2016 ERISA ADVISORY COUNCIL ON EMPLOYEE WELFARE AND PENSION BENEFIT PLANS

PARTICIPANT PLAN TRANSFERS AND ACCOUNT CONSOLIDATION FOR THE ADVANCEMENT OF LIFETIME PLAN PARTICIPATION

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Background: Changes in the Retirement Savings System

- Dramatic changes in the retirement savings system since the mid-1970s
  - Decrease in number of employers offering DB plans
  - Increase in number of employers offering DC plans with participant-directed investments
  - Increase in retirement assets held outside employer-sponsored plans in IRAs
- Workers are more mobile and the number of workers participating in multiple plans across their career has increased
- Mobile workers most often cash out their retirement assets, move their retirement assets into IRAs or leave their retirement assets behind with former employer plans
- Given these changes, many plan sponsors and others in the industry have become increasingly interested in promoting plan-to-plan transfers and account consolidations

Background: The DOL Conflict of Interest Rules

- The DOL recently issued a new definition of fiduciary investment advice (Conflict of Interest Rules) to address:
  - Changes in the retirement savings market since the mid-1970s
  - Conflicts of interest of financial services providers and advisers in providing investment advice to retirement plan participants and IRA owners
  - 1975 regulations on the definition of fiduciary investment advice that have not been meaningfully changed to reflect the existence of participant-directed 401(k) plans, the widespread use of IRAs, and rollovers from ERISA plans to IRAs
- The new Conflict of Interest Rules:
  - Cover ERISA Plans and IRAs
  - Expand the definition of "investment advice fiduciary" to move away from the 1975 rules' 5-part test and expand the range of advisory activities that are fiduciary investment advice
  - Set out a number of exceptions and examples to illustrate activities that are not fiduciary investment advice
  - Include other prohibited exemptions to support the rule changes

Impact of DOL Conflict of Interest Rules

- The new fiduciary rule will significantly impact
  - Retirement plan advisors and intermediaries that will newly become ERISA fiduciaries under the rule
  - How investment advisory services are marketed and made available to retirement plans – especially DC plans, DC plan participants and IRAs
  - How other types of investment products and services will be marketed and sold to ERISA plans, plan participants and IRA owners
  - Disclosures provided to plan fiduciaries, plan participants and IRA owners
- While the rules will have broad implications, one of the most significant effects will be on the IRA marketplace and advice given in connection with participant-directed plan transfers and rollovers
  - Prior DOL guidance supporting advice on plan distributions as not being fiduciary was rescinded
  - These changes raise questions about when communicating to plan participants about participant plan transfers, rollovers and account consolidations will trigger fiduciary status

Impact of DOL Conflict of Interest Rule: Advice on Plan Rollovers, Distributions and Transfers

- Under the new rules, providing advice to plan participants or beneficiaries, IRAs or IRA owners about rollovers, distributions or transfer decisions may be a fiduciary act
- Providing "investment advice" on distributions, including whether to take a rollover, distribution or transfer, what amount, forms of distribution, and to what destination, are fiduciary if:
  - The advice is rendered for a fee or other compensation, direct or indirect,
  - The advice meets the definition of a "recommendation", **AND**
  - The recommendation is made by a person (directly or indirectly through or together with any affiliate) who either
    - represents or acknowledges that it is acting as a fiduciary
    - renders the advice pursuant to a contract or agreement that the advice is based on the particular investment needs of the advice recipient, OR
    - <u>directs the advice to specific advice recipient(s) regarding the advisability of a particular investment or management decision.</u>

Impact of DOL Conflict of Interest Rule: "Employee" Exceptions to Fiduciary Investment Advice Definition

- Two exceptions from fiduciary status apply to employees acting in employee capacity:

	Sponsor or Fiduciary Exception	Participant Exception
Applies to employees of:	• Plan sponsor of a plan • Plan sponsor affiliate • Employee benefit plan • Employee organization • Plan fiduciary	• Plan sponsor of a plan • Plan sponsor affiliate
When they provide advice to:	• A plan fiduciary • An employee (other than in his or her capacity as a participant or beneficiary of a plan) • An independent contractor of such sponsor, affiliate, or plan	• Another employee of the plan sponsor in his or her capacity as a participant or beneficiary of the plan
If these conditions are met:	• Receives no fee or compensation (direct or indirect) for the advice beyond normal compensation for work performed for the employer	• Receives no fee or compensation (direct or indirect) for the advice beyond normal compensation for work performed for the employer • Job responsibilities do not involve providing investment advice or recommendations • Person is not registered or licensed under federal or state securities or insurance law and the advice provided does not require the person to be

✓ To take advantage of the participant exception, plan sponsors will need to determine who will be advising participants on distributions/rollovers/transfers, and how they are compensated and required to be regulated

✓ The participant exception does not expressly address agents, contractors or other providers

Impact of DOL Conflict of Interest Rule: General Communications and Plan Information Exceptions to Fiduciary Investment Advice

- The definition of fiduciary investment advice does not include providing general communications, general investment education and educational materials to plans, plan fiduciaries, participants, beneficiaries, IRAs or IRA owners
  - The final rule includes broad-based examples of “general communications”
- There are four categories of “investment education” under the new final rule that do not involve fiduciary recommendations: plan information; general financial, investment, and retirement information; asset allocation models; and interactive investment materials
  - The DOL generally retained the principles of Interpretive Bulletin 96-1
- Plan sponsors are considering the applicability of these exceptions when reviewing investment education and distribution materials with their providers in light of each party’s responsibility for its communications

Permissible Rollovers: IRS Rollover Chart

		Roll To							
		Roth IRA	Traditional IRA	SIMPLE IRA	SEP-IRA	Governmental 457(b)	Qualified Plan[1] (pre-tax)	403(b) (pre-tax)	Designated Roth Account (401(k), 403(b) or 457(b))
Roll From	Roth IRA	Yes[2]	No	No	No	No	No	No	No
	Traditional IRA	Yes[3]	Yes[2]	Yes[2,7], after two years	Yes[2]	Yes[4]	Yes	Yes	No
	SIMPLE IRA	Yes[3], after two years	Yes[2], after two years	Yes[2]	Yes[2], after two years	Yes[4], after two years	Yes, after two years	Yes, after two years	No
	SEP-IRA	Yes[3]	Yes[2]	Yes[2,7], after two years	Yes[2]	Yes[4]	Yes	Yes	No
	Governmental 457(b)	Yes[3]	Yes	Yes[7], after two years	Yes	Yes	Yes	Yes	Yes[3,5]
	Qualified Plan[1] (pre-tax)	Yes[3]	Yes	Yes[7], after two years`	Yes	Yes[4]	Yes	Yes	Yes[3,5]
	403(b) (pre-tax)	Yes[3]	Yes	Yes[7], after two years	Yes	Yes[4]	Yes	Yes	Yes[3,5]
	Designated Roth Account (401(k), 403(b) or 457(b))	Yes	No	No	No	No	No	No	Yes[6]

[1]Qualified plans include, for example, profit-sharing, 401(k), money purchase, and defined benefit plans.
[2] Only one rollover in any 12-month period.
[3]Must include in income.
[4]Must have separate accounts.
[5]Must be an in-plan rollover.
[6]Any nontaxable amounts distributed must be rolled over by direct trustee-to-trustee transfer.
[7]Applies to rollover contributions after December 18, 2015. For more information regarding retirement plans and rollovers, visit Tax Information for Retirement Plans.

- Taken from IRS website (https://www.irs.gov/pub/irs-tege/rollover_chart.pdf)

Permissible Rollovers: Challenges

Certain assets are more difficult to recordkeep in rolled-over plans

- Examples of rollover challenges include:
  - After-tax contributions
  - Loans
  - Hardship withdrawals
  - Roth Accounts

Rollovers From The Plan Sponsor's Perspective: DOL Rule Considerations

- Considerations raised by Conflict of Interest Rules for plan distributions, rollovers, transfers and account consolidation include:
  - *Participant inertia* - Without rollover assistance and advice, plan participants may be less likely to take steps toward consolidating their retirement plan accounts, which may negatively impact efforts to facilitate lifetime plan participation
  - *Impact of new rules in "promoting" roll-ins* - If a plan sponsor "promotes" roll-ins in-house, plan sponsor employees have the "employees" exception, but the "newness" of the rule may give reason for pause. Also, when plan sponsors look to outside providers to help promote roll-ins, questions arise about how to structure these relationships in light of the new rules.
  - *Added plan sponsor responsibilities?* - Plan sponsors question what changes will need to be made when communicating to participants to (1) address whether providers will be fiduciaries and if they are – how their roles and responsibilities need to be updated in plan contracts, (2) ensure plan sponsor communications are not fiduciary investment advice and (3) review investment education programs for any needed updates

Transfers/Rollovers From The Plan Sponsor's Perspective

- Other issues with plan to plan transfers and rollovers that may negatively impact efforts to facilitate account consolidation include:
  - ***Some plan sponsors do not accept rollover contributions because of the need to administer the verification process*** – Retirement plans are not required to accept rollover contributions. Those that do must verify reasonable steps to evaluate whether the rollovers are permissible, are eligible roll-over assets and meet the 60-day rollover deadline.
  - ***Added complexity associated with lifetime income options*** – Many sponsors of defined contribution plans do not offer lifetime income options within the plan. Instead, they offer the ability for participants to roll over their account balances to purchase annuities that provide for lifetime income outside of the plan.
  - ***Added complexity associated with certain rollovers*** – As described above, it can be challenging dealing with loan rollovers, Roth rollovers and the rollover of other after-tax accounts.

Transfers / Rollovers From The Plan Sponsor's Perspective: Undesirable Accounts

- Other considerations include:
  - ***Some plan sponsors do not want to administer small account balances*** – The preferred distribution method for small account balances of former employees in many plans is to automatically roll over the amounts to IRAs to get them out of the plan. Sponsors may want to lessen the administrative headaches (e.g., missing and lost participants) and fees (higher fees relative to lower account balances) often attributed to large numbers of accounts with small balances.
  - ***Some plan sponsors do not want to maintain accounts for former employees*** – Some plan sponsors encourage former employees to take distributions or rollovers of their accounts. These sponsors may not want to administer the plan for former employees including to minimize expenses associated with searching for missing participants and beneficiaries and notice and disclosure costs.

Transfers / Rollovers From The Participant's Perspective

- From a participant's perspective, making distribution and rollover decisions can be challenging because of the complexity and overwhelming number of options available
- Participants may find it difficult to assess and adequately compare the fees and costs associated with different alternatives, particularly as it relates to rollovers
- Participants are also hampered by the need to make multiple calls and complete multiple forms to execute distribution and rollover decisions
- Some participants may view transferring their account balances out of employer sponsored plans as (1) easier to facilitate and (2) a less costly option
- The required participant notices (e.g., 402(f) notice) may be confusing or not relevant to participants
- Participants, particularly those who are less sophisticated, rely on guidance from employers and financial service providers to help them make distribution and rollover decisions
- Without guidance and assistance, plan participants may not take action to consolidate their plan accounts

Key Takeaways

- DOL and the Treasury should work together to consolidate guidance and promote the value of plan rollovers and account consolidation to plan sponsors and participants
- Empowering good action by plan sponsors and participants is critical for improving participant retirement outcomes
- Reinforcing some of the exceptions included in the fiduciary rules would provide additional support and needed encouragement for plan sponsors

What Can the U.S. Department of Labor Do To Help?

- ***Issue additional guidance on the "employees" exception to fiduciary status under the DOL Conflict of Interest Rule -*** Under the DOL Conflict of Interest Rule, the exception from fiduciary status exists for plan sponsor employees providing investment advice to participants. Additional guidance, with examples, would help explain the exception, advise plan sponsors on how to meet the exception and support the use of the exception.
- ***Issue additional guidance specifically to support roll ins and account consolidation in light of the DOL Conflict of Interest Rule -*** Guidance in the form of a tip sheet or Q&A could be issued to further advise plan sponsors on how to promote roll ins and account consolidation in compliance with the conflict of interest rule.

What Can the U.S. Department of Labor Do To Help?

- ***Issue additional guidance to clarify the general communication and plan information exceptions -*** DOL could help by providing information that is more plan sponsor-centric to explain the broad range of communications that fall within these exceptions.
- ***Simplify guidance on fee disclosures as it relates to rollovers -*** One of the challenges participants face when making distribution and rollover decisions is how to compare fees of different investment products. Guidance in the form of a tip sheet or model disclosure that plan sponsors can use to provide participant-friendly guidance on fee disclosures as it relates to rollovers would be useful to address this issue.
- ***Provide guidance for advisors on what factors should be taken into account when advising on rollovers and plan transfers -*** Providing clear guidance to advisors will also assist plan sponsors that review these advisors' activities.

What Can the U.S. Department of the Treasury Do To Help?

- ***Promote existing guidance on how to conduct the plan verification process -*** Treasury and the IRS have issued guidance in the form of two examples in Rev. Rul. 2014–9 on how plan sponsors could reasonably conclude that a potential rollover from another plan is valid. Treasury and the IRS have also issued other guidance on rollovers generally. Treasury could consider consolidating this guidance into a single resource and promoting and reinforcing this guidance in public speaking.
  - Treasury could also consider issuing additional guidance to advise plan sponsors on (1) how they can ensure a potential rollover comes from a tax qualified plan beyond looking at the representation made on the transferring plan's latest publicly available Form 5500, and (2) what impact, if any, changes to the IRS determination letter program will have on the verification process going forward.
- ***Revamp 402(f) Notice -*** When a participant is to receive a distribution from a plan, the plan administrator must provide the participant with a 402(f) Notice explaining the rollover rules, describing the effects of rolling an eligible rollover distribution to an IRA or another plan and the effects of not rolling it over, including the automatic 20% withholding.
  - One concern is that the 402(f) Notice may be confusing to participants. Treasury could simplify the notice so that it is easier for participants to understand and include information on their rollover options. The revamped notice could also include language encouraging account consolidation and preventing leakage.

What Can the U.S. Department of Labor Do To Help?

- ***Consider issuing companion guidance to the 402(f) Notice***
  - The 402(f) Notice is lengthy but does not help participants define the universe of distribution options or how to evaluate them.
  - DOL could issue guidance in the form of a model notice to participants that includes a balanced description of distribution options when leaving an employer (leaving the balance with former employer's plan, transferring the balance to new employer plan, rolling into an IRA, or cashing out). The notice could also provide tips or considerations for the participant to consider, such as the negative impact of cash-outs.

Questions?

Biography

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Providing strategic, day-to-day guidance on employee benefits plan matters, Amy Pocino Kelly advises plan sponsors, including public and private companies, tax-exempt organizations, and governmental employers. She counsels these clients on the design, governance, operation, and compliance of qualified and nonqualified retirement plans, equity and executive compensation arrangements, and welfare benefit plans. Amy also represents plan sponsors in audit and correction matters before the US Department of Labor (DOL) and the Internal Revenue Service (IRS).

In addition, Amy counsels clients on plan governance and fiduciary obligations, including investment issues and prohibited transactions. To keep clients in compliance with US federal rules, she helps them identify and correct administration or document failures in accordance with the IRS Employee Plan Compliance Resolution System. She also guides them in analyzing and fixing fiduciary failures under the DOL's voluntary correction program.

Biography

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Marla J. Kreindler advises clients on a broad range of fiduciary governance, regulatory and investment matters impacting sponsors, fiduciaries and service providers to U.S. tax qualified retirement plans. Marla represents and counsels corporate, non-profit and governmental plan sponsors on their institutional retirement plans, as well as major record keepers, consulting and investment management firms, insurance companies, banks and financial firms on managing and investing employee benefit plan assets and tax-qualified retirement plans. She serves as counsel to the Defined Contribution Institutional Investment Association (DCIIA) and is a regular speaker at national industry conferences, including those hosted by DCIIA and Pensions & Investments, before meetings sponsored by the Committee on the Investment of Employee Benefit Assets (CIEBA), the Worldwide Employee Benefits Networks (WEB) and Women Investment Professionals (WIP), at external co-hosted events with other leading providers, and at Morgan Lewis sponsored presentations. Marla has represented clients in matters before the U.S. Department of Labor, the Internal Revenue Service, the Securities and Exchange Commission and other U.S. regulators, has testified in hearings at the Department of Labor and the ERISA Advisory Council and has served as a judge for the Excellence and Innovation Awards sponsored by Pensions & Investments and DCIIA. She has also been recognized as one of 401(k) Wire’s Most Influential People in Defined Contribution.

Marla advises clients on the fiduciary standards and prohibited transaction rules of the Employee Retirement Income Security Act (ERISA) and related tax, banking, securities and state insurance law requirements. She counsels clients on plan governance and fiduciary risk management, and on a wide range of investment products, services and contracting matters that arise in connection with the management and investment of employee benefit plan assets. This includes developing or negotiating plan and trust agreements and related policies and procedures, collective investment trusts, white label investment options, registered investment companies, domestic and offshore private funds, investment management, consulting and outsourcing agreements, administrative services agreements, brokerage agreements, commodities and derivatives documentation and stable value contracts.

Marla has been in private practice since 1987 having joined the Chicago office of Morgan Lewis in 2012. She is a graduate of the University of Michigan (JD) 1987, (BA) 1984.

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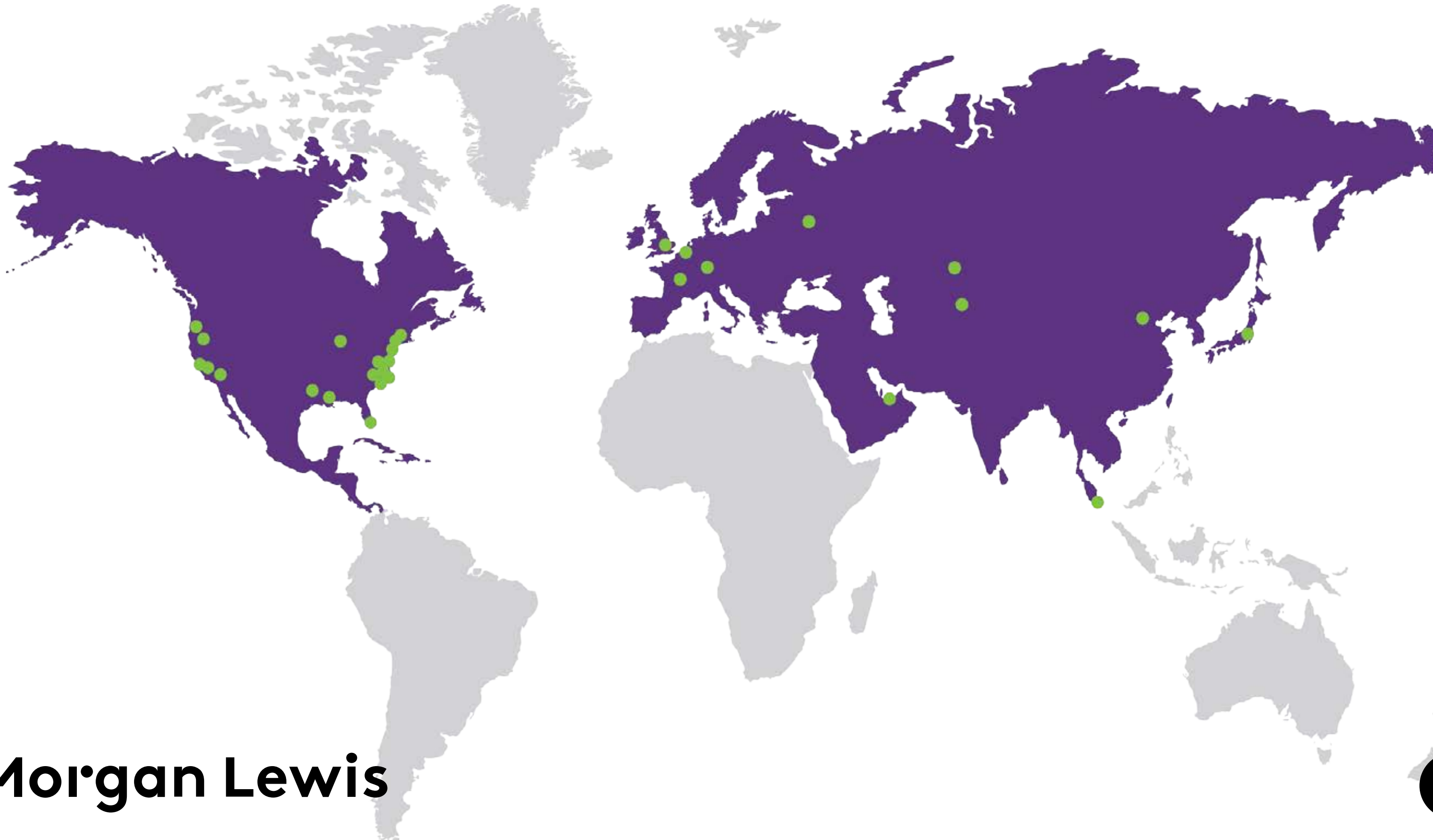

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