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## SEC Finds 'Lots of Problems' With Rollover Advice

By Jill Gregorie May 14, 2018

The DOL fiduciary rule is all but in the rearview mirror, but the SEC is prioritizing rollover retirement advice in its 2018 examinations.

The agency's Office of Compliance Inspections and Examinations considers rollover advice a "perennial issue," and it found "lots of problems" last year when monitoring how broker-dealers and advisors work with clients about to retire, said Daniel Kahl, chief counsel of OCIE's National Exam Program, during a presentation at the **Practising Law Institute's** Investment Management Institute last month.

As a result, the regulator's exam office will continue looking at firms' policies and procedures for rollovers, including checks to see whether brokers and advisors document the reasons for their recommendations, Kahl said.

Regulators have long held concerns about rollovers, since employees' investments are "essentially bubble-wrapped" by Erisa protections, which "impose the highest standard of care on fiduciaries," says Jason Roberts, CEO of the Pension Resource Institute.

Under the Employee Retirement Income Security Act, brokers and advisors need to not only adhere to strict advice standards, but also disclose fees and potential losses, while also avoiding prohibited transactions, Roberts says.

"So you have a very, very strict environment where assets are growing, and then 'poof!' When it's time to distribute, all of that [regulation] goes away," he says.

The losses that can result from bad investment advice during rollovers can be jarring, since some large defined contribution plans have access to institutional share classes and other low-cost options that may have expenses far lower than what investors can get outside of the plan, says Fred Reish, a partner at Drinker Biddle.

Advisors should be able to defend any higher-cost recommendations for clients who roll their money out of such plans and into IRAs, he says.

"If an advisor rolls over money into an IRA, the expense ratio may be 115 bps per year," he says. "What services and what value is an advisor going to provide that makes up for the more than 1% differential in cost?"

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Regulators are also checking that advisors work with clients beyond just a “one and done, I’m going to recommend to you the same thing I did the last 10 people from your employer with a check in their hand,” Roberts says.

The DOL’s fiduciary rule was vacated by court order on May 7, and the agency has communicated that it will not pursue actions against advisors who show a good faith effort to comply with a looser set of impartial conduct standards.

But the DOL could still propose a new rule covering rollovers “down the line,” Roberts says.

As a result, the SEC might step up examinations and enforcement as a way to be seen as a leader on the issue, he says.

The DOL could also revisit a 2005 advisory opinion that found that brokers' and advisors' placing plan participants in an IRA account “does not constitute ‘investment advice’” and does not trigger a fiduciary standard of care, he says.

In the meantime, firms should continue to rely on the policies they implemented ahead of the fiduciary rule’s effective date, such as using “checklists to evaluate what decision might be in the best interest of plan participants,” says Marcia Wagner, managing partner of The Wagner Law Group.

Such a checklist should include an analysis of the investments in the plan and their expenses, the services offered in the current plan compared with those in an IRA and how the client’s financial circumstances align with their projected goals and needs, Reish says.

While the industry can debate the differences between “prudent” and “suitable” recommendations, most policymakers just want brokers and advisors to show that they’ve considered each client’s information and placed them in an appropriate account, he says.

“Legally, the difference between suitability and prudence is meaningful. But in most cases where investors and participants are underserved, it’s because there was no analysis at all,” he says.

Investment providers could do more to help, such as developing lifetime income products alongside insurance providers, as there is a gap in products that help retirees spend down their assets, Reish says.

In 2007, Fidelity introduced “managed payout funds” that were designed to replace income and featured maturity dates in two-year intervals, as reported. Other providers including ING, John Hancock, Pimco, Russell, **Schwab** and Vanguard also launched similar products, but many abandoned or consolidated them when sales fizzled.

“It can be similar to target-date funds — but instead, it’s retirement income funds, designed for 5% to be withdrawn every year and managed so interest and dividends don’t get reinvested but paid out monthly or quarterly,” Reish says.

By making such products, fund firms could help brokers and advisors point to one more service they can provide to rollover clients.

There’s also a place for investment companies to provide informal education for brokers and advisors, Roberts says. Firms that lack policies and procedures will likely lose to claimants in arbitration or to plaintiffs in court, he says. But those that have policies and procedures, and fail to follow them, may end up with worse outcomes, he says.

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“One of the things that could trip up the firm is if they walk in with policies and procedures that say, ‘Do X,’ and that didn’t happen,” he says.

Investment management firms should advise and train distributors on adhering to Erisa, “stopping short of creating potential liability by mandating that this occur at the advisor level or supervisor level,” Roberts says.

The message many distributors have had for investment companies is: “Do not create materials for our advisors,” especially for non-affiliated broker-dealers and independent advisors, Roberts says. Although they may “love value-adds in a normal environment,” concerns mount when those guidelines contradict their sales practices, he says.

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