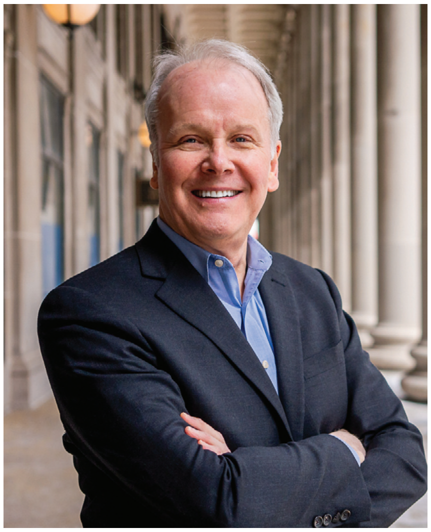

Navigating the New Guidance on Qualified Plan Rollovers

A new rule from the U.S. Department of Labor could create a regulatory landmine for investment advisors—here's what to know.

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Registered investment advisors and their firms have long viewed 401(k) and 403(b) plans as great sources of potential business. A soon-to-be retired client, current or prospective, might have a six- or seven-figure account balance begging for an investment advisor to manage it. What growth-oriented financial advisor is going to miss such a business opportunity?

Well, the U.S. Department of Labor (DOL) wants you to live up to your role as a fiduciary advisor when working with these clients and prospects. Under ERISA, an advisor's recommendation that a client roll over assets from a qualified plan into an account to be managed by the advisor or their firm creates a conflict of interest and a prohibited transaction, subject to sometimes draconian civil penalties if doing so increases the compensation the firm earns from the client. On Dec. 18, 2020, the DOL issued PTE 2020-02, which creates an exemption from the prohibited transaction rules as long as advisors follow certain steps. The rule becomes fully effective between February 1 and July 1, 2022. The bottom line is that qualified plan to IRA rollovers are still permitted, but the fiduciary advisor better make sure a whole lot more documentation is in place to justify any recommendation where the advisor manages the IRA. Let's review DOL PTE 2020-02 and some of its implementation issues.

DETERMINING ERISA FIDUCIARY STATUS

First, determine if you're a fiduciary and therefore subject to DOL oversight. When it comes to IRAs, a person (or firm) is deemed a fiduciary by the DOL if he or she (1) provides advice or recommendations on securities investing (2) on a regular basis (3) pursuant to an agreement or understanding with the IRA owner (4) such that the advice serves as a primary basis for the owner to make investment decisions and (5) that the advice is individualized based on the needs of the IRA owner. If this sounds like your relationship with your IRA clients, then the DOL says you're a fiduciary.

Note that the fiduciary nature of the client-advisor relationship is characterized by its ongoing nature. If you as a CPA provide, for example, a single recommendation to a client in a specific IRA rollover situation, you're likely not an ERISA fiduciary and therefore not subject to DOL oversight.

IMPLEMENTING THE IMPARTIAL CONDUCT STANDARDS

To enjoy the benefits of PTE 2020-02, the fiduciary advisor must comply with the impartial conduct standards defined in the DOL's Field Assistance Bulletin 2018-02. These include providing investment advice that's in the best interests of a retirement investor; assessing only reasonable compensation, based on the current competitive marketplace; making no materially misleading statements about the investment; and seeking to obtain the best execution of the investment transaction reasonably available under the circumstances. The firm must update its written policies and procedures such that they comply with the impartial conduct standards and that a reasonable person would conclude from reviewing the policies and procedures that there are no incentives for the firm or advisor to place their own interests ahead of the interest of the client.

PUTTING NEW PAPERWORK IN PLACE

A firm and/or its advisors must disclose if they're ERISA fiduciaries to the client in writing. This disclosure should include a written description of the services provided by the firm and advisors and a brief discussion of material conflicts of interest. This client communication might be crafted in such a way as to provide the client with a summary of the considerations for deciding whether or not to roll qualified plan assets into an IRA. Finally, both the client and advisor should sign this communication, whether or not the assets were rolled over into an IRA.

While PTE 2020-02 doesn't specify the form of this analysis, at a minimum I believe it's a good practice to document items such as services provided by the advisor and the retirement plan sponsor, investment choices for the IRA and qualified plan account, fees and expenses for both accounts, and various other considerations, such as withdrawal privileges, access prior to age 59.5, legal protections, etc. In other words, summarize in writing the relevant characteristics of both accounts. The advisor must make a good faith effort at obtaining this information regarding the qualified plan or document that he or she was unable to obtain it. Develop a format that can easily be reviewed by a third party (like a regulator) to show that you and the client both understood the pros and cons of funding an IRA through direct rollover of the qualified plan account balance prior to the client making the determination whether or not to do so.

The firm must also prepare an annual retrospective review, designed to document and aid compliance with the impartial conduct standards and the policies and procedures referred to above. The report is addressed to an executive officer of the firm, who must then certify that he or she has reviewed the report. The report covers the trailing 12-month period and must be completed no less than six months following the end of the review period. The initial retrospective review will cover the 12-month period ending Jan. 31, 2023—so get ready!

As we all know, the trend in financial services is for providers to become more transparent to consumers. It's not just competition and technology driving this wave, but regulatory authorities. The DOL has left no doubt that its reach extends beyond ERISA plans to include most advisor-managed IRAs. PTE 2020-02 provides tangible, measurable criteria for advisors to demonstrate this transparency. While I'm certain that more guidance will be forthcoming—some of which may be advisor-friendly—for now advisors need to take care to document the process that a client should follow when deciding what to do with his or her retirement plan account. It's a new world when advising clients on IRA rollovers—proceed accordingly.