

Client Alert

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Retirement Funds Rollovers: FINRA Ends 2013 By Identifying Its First 2014 Priority

By Daniel A. Nathan

It is the end of the year, and many people are thinking about the status of their retirement accounts and planning any changes to their investments. FINRA also has retirement accounts on the brain. It is thinking about the ways member firms *recommend* investments in retirement accounts, and planning what to do about *that*.

FINRA recently issued [Regulatory Notice 13-45](#), giving notice that one of its examination priorities in 2014 will be reviewing firm practices when recommending a rollover of assets from an employer-sponsored retirement plan to an IRA.

THE SECURITIES RECOMMENDATION

According to FINRA, when a participant in an employer-sponsored 401(k) retirement plan changes employers, he or she has four options:

- leave the money where it is;
- roll the assets to the new employer's plan (if possible);
- roll the assets over to an IRA (by far the largest source of contributions to IRAs); or
- cash out the account, which could have tax penalties and unfavorable tax treatment if the employee is under 59½ years old.

When making this decision, many investors seek the advice of a financial advisor, who may be a registered representative of a broker-dealer. If a broker-dealer recommends that an investor roll over retirement plan assets to an IRA, or otherwise engages in marketing IRAs, it typically makes securities recommendations. These activities are subject to FINRA rules.

THE RELEVANT CONSIDERATIONS

The Notice lists the following considerations relevant to any recommendation to roll over assets from a 401(k) plan to an IRA:

- an increased range of investment options available under an IRA (although FINRA notes that a 401(k) plan's more limited options might be preferable if they include low-cost institutional funds);
- the amount of the expenses and fees charged by the 401(k) plan versus any IRAs under consideration;
- availability of services – such as investment advice or brokerage services – under each option;

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- whether 401(k) plan participants have a greater ability to withdraw funds without penalty or to borrow funds;
- whether there are greater protections from creditors available to 401(k) plan assets versus IRA assets;
- the fact that the required minimum distribution at age 70½ generally does not apply to 401(k) plan participants if they are still working; and
- any adverse tax consequences of rolling appreciated employer stock held in a plan to an IRA. For example, stock appreciation generally will be taxed as ordinary income upon distribution. On the other hand, there may be long-term advantages to liquidating that stock and rolling over the value to an IRA, where greater diversification is generally available.

FINRA'S CONCERNS

In the Notice, FINRA voices its full range of sales practice concerns with respect to rollover recommendations. These familiar issues are likely to appear in any consideration of these recommendations in examinations during the coming year:

- **Conflicts of Interest** – the economic incentives all favor brokers who recommend a rollover, versus those who tell a 401(k) holder to stay put. Similarly, an investment adviser stands to earn an asset-based fee if the investor rolls over his assets.
- **Suitability** – to the extent their recommendation involves securities, a broker-dealer and its registered representatives must have a reasonable basis to believe that the recommendation is suitable for the customer, taking into account the considerations listed above. If a firm provides educational information to 401(k) plan participants regarding their retirement choices, but prohibits recommendations, the Notice admonishes firms to make sure that their educational materials do not cross the line into recommendations, since that would trigger their suitability obligations.
- **Supervision** – a firm's procedures should be designed to ensure, among other things, that brokers perform customer-specific suitability analyses, and that marketing materials are fair and balanced.
- **Training** – a firm's representatives who recommend rollovers should be trained concerning retirement savings options, and the relevant considerations in rollover decisions.
- **Communications** – marketing materials or oral statements must be fair and balanced, and cannot imply that a retiree's only sound choice is to roll over retirement plan assets to an IRA. Moreover, communications cannot misrepresent the fees or expenses associated with a rollover, and must fairly compare the benefits of an IRA to those of other options.

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2014 EXAMINATIONS

Based on the content – and timing – of FINRA’s Regulatory Notice, it is fair to predict that examiners will review this area by looking at the following:

- **IRAs opened through transfer of funds from 401(k) plans:** once FINRA examiners identify those transactions, they are likely to apply this analysis to a sample of those transactions:
 - Was the transfer suitable from a tax, expense and investment objective standpoint, among other things?
 - What representations were made by the registered representative to the customer to induce the transfer?
- **Marketing materials:** Are they fair and balanced with respect to the fees and expenses attributable to transfers, and do they provide advantages of all the options available to a retiree?
- **Written supervisory procedures:**
 - Do they provide for review of new IRAs and transfers of funds into IRAs with the relevant considerations in mind?
 - Do they identify conflicts of interest inherent in rollover recommendations, and provide for heightened supervision to mitigate those conflicts?
 - Are the firm’s brokers trained as to the considerations relevant to rollovers?

RECOMMENDATION

As with any other “priority” issue identified by FINRA, we recommend that firms review their transactions, communications, and procedures to determine whether there are any issues that need to be addressed before FINRA discovers them.

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