

Capturing Rollovers

By Fred Reish

This article examines statements made by the Department of Labor (DOL) regarding distributions and rollovers from qualified plans to IRAs. We are advising RIA and broker-dealer clients on how to structure their rollover programs in light of this guidance, and it is important for advisers to understand the DOL's views on this significant issue.

Background

In 2005, the DOL issued Advisory Opinion 2005-23A, which addressed whether the recommendation that a participant take a distribution from his 401(k) plan and roll the funds to an IRA was subject to the fiduciary standards and prohibited transaction rules of ERISA. This activity is sometimes referred to as "capturing rollovers" and "cross-selling."

In that guidance, the DOL said that a person making a recommendation would not be treated as a fiduciary even where he offered investment advice with respect to the funds in the rollover IRA. However, to the surprise of many, the DOL went on to say that, if the adviser was *already* a fiduciary to the plan, then making a recommendation to take a distribution, advising on how to invest the funds in the IRA or even *answering questions* about these matters would be subject to both ERISA's fiduciary responsibility and prohibited transaction rules. The DOL reasoning was that those activities amounted to the exercise of discretion over the management of the plan. (Curiously, 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).)

To quote from the advisory opinion:

Question 2: *Does a recommendation that a participant roll over his or her account balance to an individual retirement account (IRA) to take advantage of investment options not available under the plan constitute investment advice with respect to plan assets?*

Answer: *It is the view of the Department that merely advising a plan participant to take an otherwise permissible plan distribution, even when that advice is combined with a recommendation as to how the distribution should be invested, does not constitute "investment advice" within the meaning of the regulation (29 CFR § 2510-3.21(c)).*

Where, however, a plan officer or someone who is already a plan fiduciary responds to participant questions concerning the advisability of taking a distribution or the investment of amounts withdrawn from the plan, that fiduciary is exercising discretionary authority respecting management of the plan and must act prudently and solely in the interest of the participant. Moreover, if, for example, a fiduciary exercises control over plan assets to cause the participant to take a distribution and then to invest the proceeds in an IRA account managed by the fiduciary, the fiduciary may be using plan assets in his or her own interest, in violation of ERISA section 406(b)(1).

Question 3: *Would an advisor who is not otherwise a plan fiduciary and who recommends that a participant withdraw funds from the plan and invest the funds in an IRA engage in a prohibited transaction if the advisor will earn management or other investment fees related to the IRA?*

Answer: *No. For the same reasons explained above, a recommendation by someone who is not connected with the plan that a participant take an otherwise permissible distribution, even when combined with a recommendation as to how to invest distributed funds, is not investment advice within the meaning of the 29 CFR § 2510-3.21(c).*

However, as indicated above with respect to question 2, this position applies only to advice provided by a person who is not a plan fiduciary on some other basis. Advice of this nature given by someone who is already a fiduciary of the plan would be subject to ERISA's fiduciary duties.

Discussion in the Preamble

The Preamble for the DOL's 2009 proposed regulation on fiduciary advice to participants discussed capturing rollovers in the context of disclosures that the exemption requires be made to participants where the advice is conflicted. However, the DOL did not stop there. It went on to reiterate its position stated in Advisory Opinion 2005-23A in the context of what it referred to as "cross-selling, *i.e.*, using existing clients, plan participants and beneficiaries in this case, to *market additional services or products...*" [Emphasis added] The DOL said:

"When a person is already acting in a fiduciary capacity with respect to the plan, the Department has indicated that recommendations relating to the taking of a distribution or the investment of amounts withdrawn from the plan would constitute the exercise of discretionary authority respecting management of the plan and, therefore must be undertaken prudently and solely in the interest of the participant or beneficiary, consistent with section 404(a)(1). The Department further notes that if, for example, a fiduciary exercises control over plan assets to cause a participant or beneficiary to take a distribution and then to invest the proceeds in an IRA account managed by the fiduciary, the fiduciary may be using plan assets in his or her own interest, in violation of [the prohibited transaction rule in] ERISA section 406(b)(1)." [Emphasis added]

In other words, in 2009 the DOL reaffirmed its 2005 Advisory Opinion, but may also have "softened" it . . . in the sense that the preamble only refers to recommendations, as opposed, *e.g.*, to answering questions.

In 2010, the DOL addressed the issue again in a preamble to a regulation. In that guidance, the DOL stated:

The Department notes that it also has taken the position that, as a general matter, a recommendation [by someone who is not already a fiduciary] to a plan participant to take an otherwise permissible plan distribution does not constitute investment advice within the meaning of the current regulation, even when that advice is combined with a recommendation as to how the distribution should be invested. Concerns have been expressed that, as a result of this position, plan participants may not be adequately protected from advisers who provide distribution recommendations that subordinate participants' interests to the advisers' own interests. The Department, therefore, is requesting comment 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. The Department is specifically interested in information on other laws that apply to the provision of these types of recommendations, whether and how those laws safeguard the interests of plan participants, and the costs and benefits associated with extending the regulation to these types of recommendations.

With that request, the DOL has signaled that it is revisiting the issue of capturing rollovers. The explanation suggests that the DOL may be expanding its position, in the sense that the recommendation by a non-fiduciary to take a distribution, combined with a recommendation about how to invest the rollover, may result in functional fiduciary status for the adviser.

Conclusions

The DOL's position seems overly broad and unsupportable in the ordinary case where an RIA serves as a plan-level fiduciary adviser. Nonetheless, the guidance exists and a conservative approach is advisable. Here are some thoughts:

- > RIAs should decide whether to "capture" high account balance rollovers or to attempt to capture all rollovers. (The former is less likely to be subject to DOL scrutiny.) They should then develop programs consistent with those objectives.
- > In our experience, most RIA firms target the high account balance participants. The other participants can be helped by the recordkeeper or by a relationship with a broker-dealer.

We have helped RIAs, broker-dealers and recordkeepers develop programs for their rollover services. Those programs vary significantly based on the type of entity and its objectives. The programs that we have developed include client education and forms and procedures designed to minimize risk for capturing rollovers under this DOL guidance.

Drinker Biddle

Employee Benefits & Executive Compensation Practice Group

CALIFORNIA | DELAWARE | ILLINOIS | NEW JERSEY
NEW YORK | PENNSYLVANIA | WASHINGTON DC | WISCONSIN

Other Publications



www.drinkerbiddle.com/publications

Sign Up



www.drinkerbiddle.com/publications/signup

© 2012 Drinker Biddle & Reath LLP.
All rights reserved.
A Delaware limited liability partnership

Jonathan I. Epstein and Edward A. Gramigna, Jr.,
Partners in Charge of the Princeton and Florham Park,
N.J., offices, respectively.

This Drinker Biddle & Reath LLP communication is intended to inform our clients and friends of developments in the law and to provide information of general interest. It is not intended to constitute advice regarding any client's legal problems and should not be relied upon as such.