THE WAGNER LAW GROUP

A Few Hot Topics for Advisors and Plan Sponsors

Steve Wilkes, Esq.

July 23, 2014

Steve Wilkes

- Advise national client base of mutual funds, CIFs, private funds, registered investment advisers, insurance companies, broker dealers, wealth management firms, banks, trust companies, third party platforms and corporate employers on ERISA, tax, and related securities law matters.
- ERISA fiduciary and prohibited transaction counseling on product development, investment services, regulatory compliance and plan asset transactions involving financial service clients and corporate plan sponsors.
- Prepare non-discretionary or discretionary advisory agreements, Form ADV Part 2a and 2b, regulatory disclosures and filings, marketing materials, prospectus, revenue sharing, best investment management practices, CIF advisory and sub-advisory agreements, selling and administrative services agreements, distribution agreements, vendor agreements, compliance manuals and WSP's with emphasis on retirement plan products and services.
- Advise corporate employers on retirement plans, deferred compensation, equity compensation and employment tax related issues.
- Represent clients before DOL, IRS, SEC, and FINRA on retirement plan related matters.

Introduction

- 1. Capturing 401(k) Rollovers
- 2. Lifetime Income Initiatives
- 3. Impact of Healthcare Reform on Retirement Industry

The Regulatory Divide

- **Portability of 401(k) Accounts**
  - Participants may roll over accounts upon termination of employment.
  - Rollover IRAs provide investment flexibility.
- **Services Offered by Advisors**
  - Plan Services for plan sponsor.
  - Plan Services for participants.
  - Rollover IRA Services for participants.

Restrictions Under ERISA

- **ERISA and Advisor's Services**
  - Advisor's ability to offer Plan Services and Rollover IRA Services is restricted.
- **Possible Solutions**
  - Stop offering Rollover IRA Services.
  - Adopt service model which allows Advisor to offer Rollover IRA Services.

Potential Abuses of Cross-Selling

- **Issues Arising from Cross-Selling**
  - Potential conflicts of interest.
  - Exploiting trust to sell at unfavorable terms.
- **Capturing Rollover Assets**
  - Advisor develops relationships with plan sponsor and participants.
  - Potential conflict if Advisor's fees on rollover assets are higher than fees on plan assets.

DOL Guidance

- **“Potential for Abuse”**
  - Policy concern for DOL.
  - DOL has issued interpretive guidance for cross-selling of Rollover IRA Services.
  - Starting point is ERISA’s general prohibition against self-dealing.

Prohibited Transaction Rules

- **Prohibition Against Self-Dealing**
  - ERISA Section 406(b) and mirror IRC provision.
  - Advisor cannot provide fiduciary advice that increases Advisor’s compensation.
- **Example**
  - Advisor’s fiduciary advice steers participants to fund with highest 12b-1 fee.
  - Advice is tainted even if provided in good faith.

DOL Rollover Option

- **Advisory Opinion 2005-23A**
  - Broadly suggests that if Advisor is fiduciary, any rollover advice to participants may trigger PT.
  - DOL does not fully explain reasoning.
  - If Advisor is not fiduciary, rollover advice will not trigger PT.

DOL-Related Concern for All Advisors

- **Advisors Appointed as Fiduciaries**
  - DOL Rollover Opinion seems to say they cannot capture rollover assets.
- **All Other Advisors**
  - If Advisor provides “accidental” fiduciary advice, Advisor becomes fiduciary.
  - Therefore, all Advisors may become subject to restrictions in DOL Rollover Opinion.

Definition of Investment Advice

- **You provide "investment advice" if:**
  - Individualized investment advice is provided on regular basis; and
  - It serves as primary basis for plan decisions.
- **Advisors and Investment Advice**
  - Many Advisors hope their advice does not meet ***regular basis*** and ***primary basis*** conditions.
  - But Advisors may become "accidental" fiduciaries as contact with plan sponsor increases.

The Wagner Law Group

Critical Supreme Court Guidance

- **Varity Corp v. Howe (1996 Supreme Ct.)**
  - Cited in DOL Rollover Opinion.
  - Court rules that same person may operate in fiduciary and non-fiduciary capacities.
  - Legal analysis also applies to Advisors and Rollover IRA Services.
- **Game Plan**
  - Advisor is clearly acting in non-fiduciary capacity when offering Rollover IRA Services.
  - Consistent with Varity Corp decision.

Core Analysis <u>in Varity Corp</u>

- **Factual Background for Case**
  - Employer transfers money-losing division to subsidiary.
  - Falsely communicates that benefits are secure.
  - Benefits forfeited after subsidiary goes bankrupt.
- **Was Employer Acting as a Fiduciary?**
  - Employer argues its communications to employees were not fiduciary acts.
  - Court disagrees.

Three-Factor Test from <u>Varity Corp</u>

- **Court examines 3 key factors:**
  - <u>Factual context</u> of communication.
  - <u>Plan-related authority</u> of person providing communication.
  - <u>Plan-related nature</u> of communication.
- **Applicability to Advisors**
  - Need to ensure 3-Factor Test is met by Advisors when offering Rollover IRA Services.

Meeting the 3-Factor Test

- **Rollover Communications**
  - Manner and content must satisfy all 3 factors.
- **<u>1st Factor</u>: Factual Context**
  - Non-plan related setting.
  - Refrain from promoting Rollover IRA Services at Plan meetings.
  - Offer Rollover IRA Services at one-on-one meetings with participants.

The Wagner Law Group

Meeting the 3-Factor Test *(cont'd)*

- **2nd Factor: Plan-Related Authority**
  - Request written confirmation letter from plan sponsor.
  - Letter confirms that Advisor's Rollover IRA Services are unrelated to Plan Services.
- **3rd Factor: Plan-Related Nature**
  - Request written acknowledgment from participant.
  - Acknowledgment form explains that Rollover IRA Services are not a plan fiduciary service.

Document-Related Issues

- **Plan Sponsor/Participant Will Not Sign**
  - Advisors appointed as fiduciaries should not offer Rollover IRA Service.
  - All other Advisors may offer Rollover IRA Service if certain that there has been no fiduciary advice.
  - Protection of written forms necessary for Advisors acting as fiduciaries.

Procedural Guidelines

1) **Discussion of Rollovers at Plan Meetings**
   - Advisor may discuss availability of rollover distributions, but not advisability.
2) **Promotion of Rollover IRA Services**
   - Limit promotion of Rollover IRA Services at Plan meetings.
   - Do not indicate that Rollover IRA Services are part of Plan Services.

THE WAGNER LAW GROUP

Procedural Guidelines *(cont'd)*

3) **Offering Rollover IRA Services**
   - Make offer at one-on-one meeting with participant, but not at Plan meetings.

4) **Meeting with the Plan Sponsor**
   - Ask plan sponsor to sign written confirmation letter.
   - Plan sponsor should not endorse Advisor's Rollover IRA Services to participants.

Procedural Guidelines *(cont'd)*

5) **Meeting with Participant**
   - Ask participant to sign written acknowledgment form.
   - Do not suggest that participant is obligated to work with Advisor as part of Plan Services.

6) **Confirmation Letter for Plan Sponsor**
   - If sponsor refuses to sign, do not offer Rollover IRA Services if fiduciary advice has been provided.

Procedural Guidelines *(cont'd)*

7) **Acknowledgment Form for Participant**

- If participant refuses to sign, do not offer Rollover IRA Services if fiduciary advice has been provided.

Conclusions

- **Advisors and Rollover IRA Services**
  - May offer Rollover IRA Services consistent with procedural guidelines.

- **Purpose of Procedural Guidelines**
  - Factual context is non-plan related setting.
  - Rollover IRA Services are not offered under Advisor’s authority to provide Plan Services.
  - Participant understands non-plan related nature of Advisor’s offer.

Conclusions *(cont'd)*

- **Advisors Appointed as Fiduciaries**
  - Should follow procedural guidelines carefully.
- **All Other Advisors**
  - Should also strongly consider following procedural guidelines as "best practices" matter.
  - Any Advisor may become an accidental fiduciary.

Important Information

- The legal analysis of the rollover issue and the related information presented is intended for general informational purposes only.

- It does not constitute legal, tax or investment advice on the part of The Wagner Law Group.

- Future case law or other legal and regulatory developments may impact the analysis and information presented.

Hot Topics

- 1. Capturing 401(k) Rollovers
- 2. Lifetime Income Initiatives
- 3. Impact of Healthcare Reform on Retirement Industry

Goals of Policymakers

- Help retirees take plan distributions without outliving them
  - Motivate retirees to annuitize accounts
  - Retirement paycheck for life

- Encourage plan sponsors to voluntarily offer annuity options
  - Permit longevity annuities
  - Remove regulatory hurdles
  - Facilitate default annuities
  - Promote education and disclosures

Lifetime Income Solutions for DC Plans

- Three Basic Approaches
  1) External Solution (Outside of Plan)
  2) Distribution Option Within Plan
  3) Investment Vehicle Within Plan

- External Solution
  - Participants purchase IRA Annuities.
  - Annuitization occurs outside of plan through rollovers.
  - Internet portals can improve participant access.

“In Plan” Lifetime Income Solutions

- Distribution Option Within Plan
  - Plan purchases <u>Distribution Annuities</u>
  - Immediate annuity purchased at time of distribution
  - Annuity contract is distributed to participant

- Investment Vehicle Within Plan
  - Plan invests in <u>Group Annuity</u>
  - Offers various investment and distribution options
  - Participant’s account converted to lifetime income

Comparison of Retirement Income Strategies

	Guaranteed Income?	Access to Cash In Retirement?
Systematic Withdrawals	**No**	**Yes**
Managed Payout	**No**	**Yes**
Distribution Annuities	**Yes**	**No**
Group Annuity (Traditional)	**Yes**	**No**
Longevity Insurance	**Partial**	**Partial**
GLWB (Group Annuity)	**Yes**	**Yes**

Guaranteed Living Withdrawal Benefit (GLWB)

- **Guaranteed Withdrawal**
  - Guaranteed percentage of "Benefit Base" may be withdrawn annually during retirement years.
  - Guarantee takes effect when account's investment value is insufficient to cover guaranteed withdrawals.

- **Benefit Base**
  - Initial value is based on contributions.
  - Future value may "roll up" by fixed percentage each year, or "step up" based on anniversary value of account.

THE WAGNER LAW GROUP

Need for Additional Fiduciary Guidance

- Selection of Annuity Provider and Annuities
  - Subject to ERISA fiduciary standards.
  - Must act in accordance with duty of prudence and loyalty.
- Existing DOL Guidance
  - 1995 guidance on Distribution Annuities for DB plans.
  - 2008 safe harbor on Distribution Annuities for DC plans.
  - No clear guidance on other annuities for DC plans.

Current Fiduciary Standard for Annuities

- DC Plans and Lifetime Income
  - Lack of clear guidance has not stopped DC plan sponsors (e.g., United Technologies adds GLWB annuity option)

- Selection of Annuity Provider and Annuities
  - Subject to ERISA fiduciary standards.
  - Act in accordance with duties of prudence and loyalty
  - 2008 DOL safe harbor on Distribution Annuities for DC plans:

1. Procedural prudence
2. Insurer's ability to pay
2. Cost
4. Draw appropriate conclusions
5. Seek expert advice

THE WAGNER LAW GROUP

First Step in Annuity Selection (Procedural Prudence)

- Engaging in Objective, Analytical Process
  - Prudence of fiduciary act is based on process
  - Must conduct appropriate investigation of annuity investment
- Documentation of Selection Process
  - Maintain minutes of fiduciary reviews
  - Records for ongoing monitoring

THE WAGNER LAW GROUP

2nd Step for Annuity Selection (Insurer's Ability to Pay)

- Obtaining Sufficient Information
  - Insurer's experience and expertise
  - Level of capital
  - Ratings
  - Contract's structure and benefit guarantees
  - Protection through state guaranty associations
- DOL Proposal
  - Proposed amendment to DOL safe harbor

3rd & 4th Steps for Annuity Selection (Cost and Appropriate Conclusions)

- Considering Annuity’s Cost
  - Cost considered in relation to benefits and services.
  - Evaluate fees, commissions and other charges.
  - No requirement to select cheapest annuity.
- Drawing Informed Conclusions
  - Conclude insurer will be able to make future payments.
  - Conclude annuity’s cost is reasonable.

5th Step for Annuity Selection (Seeking Expert Advice)

- Necessity of Hiring Expert
  - Must hire expert if plan fiduciary cannot properly evaluate annuity providers, contracts and costs.
- Procedure for Hiring Insurance Advisor
  - Investigate advisor’s qualifications.
  - Identify advisor’s compensation.
  - Provide complete information to advisor.
  - Ensure reliance on advisor’s advice is reasonable.

QDIA Considerations & Group Annuities

- Investment Requirement for QDIA
  - Must be balanced or target date strategy

- Special Rule for Group Annuity
  - QDIA may be offered through group annuity
  - Investment guarantees (*e.g*., GLWB) permitted
  - GLWB option must meet QDIA investment requirement

The Wagner Law Group

Removing Regulatory Obstacles to Annuity Distributions

- Rollovers to DB Plans
  - Rev. Rul. 2012-4
  - 401(k) accounts may be rolled over and converted to DB plan annuity benefits
  - Provides favorable annuity rates for participants
- Relief for DC Plans With Deferred Annuities
  - Rev. Rul. 2012-3
  - Ruling confirms 401(k) plans with deferred annuities can avoid onerous death benefit rules

Promoting Longevity Annuities

- IRS proposal would relax required minimum distribution rules
  - RMD rules mandate start at age 70 ½ but longevity annuities provide income stream for later in life

- Proposed Regulations.
  - Exception from RMD rules for investment in longevity annuity
  - Investment capped at $100,000 or 25% of account
  - Must start no later than age 85

Default Annuities

- Should annuity option be default for plan?
- Possible Approach: Amend QDIA Rules
  - Permit annuity option to qualify as QDIA.
  - Critics argue annuities not appropriate for all.
  - Default annuity investments not easily reversed.
- Possible Approach: 2-Year Trial Period
  - Retirees receive annuity during trial period (unless opt out).

Education and Disclosures for Participants

- GAO Recommendations
  - Update DOL's "investment education" guidance to cover decumulation
  - But DOL is concerned about conflicts
  - Guidance likely to restrict sales pitches
- Lifetime Income Disclosure Act
  - Plan to show account balances converted into guaranteed monthly amount
  - Encourages participants to think about retirement paycheck for life

DOL Proposal for Lifetime Income Disclosures

- **Advance Notice of Proposed Rulemaking**
  - Lifetime income illustration in participant statements
  - Must provide estimated income streams based on (1) current account and (2) projected account at NRA
- **Safe Harbor for Projected Account**
  - Assume 7% investment return
  - Assume current contribution level, with 3% increase
  - Use 3% discount rate to convert to current dollars

Lifetime Income Illustrationc

- **Illustration for 50-Year Old Participant**

	Account Balance	Estimated Monthly Lifetime Payment
Current Account (2014)	$125,000.00	$ 700.00
Projected Amount (2029)	$500,000.00	
Projected Account (Current Dollars)	$321,000.00	$1,800.00

- **Required Disclosures/Disclaimers**
  - Explanation of assumptions
  - Estimates are not benefit guarantees

The Wagner Law Group

Hot Topics

- 1. Capturing 401(k) Rollovers
- 2. Lifetime Income Initiatives
- 3. Impact of Healthcare Reform on Retirement Industry

Effect of PPACA on Employees

- Earlier plan distributions, because employees will not be tied to their jobs in order to maintain health insurance
  - New investment and liquidity strategies needed
- Older generation of workers to be replaced more quickly by younger less experienced employees
  - Lower salaries will result in smaller plan contributions
  - Some industries could experience higher pay and larger contributions
  - New generation will be less vested making plans less expensive
- Low-paid workers will choose health insurance over 401(k) contributions
  - ADP/ACP problems and issues with discrimination testing may result

Effect of PPACA on Employers

- PPACA-mandated healthcare benefits likely to reduce level of employer support for 401(k) plans
  - Knock on effect of smaller match; smaller employee contributions
  - Shrinking employee contributions exacerbates discrimination issues

- PPACA disincentive to maintain 401(k) plan
  - $3000 per head penalty for unaffordable health insurance avoided if cost of single-person coverage not in excess of 9.5% W-2 wages
  - 401(k) reduction of wages makes avoiding penalty harder

- PPA 90-day rule for health plan availability can compromise overall plan administration
  - Delay greater than 90 days for entry into <u>al</u>l benefit plans no longer possible
  - May necessitate enrollment at different times

PPACA Effect on Retirement Industry

- Increased competition in healthcare marketplace
  - Government-regulated exchanges
  - Reduced brokers' commissions
  - Potential expansion of healthcare brokers into retirement plan industry

- New legislatively-mandated retirement plan models
  - Reduces/eliminates role of employer
  - Marketing focus redirected to employees

Next Webinar

Update on Select Advisers Act and FINRA Issues

September 10, 2014

1 p.m. PT, 4 p.m. ET

The Wagner Law Group

THE WAGNER LAW GROUP

Steve Wilkes, Esq.

THE WAGNER LAW GROUP
A PROFESSIONAL CORPORATION

315 Montgomery Street, Suite 904
San Francisco, California 94104
Tel: (415) 625-0002
swilkes@wagnerlawgroup.cpm
Website: www.wagnerlawgroup.com