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RECOMMENDING ROLLOVERS

WHAT ADVISORS (STILL) SHOULD KNOW AND DO.

BY FRED REISH & JOSHUA WALDBESER

Love it, hate it, or somewhere in between, everyone can agree that the 5th Circuit's decision to vacate the DOL fiduciary rule has created uncertainty about a number of issues. One of them is the nature of an advisor's[1] obligations when recommending a rollover from a retirement plan to an IRA. Separate and apart from the rule, it is important not to lose sight of other sources of regulation. As applicable to different types of advisors, FINRA and the SEC have both issued guidance on this important topic.

In this article, we hope to help advisors cut through the confusion. Let's start by discussing the effect of the 5th Circuit's ruling.

REINSTATED DOL GUIDANCE

The 5th Circuit's ruling says that the rule is vacated *in toto*, meaning entirely.[2] This means the narrower 1975 DOL regulation defining "fiduciary" investment advice still applies. It also means that the Best Interest Contract (BIC) Exemption is not available.

The 1975 Regulation

The now-reinstated 1975 regulation says that, to be an advice fiduciary, a person must provide investment advice that satisfies five distinct requirements — one of which is that the advice must be provided on a "regular basis." If an advisor doesn't have an existing relationship with the plan, a recommendation of an IRA rollover would not generally satisfy the "regular basis" prong, and possibly others. In that case, because the recommendation is not fiduciary advice, ERISA's duties of prudence and loyalty don't attach, and the advisor does not commit a prohibited transaction for "fiduciary self-dealing" by recommending a rollover to an IRA that will pay the advisor additional compensation.

In our experience, RIAs usually act as fiduciaries to their retirement plan clients. For brokers, the issue may be more "facts-and-circumstances" driven. But both types of advisors can be advice fiduciaries under the functional five-part test, which is important in light of the discussion below.

Advisory Opinion 2005-23A

Another effect of the 5th Circuit's ruling is that previous DOL guidance on IRA rollovers is reinstated. In Advisory Opinion 2005-23A, the DOL adopted a position that a person recommending an IRA rollover would not be acting in a fiduciary capacity so long as that person is not otherwise a plan fiduciary. However, it went on to indicate that if the person is otherwise a plan fiduciary, such a recommendation (including merely "responding to participant questions" about the advisability of distribution options) would

constitute an exercise of fiduciary discretion over plan management. In this latter case, ERISA's duties of prudence and loyalty, and the requirement to avoid prohibited self-dealing, would apply.

Particularly on the second point, the DOL's position is controversial. Under ERISA, only certain functions are "fiduciary" in nature, and fiduciary status attaches only "to the extent" a fiduciary function is being carried out. This is understood to mean that whether a particular function is a fiduciary function should not depend on the person's fiduciary status as to other matters. Furthermore, the characterization of a rollover recommendation as a discretionary act is arguably dubious.

However, this is the DOL's position, and the safe approach is to follow the guidance in the advisory opinion until different guidance is issued. "Existing" fiduciary advisors to plans should therefore expect that they will be considered fiduciaries when recommending IRA rollovers, and conduct themselves accordingly.

TRANSITION RELIEF

Unless the IRA pays the advisor and his or her firm the same level of compensation as they received under the plan (or less), a rollover recommendation made by a fiduciary advisor may, according to the advisory opinion, constitute a prohibited transaction. The BIC Exemption is gone, and "pre-rule" prohibited transaction exemptions that are still on the books don't provide clear relief for rollover recommendations. So, for advisors who are otherwise plan fiduciaries — say, advisors to the plan — the question is: what now?

Fortunately, the DOL has recognized this vacuum. On May 7, 2018, it issued Field Assistance Bulletin (FAB) 2018-02 announcing a temporary enforcement policy as to prohibited transactions. The FAB is applicable retroactively to the rule's implementation date of June 9, 2017, and prospectively until further exemptions or guidance are issued. In relevant part, it states that:

> *…the Department will not pursue prohibited transactions claims against investment advice fiduciaries who are* ***working diligently and in good faith to comply with the impartial conduct standards*** *for transactions that would have been exempted in the BIC Exemption…* (Emphasis added).

The FAB is also binding on the IRS, meaning that excise taxes for prohibited transactions will not be assessed under the same conditions that preclude DOL enforcement. Remember that the BIC Exemption's impartial conduct standards require that:

- advice be in the "best interest" of the investor;
- the compensation to the advisor and firm, their affiliates, etc. not exceed a reasonable level (this is an industry standard); and
- no misleading statements be made to the investor.

The FAB does not bind private parties, meaning that it cannot directly prevent ERISA fiduciary breach claims. However, the "best interest" standard is functionally the equivalent of ERISA's prudence and loyalty requirement. A fiduciary advisor who satisfies the "best interest" and other impartial conduct standards is unlikely to have breached any ERISA-imposed duties.

So, even though the BIC Exemption has been set aside along with the rest of the fiduciary rule, what the FAB essentially does is to provide for non-enforcement where the impartial conduct standards set forth in the BIC Exemption are satisfied. Since the BIC Exemption was the only "clearly applicable" exemption for IRA rollovers, it contains the most reliable guidance we have on what the DOL thinks "best interest" means in the context of a rollover recommendation.

BIC 'Best Interest'

Under the BIC Exemption, to determine whether an IRA rollover would be in the investor's "best interest," the advisor would have been required, *at a minimum*, to consider for the plan and the IRA the:

- investment options;
- fees and expenses; and
- services.

This would require the advisor to request certain information about the plan (including the "comparative chart" of investment options provided to defined contribution plan participants)[3] and consider the investment objectives, risk tolerance, financial circumstances and needs of the participant before making a recommendation. For example, IRAs usually offer a broader range of investment options than plans, unless the plan has a brokerage window. But in applying this

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"THE SAFE APPROACH IS TO FOLLOW THE GUIDANCE IN THE ADVISORY OPINION UNTIL DIFFERENT GUIDANCE IS ISSUED."

factor, an advisor should consider whether the investor actually would benefit significantly from access to investments that aren't available under the plan. If not, this factor may not favor the IRA.

The preamble of the BIC Exemption also encouraged the examination of those additional factors set forth in FINRA Regulatory Notice 13-45, which is discussed below.

OTHER STANDARDS

FINRA and SEC conduct standards, as applicable, still apply separately to advisors whether or not they are ERISA fiduciaries.

FINRA

In Notice 13-45, FINRA explained that IRA rollover recommendations are typically securities recommendations subject to FINRA rules — and thus must be "suitable" for the investor. It then delineates seven factors that brokers should take into account. The first three — investment options, fees and expenses, and services — overlap the specifically required "best interest" factors. The other four factors are:

- penalty-free withdrawals (for investors between ages 55 and 59½, which are available from plans but not IRAs);
- creditor protections (which may be more limited for IRAs);
- required minimum distributions (which can be deferred under plans, but not IRAs, for age 70½ investors who remain employed); and
- employer stock (favorable tax treatment vs. diversification).

This is not an exhaustive list and other factors may be relevant in many cases. For example, say the investor needs to take periodic withdrawals, but the plan doesn't offer partial withdrawals, or does but charges check-writing fees. Assuming that's not the case for the IRA, the additional "distribution flexibility" may be a factor that favors the rollover.

SEC

In 2015, the SEC launched its Retirement-Targeted Industry Reviews and Examinations ("ReTIRE") initiative. SEC materials on ReTIRE explain that an IRA is a "type of account" which any advisor subject to SEC registration must have a "reasonable basis" to recommend, citing to Notice 13-45 as an example of the rules that may attach to such recommendations.

TYING IT ALL TOGETHER

Advisors should consider whether they will be treated as ERISA fiduciaries when recommending IRA rollovers, due to "existing" plan fiduciary status.

If the answer is no, then complying with FINRA and/or SEC rules, as applicable, may be all that is necessary. Despite many similarities, FINRA "suitability" and the SEC "reasonable basis" standards may arguably be somewhat lower than "best interest." However, this is largely a distinction without a difference. After all, an advisor needs to gather the relevant information and analyze it, and consider the investor's personal circumstances, to make a "suitable" recommendation of an IRA rollover, or form a "reasonable basis" for such a recommendation, anyway.

What if the answer is yes? We've explored why adherence to the "best interest" and other impartial conduct standards will protect advisors from DOL enforcement and excise taxes for prohibited transactions. We've noted that this should also help ensure that the advisor's ERISA fiduciary duties have been satisfied, so as to avoid breach claims. And because "best interest" is a similar (even if somewhat higher) standard than "suitability" or "reasonable basis," it seems safe to presume that satisfying "best interest" should preclude violations of FINRA and SEC rules as well.

This is the approach we recommend. An advisor who gathers and analyzes the necessary information, taking into account all the factors above (and others that are relevant), and recommends IRA rollovers only where they are in the investor's best interest, will be most protected against liability from all sides.

As a final note, we should point out that all advisors who recommend IRA rollovers, whether or not as ERISA fiduciaries, need to maintain records and document the reasons for those recommendations, in each case in accordance with all applicable standards. In the event of a dispute or regulatory examination, an advisor's process is only as good as can be shown.

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[1]For simplicity, we use the term "advisor" to refer to broker-dealer registered representatives and individual adviser representatives of RIA firms alike.
[2]As of the current date, the 5th Circuit's order officially vacating the fiduciary rule has not yet been issued, but we are writing this article as if it has (and presuming that it will).
[3]The DOL has indicated that benchmarks and "general" industry data may be relied upon in some cases where the participant refuses to provide plan-specific information.