Independent Thought Leadership

New Rollover Rules:

Death Knell or Rally Cry?

Retirees and job-changers are driving the snowballing rollover market—estimated to reach $760 billion annually in the next five years.[1] Rollovers from workplace retirement plans to IRAs are the greatest source of dollars flowing into IRAs. Total IRA assets now exceed $13 trillion, ahead of the $10.4 trillion of assets in defined contribution plans.[2] Because of the volume of assets involved, the essential role these assets play in retirement security, and the potential for financial professionals to deliver advice that may conflict with their clients' best interests, government agencies have stepped up protective action. They have increased regulatory requirements and enforcement efforts on IRA rollovers and the financial professionals who recommend them. Skeptics claim the new rules toll the death knell for rollovers, but astute financial professionals hear a rally cry in the regulations. Finally, the new rollover rules give the financial services industry more clarity on how to conduct compliant rollovers now and on a go-forward basis. And frankly, the new rules and regulations are quite manageable. This paper is the first in a series that will illustrate how financial professionals can successfully navigate the new rollover reality.

Who's Driving IRA Rollovers?

There are two main groups that drive the IRA rollover market: Retirees and job-changers.

The Retiree Market

With an eye toward retirement, wealth accumulation has been the focus of U.S. workers over the last 40 plus years. By 2032, the youngest of the Baby Boomer generation will reach full Social Security retirement age[3]. Our beloved Baby Boomers are leaving the workforce and must decide what to do with their precious retirement plan balances—take a lump sum payment, leave the assets in the plan, or roll the assets to an IRA. Roughly half of retirees choose an IRA rollover when they retire.[4]

Job-Changers

Job changers account for most (70 percent) of IRA rollovers.[5] The average person will change jobs over a dozen times throughout his or her working years.[6] Thirty-one percent of job changers choose an IRA rollover when switching jobs.[7]

Most retirees and job changers choose to roll over their retirement plan balances. The following table summarizes the reasons why. In a nutshell, investors want a consistent place to consolidate plan and IRA dollars that offers customized options to help them continue to build their retirement assets.

1 LIMRA Secure Retirement Institute, Money in Motion: Understanding the Dynamics of the IRA Rollover Market, May 2021

2 Investment Company Institute (ICI), Retirement Market Data, Second Quarter 2021, September 29, 2021

3 SSA.gov

4 The Pew Charitable Trusts, Pew Survey Explores Consumer Trend to Roll Over Workplace Savings Into IRA Plans, Sept. 2021

5 ICI, Research Perspective, Vol. 27, No. 1, The Role of IRAs in US Households' Saving for Retirement, 2020, January 2021

6 U.S. Department of Labor, Bureau of Labor Statistics News Release, August 2021

7 The Pew Charitable Trusts, How Employees Handle Their Retirement Savings During Work Transitions, May 17, 2021

Reasons for Choosing an IRA Rollover		
	Industry Research	**RLC Observations**
Retirees[8]	• Access to professional management and advice; • Control over their savings and investment decisions, not their former employer; • Ability to access funds without needing to withdraw all the money at one time; • Greater level of trust in the IRA provider to manage savings; and • Access to a wider array and better performing funds.	In RLC's experience, another key reason retirees choose an IRA rollover is to facilitate an asset location strategy more easily as part of an individual's overall household financial plan to help improve net after-tax returns.
Job Changers[9]	• Did not want to leave assets with their former employer; • Wanted to preserve the tax treatment of the savings; • Wanted to consolidate their assets; and • Wanted to access more investment options.	RLC has also found job-changers tend to opt for IRA rollovers because they wanted to • Bring order across their assets; and • Include their retirement assets in a household financial plan.

Financial Advisors and Rollover Recommendations

Driven by concerns that potential conflicts of interest may cause financial professionals to give rollover recommendations that do not serve their investors' best interests, the Financial Industry Regulatory Authority (FINRA), the Securities and Exchange Commission (SEC) and the Department of Labor (DOL) each have issued rollover guidance and regulations. At the heart of the issue are the differences between retail IRA and institutional qualified plan costs and pricing that could lead to conflicted advice. Industry research has found that investment costs are still lower, on average, in 401(k) plans than in retail IRAs,[10] although plan fees are compressing. With an IRA rollover, the hurdle for an advisor is this: Can he or she demonstrate that moving from institutional to retail pricing is in the best interest of a plan participant? Confounding this task is participants' fundamental lack of knowledge regarding institutional and retail fee structures; hence the need for additional scrutiny by the DOL, FINRA and SEC.

FINRA's Suitability Standard

FINRA is a private corporation that acts as a self-regulatory organization overseeing broker-dealers and member firms. In 2013, FINRA issued Notice 13-45 to remind firms of their responsibilities when 1) recommending a rollover or transfer of assets in an employer-sponsored retirement plan to an IRA or 2) marketing IRAs and associated services. FINRA stated that it would evaluate securities recommendations made in rollover scenarios to determine whether they comply with the "suitability standards" under FINRA Rule 2111. Later, the SEC broadened its regulatory reach to include broker-dealers when it issued Regulation Best Interest (Reg. BI), which now imposes a "best interest" standard of care on broker-dealers who offer rollover advice.

The SEC's Fiduciary Duty and Best Interest Standard

When delivering investment advice, registered investment advisers (RIAs) have a fiduciary duty to their clients under the Investment Advisers Act of 1940. They must serve the best interest of their clients and not subordinate their clients' interest to their own.

[8]The Pew Charitable Trusts, Pew Survey Explores Consumer Trend to Roll Over Workplace Savings Into IRA Plans, Sept. 2021
[9]ICI, Research Perspective, Vol. 27, No. 1, The Role of IRAs in US Households' Saving for Retirement, 2020, January 2021
[10]ICI, Research Perspective, Vol. 27, No. 6, The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2021 June 2021

The SEC's new Reg. BI affirms the fiduciary duty of RIAs and elevates the standard of conduct for broker-dealers to a Best Interest Standard, which is beyond the prior suitability standard, but not the same as the fiduciary standard required of RIAs. It applies to any recommendations about securities transactions or investment strategies, including recommendations to roll over assets from a workplace retirement plan account to an IRA, and recommendations to take a plan distribution. Broker-dealers and RIAs were required to comply with Reg. BI as of June 30, 2020.

A broker-dealer must act in the retail customer's best interest and cannot place its own interests ahead of the customer's interests. The advisor must

- Provide disclosures;
- Exercise reasonable care;
- Address conflicts of interest; and
- Follow written policies and procedures.

The "care" obligation requires a broker-dealer to have a reasonable basis to believe that the IRA or IRA rollover is in the best interest of the retail customer at the time of the recommendation and does not place the financial or other interest of the broker-dealer ahead of the interest of the retail customer, taking into consideration the retail customer's investment profile and other relevant factors, as well as the potential risks, rewards, and costs of the IRA or IRA rollover compared to the investor's existing 401(k) account or other circumstances.

The DOL's Fiduciary Standard

Financial professionals and their firms who provide fiduciary investment advice to plan sponsors, plan participants, IRA owners and beneficiaries, including recommending a rollover, are fiduciaries under the Employee Retirement Income Security Act (ERISA). Consequently, they may not receive payments for advice that would create conflicts of interest, unless they comply with the protective conditions in a prohibited transaction exemption (PTE).

What Constitutes Advice?

By Executive Order Reorganization Plan No. 4 of 1978, the DOL has the authority to write the investor protection rules that govern both qualified retirement plans and IRAs. The DOL applies its original five-part fiduciary test (the Five-Part Test) from its 1975 regulations, adjusted for the DOL's updated interpretation for "on a regular basis," to determine whether "investment guidance" rises to the level of fiduciary "investment advice."

What is the DOL's Five-Part Fiduciary Investment Advice Test?

The DOL will evaluate advisor/client interactions using five questions to assess whether the advisor has delivered investment advice subject to a fiduciary standard. If the answer is "yes" to all five of the following questions, and the advisor receives payment for the advice, he or she is an ERISA investment advice fiduciary.

DOL's Five-Part Fiduciary Test	
Question	**Consideration**
1. Will the advisor render advice to the plan, plan fiduciary, or IRA owner as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing, or selling securities or other property?	*Advice could include a recommendation to an investor to conduct a rollover. A recommendation to roll assets out of a retirement plan is advice with respect to moneys or other property of the plan and, if provided by a person who satisfies all of the requirements of the five-part test, constitutes fiduciary investment advice.*

Question	Consideration
2. Will the advice be given on a regular basis?	*Whether advice to rollover assets from a workplace retirement plan to an IRA constitutes advice "on a regular basis" depends on whether the advice* • *Is a single, discrete instance;* • *Occurs as part of an ongoing relationship; or* • *Occurs at the beginning of an intended future ongoing relationship that an individual has with an investment advice provider.*
3. Is the advice given pursuant to a mutual agreement, arrangement, or understanding with the plan, plan fiduciary or IRA owner?	*When making a determination on this question, the DOL intends to consider the reasonable understandings of the parties based on the totality of the circumstances.*
4. Will the advice serve as a primary basis for investment decisions with respect to plan or IRA assets?	*The recommendation need only be "a" primary basis for investment decisions—not necessarily "the" primary basis for investment decisions—before it would constitute investment advice. If the parties reasonably understand that the advice is important to the investor and could affect the investor's decision, that is enough to satisfy the primary basis requirement.*
5. Will the advice be individualized based on the particular needs of the plan or IRA?	*Put another way, is the advisor making an individualized recommendation to an investor upon which he or she will rely on to make an investment decision? Here again, the DOL will look at the reasonable understandings of the parties based on the totality of the circumstances.*

DOL PTE-2020-02

Through the years, the DOL has issued several statutory, class and individual exemptions to address the provision of investment advice. The DOL's newest PTE is 2020-02, Improving Investment Advice for Workers & Retirees, which allows financial advisors and financial institutions that give investment advice to retirement investors (i.e., plan sponsors, plan participants, IRA owners and beneficiaries) to be paid for their services without engaging in a prohibited transaction under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (IRC). The PTE also allows financial institutions to engage in "principal transactions" with plans and IRAs in which the financial institution purchases or sells certain investments from its own account.

Who Can Rely on PTE 2020-02?

Which financial professionals, potentially, can rely on PTE-2020-02?

- Broker-dealers,
- Registered investment advisors (RIAs),
- Fiduciaries under a signed ERISA 3(21) agreement to provide investment advice,
- "Functional fiduciaries" who, by exercising the necessary control over plan assets assume fiduciary responsibility and liability,
- Financial institutions such as banks and insurance companies.

When PTE 2020-02 Cannot Provide Protection

Instances when PTE 2020-02 cannot be relied upon for relief include

- Advice that is given by registered investment managers under ERISA 3(38);
- Computer or "robo-only" advice arrangements such as interactive websites and computer software without any personal interaction with an investment professional; and
- When the investment professional, financial institution, or an affiliate is 1) The employer of employees covered by the plan; or 2) a named fiduciary or plan administrator, or an affiliate, who was selected to provide advice to the plan by a fiduciary who is not independent.

Compliance with PTE 2020-02

Financial professionals and institutions that seek to comply with PTE 2020-02 must satisfy the following six steps.

1. Provide advice in accordance with the "Impartial Conduct Standards," which mandate that advice be given in the best interest of the retirement investor at a reasonable price without any misleading statements;
2. Acknowledge in writing their fiduciary status under ERISA and the IRC;
3. Describe in writing the services to be provided and any material conflicts of interest that may exist;
4. Adopt policies and procedures prudently designed to ensure compliance with the Impartial Conduct Standards and that mitigate conflicts of interest;
5. Conduct an annual retrospective review of their compliance with the requirements and produce a written report that is certified by one of the financial institution's senior executive officers;
6. If the advice involves a rollover recommendation, then
   - Document the reasons that a rollover recommendation is in the best interest of the retirement investor; and
   - Disclose the justification for the rollover in writing to the retirement investor.

   Rollover documentation

   To satisfy the documentation requirement for rollovers from an employee benefit plan to an IRA, investment professionals and financial institutions should make diligent and prudent efforts to obtain information about the existing qualified retirement plan and the participant's interests in it. As stated in a series of frequently asked questions on PTE 2020-02, the DOL identified the ideal documentation as a copy of the plan participant's ERISA §404(a)(5) fee disclosure. If the fee disclosure is unattainable, the financial institution and investment professional could rely on alternative data sources, such as the most recent Form 5500 or reliable benchmarks on typical fees and expenses for the type and size of plan at issue.

   Written rollover disclosure

   To satisfy PTE 2020-02 with respect to a rollover recommendation, financial institutions and investment professionals must disclose to the investor the specific reasons that a rollover of assets from a workplace retirement plan to an IRA, or from one type of account to another, is in the best interest of the retirement investor.

Enforcement of PTE 2020-02

The DOL has chosen to delay enforcing elements of PTE 2020-02 temporarily. According to Field Assistance Bulletin (FAB) 2021-02, released October 25, 2021, the DOL has delayed its enforcement effective date into 2022 for certain provisions of Prohibited Transaction Exemption (PTE) 2020-02, which are set to apply on December 21, 2021. FAB 2021-02 states that through January 31, 2022, the DOL will not pursue cases against advisors utilizing PTE 2020-02, provided they make a good faith effort to follow the three Impartial Conduct Standards outlined in the exemption. Further, if the advice involves a rollover recommendation, the DOL will not enforce the rollover documentation and disclosure requirements of the PTE through June 30, 2022. All other requirements of the exemption, however, will be subject to full enforcement as of February 1, 2022.

The Big Take Away

Despite all the noise and added scrutiny from regulatory bodies, a rollover can be and is a good thing for both investors and advisors that is here to stay. It's imperative for advisors who are serious about capturing IRA rollovers to have a compliant solution embedded in their practices. Investor demand and need for rollover advice is increasing—it just must be delivered correctly. There is a right and a wrong way to advise on rollovers. The right way is to have a balanced conversation that carefully considers the important factors of the plan environment contrasted with the IRA environment.

Financial institutions and investment professionals must consider and document their prudent analysis of why a rollover recommendation is in a retirement investor's best interest. The relevant factors include but are not limited to

- the alternatives to a rollover, including leaving the money in the investor's employer's plan, if permitted;
- the fees and expenses associated with both the plan and the IRA;
- whether the employer pays for some or all of the plan's administrative expenses; and
- the different levels of services and investments that are available under the plan and the IRA.

Financial professionals who choose to advise investors on liberating proceeds from a qualified plan and moving them into an IRA must demonstrate the IRA represents a better environment. There are several ways to accomplish this***. In our second paper in this series, RLC will explore two compelling ways advisors can demonstrate how an IRA environment can be competitive, namely, by providing access to holistic financial planning and institutionally priced IRA investments.***

Conclusion

In part because of the sheer size and importance of U.S. workers' retirement assets, the SEC and DOL have increased protections and safeguards for investors who receive investment advice from financial professionals related to securities transactions and investment strategies, including recommendations to roll over assets from workplace retirement plans to IRAs. While there are nuances between the rules and regulations imposed by the SEC and DOL that firm compliance departments must iron out, the net effect on financial professionals who provide investment advice is to impose the highest standard of investor care, diligence, disclosure, and documentation—regardless of account type. With respect to rollovers in particular, financial advisors who recommend liberating proceeds from a qualified retirement plan environment and moving them to an IRA environment must be able to knowledgeably compare and contrast the two environments based on relevant factors.

The industry now has manageable and intelligent standards from regulators (after many fits and starts) that allow financial professionals to approach the IRA rollover advisory discussion with confidence and help clients make the best decision for themselves and their household situations to maximize their retirement assets. For those paying attention, the future is very bright for advisors and their clients to navigate this new rollover reality.

About Retirement Learning Center

The Retirement Learning Center (RLC) is the independent thought leader in the retirement and rollover space. We offer multi-dimensional, business-building solutions to the financial services industry, designed to help asset managers, broker dealers, financial advisors, CPAs and independent financial planners better serve their clients in their quest to retire with confidence. With over 180 years of combined retirement industry experience among our consultants, our depth and breadth of knowledge and experience is superior. Since 2003, RLC has helped over 43,000 financial professionals provide expert guidance to their clients. For more information, please visit www.retirementlc.com

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