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IRA Rollovers

Their marketplace may soon be reshaped

Federal regulators and policymakers appear to have embarked on a mission to reshape the operation of the individual retirement account (IRA) rollover marketplace. Several announcements from various officials signal efforts to impose new duties on financial institutions and intermediaries when interacting with distribution-eligible plan participants, or to reinterpret existing duties and standards of care in new ways as a means of influencing and reconfiguring the rollover discussion.

Why is this so important? The IRA market has become the largest retirement system in the U.S., totaling more than $6 trillion, with contributions in excess of $300 billion per year. Below, we survey recent regulatory initiatives at the Department of Labor (DOL), Financial Industry Regulatory Authority (FINRA) and the Securities and Exchange Commission (SEC), focusing on rollover decisionmaking.

DOL. Financial institutions that provide services to 401(k) plans have been concerned that the DOL's 2005 Advisory Opinion to Deseret Mutual Benefit Administrators created an uneven playing field. In *Deseret*, it was suggested that service provider firms maintaining one or more fiduciary relationships with a 401(k) plan may risk allegations of having improperly leveraged that fiduciary relationship when recommending a proprietary IRA rollover product to a distribution-eligible participant. By contrast, financial institutions with no pre-existing relationships have been left with a relatively free hand to sell rollover products and to make distribution recommendations. The department has hinted that it may revisit its opinion in *Deseret* in the context of its regulatory initiative to redefine fiduciary investment advice under the Employee Retirement Income Security Act (ERISA).

A year ago this month, the U.S. General Accounting Office (GAO) released GAO Report 13-30, titled "401(k) Plans: Labor and IRS [Internal Revenue Service] Could Improve the Rollover Process for Participants." This report identified problems with what the GAO perceived as efforts by providers to "steer" participants into proprietary IRA products, as well as pervasive marketing of IRA rollover products in general. It noted that these accounts may often involve higher levels of fees and expenses relative to 401(k) plans, and posed the question of whether participants might be better off either remaining in their prior employer's plan or rolling their account balance to the plan of a new employer.

FINRA. Quite possibly as a result of GAO Report 13-30, FINRA issued Regulatory Notice 13-45 this past December, to address the obligations of broker/dealer (B/D) firms that make recommendations to 401(k) retirement plan participants to roll over or transfer their plan account balances to IRAs. Although styled as a "reminder" to its member firms about already existing obligations—viz., to recommend suitable products, to be fair and balanced in customer communications and to appropriately supervise—the notice essentially reinterprets the application of those responsibilities in the context of a rollover discussion with a plan participant.

In FINRA's view, a member firm's obligation to make securities recommendations that are "suitable" typically extends beyond the securities the firm suggests that a client purchase to the type of retirement account in which securities are held. Moreover, where a firm advises an investor to sell his 401(k) plan assets and roll over the cash proceeds into an IRA, the recommendation to sell the plan-held securities is equally as subject to the Rule 2111 suitability standard as the recommendation to purchase securities in the IRA. The notice indicates that, in FINRA's view, rollover-related suitability obligations extend to the plan of the participant's current employer.

SEC. The SEC's Office of Compliance Inspections and Examinations (OCIE) has announced that its 2014 priorities will include a focus on rollovers. Part of that focus will be on the sales practices of investment advisers that target rollovers of 401(k) assets into higher-cost investments, including whether advisers may misrepresent the benefits and features of IRAs.

While it is too soon to tell the influence that these regulatory initiatives may have, recent announcements from FINRA and the SEC's Office of Compliance Inspections and Examinations signal a clear intent to test and further develop the standards of conduct that may apply to individuals and firms doing business in the rollover space. The same may be true later this year when the DOL is expected to re-propose its regulation defining fiduciary investment advice.

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