IRALERT

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TO: IRA Group Distribution

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RE: Emerging IRA "Rollover Desk" Issues

Several recent developments draw attention to the operation of financial institution IRA "rollover desks" and similar practices geared to attracting IRA rollovers from qualified retirement plans.

Citigroup Settlement. In June, Citigroup Global Markets entered into a $15 million settlement with the NASD (now FINRA) to settle allegations that several of its employees held seminars and used misleading and inadequate disclosures to induce over 400 BellSouth employees – most below age 60 – to take lump sum distributions from their retirement plans and roll them over into Citigroup brokerage IRAs. It appears that the settled claims related to alleged violations of securities laws, rather than ERISA. FINRA's press release can be found at: http://www.finra.org/PressRoom/NewsReleases/2007NewsReleases/P019240. A similar recent settlement involved Securities America, Inc. of Omaha, Nebraska, and a group of ExxonMobil employees in Texas. In a September 10 speech at the SEC Seniors Summit, FINRA's CEO announced that it is conducting several brokerage industry "sweeps" aimed at sales practices targeting investors age 50 and over, including early retirement seminars similar to those in the Citigroup and America, Inc. settlements.

Principal Class Action Lawsuit. On August 28, 2007, two former participants of 401(k) plans administered by Principal Financial Group ("Principal") filed a class action suit against Principal and its broker/dealer subsidiary, Princor Financial Services ("Princor"), alleging ERISA fiduciary violations. In this lawsuit, styled Young, et al. v. Principal Fin. Group, Inc., et al., Civil Action No. 4:07-CV-386 (S.D. Iowa), plaintiffs allege that Principal sent letters to participants in Principal-managed 401(k) accounts who were nearing retirement age, "urging" them to call Principal about their accounts. Concurrently, Plaintiffs filed a separate lawsuit against Principal and Princor alleging violations of federal securities laws – Young, et al. v. Principal Fin. Group, Inc., et al., Civil Action No. 4:07-CV-387 (S.D. Iowa).

The suit alleges that Principal intentionally misled the plaintiffs into believing that they would be calling Principal's plan administration department when, instead, the number they were given was for sales agents at Princor. Plaintiffs allege that Principal instructed Princor sales agents to encourage plaintiffs and other 401(k) participants not to leave their money in their retirement accounts, but to "rollover" their accounts to Principal IRAs offering "J-Share" class Principal mutual funds. Plaintiffs claim that Princor sales agents were instructed to offer only J-Share class mutual funds, even though Principal allegedly has several classes of less expensive funds available. Plaintiffs claim that Princor sales agents received bonuses and commissions for persuading participants to move their retirement accounts over to Principal IRAs.

The Principal complaint alleges that – like many financial institutions – Principal offers "full service" retirement plans to sponsoring employers, including a menu of mutual funds from which an employer can select funds to be offered to plan participants for investment. According to the complaint, once an employer has made its selections, Principal retains the authority to substitute mutual funds from those selected by the employer and to close funds to new investment. The complaint also alleges that Principal exercised discretion by sending letters urging participants to call Principal about their retirement accounts and by instructing Princor sales agents to encourage participants to rollover their accounts to Principal-managed IRAs. Plaintiffs contend that these actions by Principal make the companies fiduciaries pursuant to section 3(21)(A)(i) and (iii) of ERISA. In addition, plaintiffs allege that Principal and Princor provide "investment advice" to plans within the meaning of section 3(21)(A)(ii) of ERISA because (1) Principal represents that all the mutual funds on its platform are appropriate for its plan customers; (2) Principal provides investment advice to plan sponsors when it recommends mutual funds on the Principal platform; and (3) Princor recommends that participants rollover their retirement accounts and invest in Principal J-Shares.

Observations. The question of whether a service provider has acquired fiduciary status by creating, offering, and maintaining a menu of investment options has been raised in "401(k) fee" lawsuits brought against Principal and other plan service providers. While review of these issues is beyond the scope of this article, a new twist to the new Principal case is the allegation that Principal/Pincor acted as fiduciaries by "advising" participants to take plan distributions and roll the proceeds into Principal IRAs. In late 2005, the Department of Labor ("DOL") addressed this issue in an advisory opinion to Deseret Mutual Benefit Administrators. Advisory Opinion No. 2005-23A (Dec. 7, 2005) (Qualified Plans 2005-12). DOL concluded there that, where a person who is not otherwise a fiduciary advises a participant to take an otherwise permissible plan distribution and to invest the proceeds in an IRA, such advice does not make the person a fiduciary. DOL cautioned, however, that the propriety of the non-fiduciary's investment advice may be subject to non-ERISA (e.g., securities) laws and regulations. With respect to an existing plan fiduciary, on the other hand, the DOL indicated that if the fiduciary were to advise participants to roll over their accounts to an IRA, the advice would be subject to ERISA's fiduciary provisions and could involve self-dealing.

The reasoning behind the Deseret Advisory Opinion remains unclear. The crux of the opinion appears to be that, by itself, advising a participant to take a distribution is not a fiduciary act, as it is not advice regarding the management or disposition of plan assets, but relates to a "settlor" decision. At the same time, advising a participant to roll the proceeds over into an IRA cannot be a fiduciary act, as the proceeds are still "outside" the IRA when the recommendation is

made (indeed, the IRA may not yet exist). Informally, senior DOL staff members have generally confirmed that this is their reasoning. Nonetheless, those staff members somehow reach a different conclusion when the person making the recommendations is already a plan fiduciary. Under those circumstances, they indicate that the combined acts of recommending a distribution and recommending the rollover of the distributed assets are tantamount to providing (fiduciary) advice as to the investment of plan assets (notwithstanding the fact that they will cease to be plan assets before the investment occurs). In other words, an otherwise non-fiduciary act somehow can be "converted" into a fiduciary act merely because it is performed by a fiduciary. Beneath the surface, DOL appears to be reluctant to let a fiduciary take advantage of its position of authority to "mislead" participants into believing that it looking out for their best interests, when it is really making a sales presentation.

We expect this area of the law to develop significantly in the coming years – alongside 401(k) fee, revenue-sharing and similar claims.

Please feel free to direct questions to any of the Groom principals listed above or to IRA@groom.com.

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We will explore these issues in more detail at our October 2 meeting. Please join us or arrange to participate by telephone.