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The Fiduciary Rule, Distributions and Rollovers: Interesting Angles on the DOL's Fiduciary Rule #61

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This is 61st article about interesting observations concerning the Department of Labor's fiduciary rule and exemptions. These articles also cover the DOL's FAQs interpreting the regulation and exemptions and related developments in the securities laws.

Now that it seems likely that the fiduciary rule and the transition exemptions will continue "as is" until at least July 1, 2019, it's time to re-visit the fiduciary rule and the requirements of the transition exemptions. This article focuses on the requirements for recommending that a participant take a distribution and roll it over to an IRA with a financial institution and its advisor. (Practically speaking, the financial institutions will likely be broker-dealers, RIA firms, and banks and trust departments). For ease of reading, this article uses "advisor" to refer to both the entity and the individual.

In order to recommend that a participant take a distribution, the financial institution and advisor must satisfy ERISA's prudent man rule and duty of loyalty. That is because a recommendation to a participant is considered to be advice to a plan. Among other things, that means that, if the advisor violates the rules, there is a cause of action under ERISA for breach of fiduciary duty (as opposed to the Best Interest Contract Exemption, where a private right of action is less certain).

If the advisor will earn more money if a participant's benefits are moved to an IRA, that will be a prohibited transaction. As a result, the advisor will also need to comply with the condition of an exemption, most likely the Best Interest Contract Exemption (BICE). The transition version of BICE requires that an advisor adhere to the Impartial Conduct Standards. Of those standards, the most significant for this purpose is the best interest standard of care. Since the best interest standard of care and ERISA's duties of prudence and loyalty are substantially similar, this article just refers to the best interest standard (even though both apply). The best interest standard requires that an advisor obtain the information that is relevant to making a prudent and loyal recommendation about a distribution. The Department of Labor has said that, at the least, that includes the services, investments, and fees and expenses in both the plan and the IRA. In addition, the best interest standard requires that the plan and IRA information be evaluated in light of the needs and circumstances of the participant.

The information about the services, investments, and fees and expenses in the plan is the most difficult to obtain. Fortunately, that information can be found in the participant's plan disclosure statements. Additional important information is in the participant's quarterly statements.

But, what if the participant can't locate the information? Realistically, that should be a rare case, since plan sponsors are required to distribute the disclosures at the time of initial participation and annually thereafter.

But, what if the participant can't find those disclosure materials? In a set of Frequently Asked Questions, the DOL responded that an advisor must make "diligent and prudent efforts" to obtain the plan information. If the participant can't find those materials, then it seems likely that, at the least, a diligent and prudent effort would require that the advisor inform the participant that:

1. The information is usually available on the plan's website and they could obtain it from that source.

2. The information is available from the plan sponsor upon request to the benefits personnel.

If neither of those options is successful, or if the participant is unwilling to take those steps, the advisor can use information from the Form 5500 or from industry averages. (Interestingly, 5500 data is not considered primary data for this purpose. It can only be used after a diligent and prudent effort has been made to obtain current plan data from the participant.)

Even where 5500 data or average plan data is used, there are additional considerations:

- The advisor must provide "fair disclosure" of the significance of using the primary plan data, that is, current information about the plan from, *e.g.*, the participant disclosure forms.

- Plan averages must be based on "the type and size of plan at issue." As a result, the advisor will need to know the type and size of the plan.

- The advisor must explain the alternative data's limitations.
- The advisor must explain "how the financial institution determined that the benchmark or other data were reasonable."

However, it would likely be a rare case that alternative data could be used. If a financial institution finds that its advisors are consistently using alternative data, that suggests that the advisors are not making "diligent and prudent efforts" to obtain actual plan data. The consequence of non-compliance is that the compensation paid from the rollover IRA is prohibited and cannot be retained by the financial institution or the adviser. There could also be an ERISA claim for breach of fiduciary duty.

An additional issue is that the "alternative data" may only include information about fees and expenses. In order to perform a best interest analysis, the advisor must also have information about a plan's services and investments. For example, does the plan offer a brokerage account where, if the participant desired, the participant could have access to a wider range of investments? Another example is whether the plan offers discretionary investment management for participants' accounts. If it does not, that may be a valuable service offered by the IRA; but, if it does, the expenses and the quality of those services in the plan and IRA should be compared.

As this article suggests, there are more issues than appear at first blush.

The views expressed in this article are the views of Fred Reish, and do not necessarily reflect the views of Drinker Biddle & Reath.

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