiduciary advisor is one who makes recommendations about investments and investment managers that are "individualized" and based on the particular needs of a plan (or of a participant).[5] The definition is functional, so it is not a question of titles or even agreements; it is based on the conduct of the advisor.

In other words, an advisor may be an ERISA fiduciary if that advisor makes individualized investment recommendations to plan fiduciaries or to plan participants about their accounts, or has discretionary investment management authority for a plan or a participant.

## What additional standards apply to the fiduciary definition under ERISA?

If an advisor becomes a fiduciary, he must comply with two sets of ERISA rules—the fiduciary rules and the prohibited transaction rules.

The fiduciary rules require that the advisor act:

› solely in the interest of the participants;

› for the exclusive purpose of:

- providing benefits to the participants; and
- incurring only reasonable expenses for the plan

› with the care, skill, prudence and diligence of a knowledgeable person (i.e., the prudent man rule); and

› to diversify the investments to minimize the risk of large losses.[6]

In performing these duties, the prudent man rule requires that the fiduciary advisor engage in a prudent process to develop, deliver and document his recommendations.[7]

The prohibited transaction rules forbid a fiduciary advisor from engaging in certain conflicts with a plan. For example, a fiduciary advisor cannot receive any compensation from investments or third parties—unless the compensation is disclosed and offset against the advisor's fee.[8]

### When is an advisor not considered a fiduciary?

When advisors serve as registered representatives of broker-dealers and limit their services to providing investment education, information or non-individualized materials to plans or participants, they should not be fiduciaries. But, ERISA has a "functional" definition of fiduciary, and advisors may become fiduciaries if they provide individualized investment advice to a plan or to a participant.

## CURRENT REGULATIONS AND THEIR IMPACT ON ROLLOVERS

### Overview and context

For many years, there was little, if any, guidance about recommendations by advisors with respect to participants taking distributions of their accounts and rolling them over into IRAs. However, in 2005 the DOL published an opinion that primarily impacted fiduciary advisors. Then, after a lapse of eight years, FINRA independently issued guidance to remind the industry of requirements in making recommendations on distributions and rollovers. This paper discusses the DOL and FINRA guidance in some detail; but, before going into that detail, it is important to put the guidance into factual context. For this paper, the most important scenarios for advisors to consider are:

› A fiduciary advisor (e.g., an RIA or its representative) recommends that a participant take a distribution and roll it over to an IRA with the advisor. This is regulated by the DOL, and the SEC is examining advisor practices in this area.

› A non-fiduciary advisor (e.g., a registered representative of a broker-dealer) recommends that a participant take a distribution and roll it over into an IRA with the advisor. This is regulated by FINRA, and both the SEC and FINRA are re-examining broker-dealer practices related to distributions and IRA rollovers.

› A fiduciary or non-fiduciary advisor does not make recommendations, but instead provides unbiased and reasonably complete education and information about the options available to participants. If the materials are appropriately prepared, the DOL does not regulate the fiduciary advisor, while FINRA's regulatory oversight focuses on suitability (e.g., training and supervision).

- A participant tells a fiduciary or non-fiduciary advisor that he has decided to take a distribution and wants to roll the money over into an IRA. Thus, the advisor does not recommend a distribution or rollover nor does the advisor provide education about the options available to the participant before the decision was made. Instead, the advisor helps the participant implement a decision that was already made. Since this scenario does not involve a recommendation by a fiduciary advisor, it is not within the scope of the DOL 2005 opinion and is not governed by that guidance. Also, for non-fiduciary advisors of broker-dealers, the absence of a recommendation to take a distribution and roll over to an IRA means that the advisor did not make a recommendation about a securities transaction in the plan, and thus the suitability standard does not apply to the liquidation or the distribution of the account. In addition, since the advisor did not educate the participant, the broker-dealer's training and supervision requirements related to education about distribution and rollover recommendations should not apply. (Unfortunately, the FINRA guidance on this latter point is unclear, but this conclusion is logical.)

The following discussion of legal considerations focuses on the first three bullet points, which include recommendations and education.

## What is the legal and regulatory landscape?

In Advisory Opinion 2005-23A, the DOL discussed whether a recommendation that a participant take a distribution from his or her 401(k) plan and roll the funds to an IRA is subject to ERISA.

The DOL said that, when an advisor who is not a fiduciary to a plan or participant makes a recommendation to a participant, that advisor would not become a fiduciary to the plan because of the recommendation—even if he offered investment advice for the amounts rolled to the IRA and received compensation for that advice.

However, the DOL went on to say that, if the advisor was already a fiduciary, a recommendation to take a distribution or 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.

In effect, the DOL is taking the position that a fiduciary advisor has such influence over participants' thinking that the advisor has expanded his fiduciary responsibility to include distributions, rollovers and IRA investing.[9] That conclusion is contrary to well-established law.[10] While it is possible that, in an individual case, a fiduciary advisor could have undue influence over a participant—because of the advisor's fiduciary status—that would be highly unusual and is certainly not the ordinary situation. As a result, it will be difficult for the DOL to show that, in the typical case, a fiduciary advisor has "controlled" a participant's decision.

Nonetheless, the DOL has laid down a marker with its advisory opinion, and a prudent approach should be considered for advisors who serve as ERISA fiduciaries.

Since the DOL frames the issue in terms of "control" or "undue influence," providing participants with unbiased educational information would not result in fiduciary status for distributions and rollovers, as long as the information is accurate and not misleading or incomplete. The importance of clear, thorough and unbiased educational materials was highlighted by a recent GAO Report.[11] The GAO—which reports to Congress—found that, in many cases, participants were receiving biased, partial and inaccurate information about their distribution and rollover options. The DOL agreed with those conclusions.

In 2010, the DOL again addressed the broad issue of rollovers in the preamble to its proposed (but now withdrawn) regulation expanding the definition of fiduciary investment advice.[12] The DOL expressed concern that there might be abuses in capturing rollovers and invited comments 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."[13]

In other words, the DOL is considering 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 their money into higher cost IRAs and annuities.

## What should non-fiduciary advisors consider when working with participants on rollovers?

For advisors who are not fiduciaries, the DOL position is clear today: they can help participants with distributions and rollovers. However, that is not the end of the story. In recent months, both the SEC and FINRA have expressed an interest in advisor recommendations of IRA rollovers. The guidance issued from FINRA includes:

› Regulatory Notice 13-23[14]

› Report on Conflicts of Interest[15]

› Regulatory Notice 13-45[16]

› Investor Alert: The IRA Rollover: 10 Tips to Making a Sound Decision[17]

In addition, both FINRA and the SEC listed rollovers to IRAs as 2014 examination priorities.[18] In its examination priorities, the SEC said that it would look at the practices of both broker-dealers and RIAs in capturing rollovers to IRAs.

In Regulatory Notice 13-45, FINRA asserted jurisdiction over rollover recommendations by taking the position that a recommendation to take a distribution from a participant-directed defined contribution plan (e.g., a 401(k) or 403(b) plan) is a recommendation to liquidate the investments in a participant's account. As a result, FINRA views a distribution recommendation as an investment recommendation invoking the suitability standard.

Based on that analysis, FINRA concludes that "suitability" requires that advisors consider certain factors in developing recommendations about distributions and rollovers. While the DOL has not taken a similar stance, it could also take the position that a recommendation to take a distribution is inherently an investment recommendation and, as a result, it could be a fiduciary recommendation. In that case, an advisor would need to engage in a prudent process to develop the distribution recommendation and take steps to avoid prohibited transactions. It is possible, and perhaps even likely, that the DOL would consider the FINRA guidance and the suitability factors in determining the steps for a prudent process for making a distribution and rollover recommendation. As an additional consideration, dually registered broker-dealers may find it administratively convenient to have a single set of policies and procedures for rollover recommendations by their advisors, regardless of whether the advisors are acting as representatives of the broker-dealer or the RIA. That is particularly true since the SEC staff has taken the position that the suitability standard also applies to RIAs.[19] Similar considerations apply to hybrid advisors.

However, FINRA distinguishes between recommendations (and the suitability standard) and education. Regulatory Notice 13-45 says that, if an advisor provides education to participants, but not recommendations, there would not be an investment recommendation and, therefore, the suitability standard would not apply. In other words, one way to avoid the burden of FINRA's position in the Regulatory Notice is to provide unbiased educational materials to participants about their distribution alternatives and the advantages and disadvantages of leaving their money in the plan, transferring the money to the plan of a successor employer, taking a taxable distribution and/or rolling over into an IRA.

While that may seem relatively straightforward, it is more complex than it appears. For example, if a participant's account includes appreciated company stock, it may make sense to take a taxable distribution of the stock or to leave it in the current plan. Or if the investments in the plan are less expensive than those that can be obtained in an IRA (for example, institutional share classes), the participant should be educated on that consideration. Advisors should consider using a document or brochure to provide educational content to participants, covering the most important considerations or, as FINRA calls them, "factors."

Some advisors will want to make recommendations or will want to respond to requests for recommendations. In those cases Regulatory Notice 13-45 lists seven factors to consider when developing a suitable recommendation. Those factors are:

- **Investment options:** An IRA may enable an investor to select from a broader range of investments than a plan.
- **Fees and expenses:** Both plans and IRAs typically involve investment-related expenses and plan or account fees. While an IRA may have retail pricing for investments, a 401(k) plan may have cost advantages, including the fact that mutual funds in a 401(k) plan generally waive front-end loads. Also, a plan may offer share classes (or collective trusts) with lower expense ratios than retail mutual fund shares. However, an IRA may offer less expensive index funds and ETFs as well as non-managed individual stock positions.

- **Services:** Different levels of service may be available under the alternatives. For example, a plan may offer investment education. However, an IRA may offer personalized advice from an advisor.
- **Penalty-free withdrawals:** The FINRA guidance points out that a participant may be able to take penalty-free withdrawals from a plan if the employee leaves employment between ages 55 and 59½. However, that may not be possible until age 59½ for an IRA. Also, a participant may be able to take loans from a plan, but cannot from an IRA.
- **Protection from creditors and legal judgments:** Generally speaking, plan assets have unlimited protection from creditors under federal law, while rollover IRAs are protected under ERISA only in bankruptcy proceedings. However, state laws may provide additional protection from creditors.
- **Required minimum distributions:** Generally speaking, if an employee (other than "key" employees) is still working, required minimum distributions (RMDs) from a plan are not required to start at age 70½. RMDs must start from IRAs at age 70½ (except for Roth IRAs), regardless of whether the person is working. An important note is that RMDs are required to begin at age 70½ for "key employees" (those with major ownership and/or decision-making roles in the business), even from a plan.
- **Employer stock:** Significantly appreciated company stock may be a reason to consider taking a distribution or leaving the money in the plan because of beneficial capital gains treatment when distributed from a plan and sold. However, the capital gains treatment is lost if company stock is rolled over into an IRA.

At the end of the factors list, FINRA says, "These are examples of the factors that may be relevant when analyzing available options. Other considerations also might apply to specific circumstances." In other words, there are many factors to consider when evaluating whether a distribution or rollover is appropriate for a given individual. The expectation is that advisors will develop suitable recommendations based on those considerations.

These factors should be evaluated in terms of the circumstances of each participant. The issue is not what decision a hypothetical participant would make, but instead it is the preferences of the particular participant or investor. For example, lower costs may appear to be a major factor, but a participant may prefer the advantages of personalized advice and planning. Thus, in a given case—based on participant preferences—the weighting of the factors can vary.

While FINRA lists those factors as a basis for developing a suitable recommendation, they also are important considerations to be included in any educational materials.

Comments have been made to FINRA about the difficulty in gathering and evaluating the information needed for a suitable recommendation. However, it is clear that more is now expected in the development of recommendations about distributions from plans and rollovers into IRAs.

In that regard, the following steps should be considered as one alternative for complying with FINRA's guidance:

- Advisors should consider the feasibility of providing educational materials and tools to participants, rather than making recommendations.
- Advisors should provide participants with fair and balanced written explanations of their alternatives. FINRA's Investor Alert and the factors in Regulatory Notice 13-45 are starting points for those materials.
- Advisors who opt to make recommendations to participants about distributions, as opposed to providing educational materials, should consider using checklists of the distribution considerations for participants. These materials would be useful in documenting disclosures and conversations with participants about important factors to consider in making a rollover decision.
- If you are an advisor to the plan, disclose any difference between your compensation for plan services and the compensation for IRA services. Those factors include, but are not limited to:
  - Disclosure of any differences in available investments and about administrative and investment expenses in the plan and in the IRA.
  - Disclosure of material conflicts of interest.
  - Participant acknowledgment of these disclosures and communications in writing.

Until there is greater clarity, be conservative in your approach.

## What should fiduciary advisors consider when working with participants on rollovers?

Advisors who are fiduciaries should consider a prudent approach for assisting participants with rollovers. The first step is for advisors to decide whether they will make recommendations to participants about distributions and rollovers—or whether they will provide education and information. If an advisor makes recommendations, there is a significant risk the DOL would consider the advisor to be an ERISA fiduciary for that purpose. That means that the recommendation would need to be prudent and in the best interest of the participant. That also means that the fiduciary prohibited transaction rules apply. For example, fiduciaries cannot use their recommendations to cause themselves to receive additional payments. While it's not clear, that could include, for example, a higher fee for advising on the IRA than the advisor's fee from the plan.

On the other hand, where the advisor provides education and information about distributions and rollovers, the advisor should not be considered a fiduciary for that purpose. As a result—and so long as the information is unbiased and reasonably complete, the fiduciary prohibited transaction rules should not apply.

Here are points to be considered in developing an educational approach:

› The advisor should clearly define the fiduciary services provided to a plan so as not to include rollovers.

› The decision to take a distribution and to roll over to an IRA should be the participant's, without their advisor's encouragement or recommendation. The advisor should consider obtaining acknowledgment from the participant that the rollover decision was theirs, and that they were not influenced by the advisor's role with the plan.

› The GAO report supports and encourages the distribution of unbiased educational materials to participants about their alternatives for taking or leaving money in a 401(k) plan and about the most significant advantages and disadvantages of each. The DOL has agreed with that report. The advisor should be prepared to provide participants with unbiased educational materials regarding distribution alternatives and the most common advantages and disadvantages of those options.

› The advisor should consider providing written disclosure of fees and expenses for the IRA and its investments, as well as the advisor's compensation.

› While plan fiduciary advisors should consider avoiding making rollover recommendations, if an advisor does make a recommendation, it should be prudently developed and in the best interest of the participant. That could mean, for example, the advisor recommending that the participant leave the money in the plan.

› Advisors should also consider the FINRA guidance discussed in the preceding section of this paper. While the FINRA comments and procedures focus on the suitability standard for broker-dealers, they describe information that is helpful to participants in making distribution and rollover decisions. In addition, SEC staff has taken the position that RIAs are also subject to a suitability standard, which suggests that FINRA's guidance is applicable. Finally, it is conceivable, perhaps even likely, that the DOL will consider the FINRA suitability factors as elements of a prudent process.

These are suggestions, not requirements. The key is to have a prudent approach based on education and on accurate and unbiased information that is fully disclosed.

There are also factors that could increase the likelihood of a DOL challenge—particularly for fiduciary advisors. Those include:

› Recommending that a participant take a distribution from a plan, especially problematic if the participant is still employed at the plan sponsor (i.e., an in-service distribution).

› Recommending an investment or service that has non-disclosed costs or surrender charges, or imposes other costs or limitations on the participant.

› Making a recommendation that results in what the DOL considers unusually high advisor compensation, or compensation that is not disclosed or only partially disclosed to the participant.

› Recommending high risk or speculative investments that are inconsistent with investing money for retirement purposes for the particular investor.

- › Providing information that does not discuss the advantages of leaving the participant's money in their current plan or transferring it to a new employer plan.

There are also factors that could weigh in favor of capturing rollovers. Those include:

- › Assisting participants who are already the advisor's wealth management clients.
- › Charging fees in the IRA that are the same as the advisor's fees in the plan.
- › Charging fees that do not increase because of the rollover, e.g., a set fee for financial planning or wealth management services that covers all of the individual's assets and remains the same regardless of whether a participant takes a distribution or leaves money in the plan.
- › Assisting participants who are sophisticated and experienced investors.
- › Potentially lower costs compared with keeping assets in the plan (e.g., ETFs, mutual funds, and individual securities with lower expense ratios).
- › Providing access to a broader array of investment options outside of the plan's investment menu.

## PROPOSED REGULATION ON FIDUCIARY ADVICE

The DOL is working on a proposed regulation to broaden the definition of fiduciary advice (and perhaps to increase the regulation of distributions and rollovers to IRAs).

The effect of an expansion of the fiduciary definition—in the context of rollovers—would be to increase the number of advisors whose conduct would be regulated by ERISA and who, therefore, should take a prudent approach to providing and documenting their rollover practices. In addition, it is possible that future DOL guidance on IRA rollover services could extend to non-fiduciaries, such as broker-dealers and their advisors.

In 2010, the DOL proposed a regulation that redefined and expanded the definition of fiduciary advice. While that proposal was subsequently withdrawn, it is commonly believed that the new proposal will be similar. As a result, the best "predictor" of the anticipated guidance is the withdrawn proposal, together with statements made by Phyllis Borzi, the Assistant Secretary of the DOL's Employee Benefit Security Administration.

To understand those proposed changes, it helps to start with the five-part test in the current definition of fiduciary advice:

- › An advisor makes recommendations about buying or selling investments.
- › The advice is rendered on a "regular basis."
- › The advice is rendered with a "mutual" agreement or understanding.
- › The recommendations will serve as "a primary basis" for plan investment decisions.
- › The recommendations are individualized investment advice based on the particular needs of the plan.

The withdrawn proposal would have expanded the number of advisors who qualify as fiduciaries because it would have narrowed the definition of fiduciary advice to only two criteria:

- An advisor makes recommendations about buying or selling investments.
- The recommendations are individualized investment advice based on the particular needs of the plan.

If these changes are made, fiduciary status could apply even if:

- the recommendations by advisors were not made on a regular basis (e.g., if they were made only once);
- if there was not a mutual understanding about the significance of the recommendations (e.g., whether the recommendations were meant to be advice); or
- if they were not meant to be a primary basis for investment decision making.

In other words, almost any "individualized" investment recommendation could result in fiduciary status under the anticipated proposal.

The critical factor in defining fiduciary advice will likely continue to be whether the investment recommendations were "individualized" and based on "the particular needs of the plan" (or of the participant). If so, the recommendations would satisfy part of the fiduciary definition. "Advice" that is not individualized to the plan or participant is considered education; therefore, does not result in fiduciary status.

If these changes are made, the effect will be to focus more attention on fiduciary status and make it easier for the DOL and plaintiffs' and claimants' attorneys to prove fiduciary status. As a result, both the perception of fiduciary status and the reality of fiduciary litigation are likely to expand.

In addition, it is possible that the DOL could take a position similar to FINRA's—that a rollover recommendation is inherently a recommendation of a securities or investment transaction. If so, and if the recommendation is based on the needs of the participant and "individualized" to the participant, the DOL would conclude that the recommendation was fiduciary investment advice under ERISA. Alternatively, the proposed regulation could possibly take an even broader approach, by saying that any distribution recommendation was fiduciary advice. Either way, that would mean—at least from the DOL's perspective—that the recommendation would need to be prudent and the fiduciary prohibited transaction rules could apply.

However, these changes will be highly controversial and, even if proposed, may not be finalized in this manner. It is difficult to know what the rules, exceptions and exemptions will be or when they will be finalized. Advisors should consider their practices based on the current regulatory environment until the pending changes become clearer.

In addition to the DOL changes, the SEC is considering a uniform fiduciary standard for financial advisors and investment advisors. Many in the financial community, and some in Washington, D.C., are encouraging the DOL and SEC to work in tandem to develop a "harmonized," or similar, definition of fiduciary. If that argument prevails, the DOL regulatory process will be delayed for a considerable period of time.

## CONCLUSIONS AND NEXT STEPS FOR ADVISORS

Non-fiduciary advisors can "capture" rollovers under the DOL guidance. For non-fiduciary advisors, recommendations to participants concerning distributions, rollovers and IRA investments are not regulated by ERISA.

However, FINRA has stepped into the fray by providing rollover "reminder" guidance that may apply the suitability standard to recommendations about distributions and rollovers. As a result, non-fiduciary advisors should consider providing education and information to participants—rather than rollover recommendations. If recommendations are made, advisors should adhere closely to the policies and procedures of their broker-dealers.

In addition, both FINRA and the SEC have included the practices of broker-dealers and their advisors on their respective examination priorities for 2014 (and the SEC has included the practices of RIAs as well).

Fiduciary advisors can provide education and information to participants and IRA rollover services to plans without violating ERISA's fiduciary or prohibited transaction rules—if they take steps to satisfy the DOL concerns described in this paper. Those steps should consider DOL concerns about fiduciary advisors exercising control or undue influence to cause participants to take distributions and invest in IRAs that compensate the advisors. In addition, fiduciary advisors should be aware of FINRA's guidance and consider including the suitability factors in their educational materials. If the fiduciary advisors make rollover recommendations, those factors should be considered in the development of a prudent recommendation.

The Current Regulations and Their Impact on Rollovers section of this paper has included steps that both fiduciary and non-fiduciary advisors should consider.

All advisors are encouraged to refer to the following table for a summary of key points and additional considerations related to existing and proposed DOL guidance.

## PERSHING COMMENTARY

- Here's the bottom line regarding rollovers. Regulators, including the SEC, FINRA and the DOL, are focused on IRA rollover practices.
- The DOL has issued regulations that shape the current environment in which you operate. However, the 2010 DOL proposal (which was withdrawn in September 2011) and its current efforts to revive that proposal indicate a potential shift in the regulatory environment.
- FINRA requires rollover recommendations to be suitable and lists a series of factors that should be considered in developing a recommendation. The FINRA guidance says that broker-dealers and their registered representatives should make a reasonable effort to investigate the facts before making recommendations.

While you can rely on the regulations currently in force, it is important to understand the potential impact of the evolving landscape. The DOL has indicated its desire to cast a broader net, which would consider more advisors ERISA fiduciaries. FINRA and the SEC have a laser focus on IRA rollover practices. Now is the time to take inventory of your current business practices and begin to take steps to prepare for change.

# FINAL CONSIDERATIONS FOR ADVISORS

| Considerations for Fiduciary Advisors | Considerations for Non-Fiduciary Advisors |
|---|---|
| Under current DOL guidance, fiduciary advisors can provide information and education to participants about IRA rollovers if they consider the DOL's concerns. (As a conservative approach, fiduciary advisors should consider incorporating FINRA's guidance into their practices.) | Under current DOL guidance, non-fiduciary advisors may capture rollovers without becoming fiduciaries and without being subject to ERISA's prohibited transaction rules. As a result, it is permissible under ERISA for non-fiduciary advisors to capture IRA rollovers from plans, and to assist in the investment of those rollovers. |
| When advisors serve plans or participants as fiduciaries, a prudent approach is recommended because the DOL guidance is not clear. In addition, it is likely that the DOL will issue proposed guidance in the future that further regulates the IRA rollover recommendations of fiduciary advisors. See the Current Regulations and Their Impact on Rollovers section of this paper for suggestions on developing a prudent approach. | A non-fiduciary advisor with regard to a plan or a participant will not become an ERISA fiduciary because of recommendations related to distributions or rollovers and/or receiving compensation for IRA investment services under the regulatory guidance currently in effect. |
| | However, recent guidance from FINRA requires that advisors decide whether to make rollover recommendations or to provide education and information about rollovers. If recommendations are made, they should be suitable and consider the alternatives available to the participant. FINRA's Regulatory Notice 13-45 and Investor Alert include factors that should be considered in developing suitable recommendations. If educational materials are provided, they should be unbiased and reasonably complete, and they should also describe the advantages and disadvantages of the options available to the participant. The factors in Regulatory Notice 13-45 and the Investor Alert are a starting point for those materials. |

## Looking Forward

While the DOL may propose to regulate all advisors in their distribution and rollover recommendations, the DOL regulation has not yet been re-proposed. If and when it is, it will be subject to a comment period. After the close of the comment period, the DOL will consider the comments and ultimately issue a final regulation. The timing for any regulation to take effect will be months, if not more than a year.

Until the pending changes become clearer, advisors should consider continuing their current practices, taking into account existing guidance from the DOL.

Both fiduciary and non-fiduciary advisors should consider the educational approach. Given the lack of clarity in the DOL and FINRA guidance, this approach may be the least burdensome and potentially involve the least risk. Participants can be given information about their distribution alternatives, including:

- 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 advisor to identify and use a suitable IRA provider.

The materials could educate participants on the most important advantages and disadvantages of each option.

Those materials should be educational, not promotional. The materials should not encourage participants to take distributions from plans. Descriptions of advisor services could cover the role and fees of the advisor, the selection of the IRA provider and its fees, and the range and costs of investments.

Advisors who take this approach should consider obtaining written acknowledgment that the participant received information about the distribution alternatives (and the advantages and disadvantages of each), and decided to take a distribution from the plan, roll over to an IRA and work with the advisor, and that the participant was not influenced by the advisor.

[1] McKinsey & Company, *Capturing IRA Rollovers: The Net New Money Opportunity For Wealth Managers,* July 2011

[2] Investment Company Institute. 2014. "The U.S. Retirement Market, First Quarter 2014" (June)

[3] ICI Research Perspective, *The Role of IRAs in U.S. Households' Saving for Retirement,* November 2013

[4] Cerulli Associates, *Retirement Markets 2013: Data & Dynamics of Employer-Sponsored Plans*

[5] U.S. Department of Labor Regulation §2510.3-21(c); DOL Interpretive Bulletin 96-1

[6] Section 404(a)(1) of the Employee Retirement Security Act of 1974 (ERISA)

[7] DOL Regulation §2550.404a-1

[8] ERISA §406(b)(1) and (3); DOL Advisory Opinion 97-15A (the Frost Opinion)

[9] See, e.g., DOL Advisory Opinion 2005-23A, Q&A 2 and Footnote 5. 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)

[10] See, e.g., *Reich v. McManus,* 883 F.Supp. 1144 (N.D. Ill. 1995); *Reich v. Lancaster,* 55 F.3d 1034 (5th Cir. 1995); see also the "to the extent" language in ERISA's definition of "fiduciary" in ERISA §3(21)(A) and the only form of fiduciary advisor is an advisor who provides investment advice for a fee (that is, advice on other matters cannot result in fiduciary status)

[11] GAO 13-30, *401(k) Plans, IRS and DOL Could Improve the Rollover Process for Participants,* March 7, 2013

[12] Preamble to Prop Reg §2510.3-21, Definition of "Fiduciary," 75 Fed. Reg. 65276, 65266, October 22, 2010

[13] FINRA Regulatory Notice 13-23, Brokerage and Individual Retirement Account Fees (July 2013)

[14] FINRA Report on Conflicts of Interest, October 2013. It labels 401(k) distributions as "key liquidity events" and adds: "The recommendations a representative makes at this stage of an investor's life have profound implications for the investor and deserve thorough scrutiny and review." (Emphasis added.) (See page 4.)

[15] FINRA Regulatory Notice 13-45, Rollovers to Individual Retirement Accounts (December 2013)

[16] FINRA Investor Alert, The IRA Rollover: 10 Tips to Making a Sound Decision (January 23, 2014)

[17] FINRA Examination Priorities (January 2, 2014); FINRA Regulatory Notice 13-45 (section 8); Securities and Exchange Commission National Exam Program, Examination Priorities for 2014, Section II

[18] See, Suitability of Investment Advice Provided by Investment Advisers, Investment Advisers Act Release No. 1406 (March 16, 1994)

[19] See, e.g., ERISA §406(b)(1) and (3)

# NOTES

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