RETIREMENT MANAGEMENT SYSTEMS

The ERISA Advantage of Savings Plan Management

Clearing the Path to an Integrated Investment Solution for Both 401(k) Accounts and Rollover Assets

A White Paper Prepared by The Wagner Law Group
On Behalf of Retirement Management Systems, Inc. (RMS)

Important Information: This white paper is intended for financial advisors with individual investor clients as well as financial advisors serving as the broker of record for their plan clients. It does not address arrangements in which the financial advisor is advising an in-house plan or providing fiduciary advice to the sponsor of a third party plan. Future legislative and regulatory developments may significantly impact the legal analysis provided herein. Please be sure to consult with your own legal counsel concerning such future developments and the nature and scope of your responsibilities under ERISA and other applicable law. This white paper is intended for general informational purposes only, and it does not constitute legal, tax or investment advice on the part of The Wagner Law Group or Retirement Management Services, Inc. and its affiliates.

Executive Summary

Many people need help managing their investment portfolios, which often include tax- deferred savings in 401(k) plan accounts and other similar retirement vehicles (the "401(k) Accounts"). In many instances, the 401(k) Accounts represent the largest segment of the investor's portfolio. Ironically, financial advisors are often reluctant to give any meaningful advice with respect to 401(k) Accounts for fear that their advice will turn them into "fiduciaries" under the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

No Fiduciary Cross-Selling. Fiduciary status under ERISA triggers burdensome requirements. For example, if a financial advisor were willing to advise an individual on how to invest his or her 401(k) Account in a fiduciary capacity, due to the prohibitions against fiduciary cross-selling under ERISA, the financial advisor generally would be unable to provide any meaningful assistance when it came time for the individual to roll over the 401(k) Account balance to an individual retirement account ("IRA").

The "Advice Gap" Problem. Unfortunately, even inadvertent violations of the fiduciary rules under ERISA may result in substantial legal liability under ERISA. As a result of this problem, when advising individuals on their personal investment portfolios, many financial advisors are unwilling or unable to implement an integrated investment strategy that properly covers both 401(k) Accounts, rollover assets and non-plan investments. Conversely, if a financial advisor were to provide any fiduciary advice to investors on their 401(k) Accounts, ERISA would generally prohibit the advisor from providing any advice on rollover distributions from the 401(k) Account.

Bridging the Gap With Participant Advice. The resulting "advice gap" in the coverage of personal investments in 401(k)-style plans is an unintended consequence of ERISA. However, a participant-level advice program, such as the Savings Plan Management program sponsored by Retirement Management Systems, Inc., can help bridge this advice gap, giving financial advisors the flexibility to offer an integrated investment solution. Under this approach, advisors can seamlessly assist individuals with all segments of their investment portfolio, including their 401(k) Accounts and rollover assets.

The ERISA Advantage. The Savings Plan Management program provides a robust solution to the "advice gap" problem, by giving the financial advisor the ability to offer a tailored investment solution for an individual's 401(k) Account, without having to take on a fiduciary role. Financial advisors are, therefore, able to provide valuable assistance to participants and also provide rollover advice if and when they take plan distributions. Those financial advisors who are also serving as the broker of record for the plan client can also continue to earn any 12b-1 fees or other variable compensation payable through the plan's investments. Thus, the Savings Plan Management program is able to give financial advisors the necessary flexibility to deliver an integrated investment solution for an individual investor's entire portfolio, including the 401(k) Account and rollover assets.

A Need for an Integrated Investment Solution

Financial advisors are often reluctant to give any meaningful advice with respect to 401(k) Account investments for fear that their advice will turn them into fiduciaries for purposes of ERISA. Although the relevant rules under ERISA are based on a complex regulatory framework, financial advisors typically have a fundamental awareness of the fact that they will become subject to the fiduciary standards of ERISA if they hold themselves out as fiduciaries to clients when advising them on how to invest their 401(k) Accounts. They are also becoming increasingly aware of the DOL's position on cross-selling to plan participants, and the fact that providing any fiduciary services to plan participants will generally prevent them from providing rollover advice as they exit the retirement plan.

Due to this reluctance to take on a fiduciary role, many financial advisors are unable to implement an integrated investment strategy that properly covers both 401(k) Accounts, rollover assets and non-plan investments. Conversely, if a financial advisor were to provide any fiduciary advice to investors on their 401(k) Accounts, ERISA would generally prohibit the advisor from providing any advice on rollover distributions from the 401(k) Account. Thus, even if a financial advisor were willing to serve as a plan fiduciary, he or she would still be unable to implement an integrated investment solution for the individual investor.

The Regulatory Hurdles Under ERISA

The "Functional Fiduciary" Test. As a legal matter, the test for determining whether a financial advisor is a "fiduciary" for ERISA purposes is a functional one. If a person acts or possesses fiduciary-like powers, the person will be deemed a fiduciary even if the person has not been formally appointed on behalf of the plan to serve as the plan's fiduciary. Rendering "investment advice" for compensation within the meaning of ERISA Section 3(21) and the related regulations issued by the U.S. Department of Labor[1] (the "DOL Regulations") is clearly viewed as a fiduciary activity, which automatically causes the person providing such advice to be viewed as a plan fiduciary.

"Investment Advice" Definition. For purposes of the DOL Regulations, "investment advice" is generally defined to include any individualized advice concerning plan investments in securities or other property, where there is a mutual understanding that the advice will be provided to the plan client on a regular basis and that it will serve as the primary basis for the plan client's investment decisions. If a financial advisor limits his or her investment guidance to non-individualized "investment education" only (e.g., sample asset allocation for a conservative investor), fiduciary status may be avoided. In fact, a large number of financial advisors offer generic education only when assisting participants with the investment of their 401(k) Accounts, ultimately forcing the individual participants to make their own specific investment allocation decisions.

[1] Section 2510-3.21(c) of the DOL Regulations

The "Advice Gap" Caused by ERISA

In many instances, individuals want to know exactly how they should allocate their 401(k) Account across the plan's menu of designated investment options, and they will pressure their financial advisor to provide what amounts to fiduciary advice. However, a large number of financial advisors are unwilling or unable to accept the responsibilities associated with being an ERISA fiduciary, the key reasons for which are discussed below. As a result of this problem, non-fiduciary advisors will "walk a fine line" where they will attempt to satisfy an investor's investment needs concerning his or her 401(k) Account by providing non-fiduciary education only, and resisting any pressure to provide individualized advice on plan investments at all costs. Consequently, the fiduciary advisor will not implement an integrated investment strategy that properly covers both personal assets as well as 401(k) Accounts.

Conversely, in cases where the financial advisor provides fiduciary advice to individual investors on their 401(k) Accounts, the fiduciary advisor will generally be unable to provide meaningful rollover assistance to them as they exit the retirement plan for the reasons discussed below. Because the restrictions under ERISA appear to force financial advisors and their clients to choose between advice on 401(k) Accounts on the one hand, and advice on rollovers from the 401(k) Accounts, a "damned if you do, damned if you don't" dilemma arises. Even if the financial advisor is willing to serve as a fiduciary, the advisor is still unable to provide an integrated investment solution that covers both 401(k) Accounts and rollover assets.

Key Reasons for Avoiding Fiduciary Status

Plan Fiduciaries Cannot Give Rollover Advice. If a financial advisor provides any fiduciary investment advice concerning an individual's 401(k) Account, the restrictions under ERISA's prohibited transaction rules will effectively stop the advisor from providing any meaningful assistance when the individual rolls over the 401(k) Account to an IRA. The prohibited transaction rules specifically preclude fiduciaries from engaging in any type of self-dealing. ERISA Section 406(b)(1)[2] provides that a plan fiduciary must not deal with the assets of the plan in the fiduciary's own interest. ERISA Section 406(b)(3)[3], which is also known as the "anti- kickback" rule, provides that a plan fiduciary must not receive any consideration from a third party in connection with a transaction involving plan assets.

The DOL has issued detailed guidance under these prohibited transaction rules, addressing how financial advisors can and cannot advise participants on rollovers from the plan to an IRA. DOL Advisory Opinion 2005-23A (the "Advisory Opinion") states that a financial advisor who is a fiduciary cannot talk to participants about the advisability of taking a distribution from the plan or reinvesting the proceeds in a rollover IRA. If such financial advisor were to do so, any

[2] ERISA Section 406(b)(1) provides that a fiduciary with respect to a plan shall not "deal with the assets of the plan in his own interest or for his own account." A parallel excise tax provision is included in Section 4975 of the Internal Revenue Code of 1986, as amended (the "Code")

[3] ERISA Section 406(b)(3) provides that a fiduciary with respect to a plan shall not "receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan." Mirror excise tax provisions are included in Section 4975 of the Internal Revenue Code of 1986, as amended (the "Code")

resulting compensation generated by the rollover investments would trigger a violation of the prohibitions against self-dealing under ERISA.[4]

For example, if a fiduciary advisor were to advise a participant to roll over his 401(k) Account to an IRA, any resulting advisory fee earned by the advisor on the IRA assets would violate the self-dealing prohibitions under ERISA Sections 406(b)(1). If the advisor were to earn 12b-1 fees on any mutual fund investments made by the IRA, the rollover transaction would also violate the anti-kickback rule under ERISA Section 406(b)(3). The penalties for violating these rules are severe, imposing personal liability on the financial advisor for any losses sustained in connection with the fiduciary breach, a 20% civil penalty, as well as a "first tier" excise tax penalty of 15% and a "second tier" excise tax penalty of 100% of the amount involved.

On the other hand, in the case of a financial advisor who is not a fiduciary, the Advisory Opinion states the advisor may freely provide advice to participants for a fee regarding when the participant should take a distribution and how the resulting proceeds should be invested in a rollover IRA. Based on the DOL's analysis, a financial advisor who does not otherwise provide fiduciary investment advice with respect to a plan, would not be deemed a fiduciary merely by virtue of his or her advising plan participants to roll over their accounts to IRAs, and such advice would not be subject to the restrictions under ERISA's prohibited transaction rules.

Plan Fiduciaries Cannot Receive Variable Compensation.5 If a financial advisor provides any fiduciary investment advice concerning an individual's 401(k) Account, due to the restrictions under ERISA Section 406(b)(1), such fiduciary advisor must not earn any compensation that varies with any resulting investment decisions made on behalf of the 401(k) Account ("Variable Compensation"). This self-dealing restriction is absolute in that the mere existence of Variable Compensation in the advice arrangement will trigger a violation of ERISA, even if the actual advice provided is given in good faith and is of the highest quality.

For example, if a financial advisor serves as the broker of record for a 401(k) plan, the advisor may receive 12b-1 fees and other revenue sharing payments ("12b-1 Fees") through the plan's mutual fund investments. Such 12b-1 Fees would constitute Variable Compensation to the extent that the payment level from any particular mutual fund in the plan's menu differed from the payment level from any other fund in the menu. Fortunately, so long as the advisor only provides non-fiduciary education to the participants, no investment guidance to the participants would trigger a violation of the prohibited transaction rules under ERISA.

However, if the advisor in this example were to provide fiduciary advice to the participants relating to how they should allocate their 401(k) Accounts across the plan's menu of funds, such advice would trigger a fiduciary breach under ERISA. The mere fact that the advisor has the potential ability to steer participants to the funds with the highest 12b-1 Fees would be sufficient to trigger a violation of the prohibited transaction rules, and the fact that any actual advice was provided to participants in good faith would not serve as an adequate defense under ERISA.

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[4] ERISA Section 406(b) and Code Section 4975

[5] ERISA Sections 409(a) and 502(l), and Code Section 4975

ERISA Advantage for Savings Plan Management

The Savings Plan Management program addresses the "advice gap" caused by ERISA, arising from the fact that financial advisors generally cannot provide meaningful, individualized advice to participants without becoming subject to the stringent fiduciary requirements under ERISA. As discussed above, the key reasons for trying to avoid fiduciary status are two-fold: (1) fiduciary advisors cannot give rollover advice, and (2) fiduciary advisors cannot receive Variable Compensation through the plan's investments.[6]

The regulatory advantage under ERISA for financial advisors advising individual investor clients through Savings Plan Management, as further discussed below, is that they are able to offer fiduciary advice for their 401(k) Accounts and also provide rollover advice to these investors if and when they take plan distributions. With regard to those financial advisors who are also serving as the broker of record for the plan, they are able to meet the needs of plan participants seeking individualized assistance and also continue to receive any Variable Compensation payable through the plan's investments.

Savings Plan Management clears the path for these financial advisors, enabling them to deliver a truly complete and integrated investment solution for an individual investor's entire portfolio of plan and non-plan investments.

Non-Fiduciary Role of Advisors

From an ERISA perspective, the Savings Plan Management is able to provide a robust solution to the "advice gap" problem through the deliberate and effective allocation of responsibilities between the financial advisor and Retirement Management Systems (RMS).[7]

Role of Retirement Management Systems Inc. The Savings Plan Management program is specifically designed to assist any individual participant who would prefer to engage a prudent investment expert to manage his or her 401(k) Account. RMS, an investment adviser registered under the Investment Advisers Act of 1940 (the "Advisers Act"), is responsible for researching the various investment options available to the 401(k) Account, and developing an appropriate investment strategy based on one of the seven investment strategies available in the Savings Plan Management program, covering a range of risk and return characteristics from conservative to aggressive. RMS is also responsible for implementing the investment strategy agreed upon by the individual investor, and reallocating and rebalancing the 401(k) Account from time to time based on RMS's investment methodology. By virtue of its limited discretionary investment authority over an individual's 401(k) Account, RMS is automatically deemed to be an ERISA fiduciary with respect to the applicable retirement plan.

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[6] This white paper does not address arrangements in which the financial advisor is advising an in-house plan or providing fiduciary advice to the sponsor of a third party plan.

[7] Under Section 3(21) of ERISA, a person will automatically be deemed a fiduciary if the person exercises any discretionary authority or discretionary control respecting the management or disposition of plan assets. As discussed above, a person will also be deemed a fiduciary if the person renders investment advice for a fee or other compensation, direct or indirect, with respect to plan assets

Role of Financial Advisor. Financial advisors serve an important role under Savings Plan Management. They assist individual investors by introducing them to the program, coordinating with RMS on their initial enrollment in Savings Plan Management, helping investors select an appropriate investment strategy from those available, and contacting investors from time to time to review the investment allocations for their 401(k) Accounts. The individual investor must enter into a written agreement with RMS for Savings Plan Management (the "Program Agreement"). Thus, the financial advisor does not have the authority to unilaterally engage or terminate RMS's services without the individual client's written approval. The Program Agreement provides that the individual client acknowledges that he or she has, independently and without reliance upon RMS or the financial advisor, made his or her own decision to enter into the Program Agreement based on such documents and information as he or she has deemed appropriate.

As co-providers of the applicable services under Savings Plan Management, RMS and the financial advisor share the fee, which is typically payable from the personal, non-plan assets of the individual investor. The gross amount of the fee is level and does not vary with the investment allocation decisions made by RMS on behalf of the 401(k) Account. Similarly, the net portions of the fee payable to the financial advisor and retained by RMS, respectively, are level amounts that do not vary with the investment allocation decisions made by RMS for the 401(k) Account. In order to participate in the Savings Plan Management program, the financial advisor must be the professional equivalent of an investment adviser representative ("IAR") from a third party firm that is separately registered as an investment adviser under the Advisers Act or applicable state law or is exempt from such registration.

Non-Fiduciary Status of Advisor. Because RMS performs such a central role in the management of the 401(k) Account as plan fiduciary, financial advisors servicing individual investors through the Savings Plan Management program have no need to provide any fiduciary investment advice with respect to the plan assets held in the 401(k) Account. Thus, a financial advisor would be readily able to avoid engaging in any kind of fiduciary activity when servicing an individual investor's 401(k) Account through the program.

We note that an individual investor participating in Savings Plan Management may consult with the financial advisor on the selection of an appropriate investment strategy for the individual's 401(k) Account, based on the range of seven strategies available. However, any recommendation concerning the advisability of selecting a particular *investment strategy* would be distinguishable from a recommendation concerning the advisability of selecting a particular *security.* Therefore, in our view, a mere consultation by the individual investor with the financial advisor on the selection of an appropriate investment strategy would not result in the financial advisor's rendering any "investment advice" within the meaning of ERISA or assuming a fiduciary role under Savings Plan Management.

Thus, Savings Plan Management successfully enables the financial advisor to offer a tailored investment solution for an individual's 401(k) Account, without having to manage any plan assets as a fiduciary. By extension of this analysis, it enables the financial advisor to develop an overall investment strategy for all segments of the investor's personal investment portfolio, including the 401(k) Account, without becoming subject to the requirements of ERISA.

ERISA Hurdles Do Not Apply to Advisors Under Program

Advisor May Provide Rollover Advice. Since the Savings Plan Management program enables a financial advisor to avoid fiduciary status when servicing an individual investor's 401(k) Account, the restrictions discussed in the DOL's Advisory Opinion concerning a financial advisor's rollover advice to plan participants would not apply. As discussed above, when a financial advisor is not already a plan fiduciary, the advisor may freely provide advice for a fee to participants regarding when to take a distribution and how to invest the resulting proceeds in a rollover IRA. In addition, based on the DOL's analysis, a financial advisor who does not already provide fiduciary investment advice to a plan client, would not be deemed a fiduciary merely for providing such rollover advice.

Advisor May Receive Variable Compensation. By utilizing Savings Plan Management to avoid fiduciary status when assisting individual investors with 401(k) Accounts, the financial advisor and the services under the Savings Plan Management program would be immune from the self-dealing restrictions under ERISA's prohibited transaction rules. As the plan fiduciary under the Program, RMS would be responsible for making all specific allocation decisions for an individual investor's 401(k) Account. All compensation earned under Savings Plan Management would be level as described above. Any Variable Compensation earned outside of the Savings Plan Management program by the financial advisor would have no impact on RMS, an independent third party, and the investment allocation decisions made by RMS would be made independently of the financial advisor without any conflict of interests. For all of the foregoing reasons, financial advisors who are also serving as the broker of record for the plan would be able to continue to receive 12b-1 Fees or any other type of Variable Compensation earned outside of the Savings Plan Management program.

Conclusion

From an ERISA perspective, the Savings Plan Management program is able to provide a robust solution to the "advice gap" problem, which ordinarily prevents a financial advisor from offering fiduciary investment services to individual investors with 401(k) Accounts on the one hand, and also offering meaningful rollover assistance as they transition out of the plan. This ERISA advantage for financial advisors is derived from the fact that Savings Plan Management enables financial advisors to offer a tailored investment solution for 401(k) Accounts, without having to assume a fiduciary role themselves.

Financial advisors advising individual investor clients are, therefore, able to arrange for the delivery of fiduciary advice through Savings Plan Management to individual investors and also provide rollover advice as they take distributions from their 401(k) Accounts. And those financial advisors who are also serving as the broker of record for their plan clients are also able to continue to receive any Variable Compensation payable through the plan's investments. By its deliberate and effective design from an ERISA perspective, Savings Plan Management is able to give financial advisors the necessary flexibility to deliver an integrated investment solution for an entire investment portfolio, including the 401(k) Account and rollover assets as well as the individual investor's other personal assets.

About Retirement Management Systems

Retirement Management Systems Inc. (RMS) is an innovator of participant and plan sponsor services. RMS provides advisory, fiduciary and administrative services to the defined contribution marketplace through independent financial advisors. Their advisor network provides the personal attention and insight that clients need to address their retirement planning concerns. RMS registered with the U.S. Securities and Exchange Commission in 2010 and manages approximately $800 million in retirement plan assets.

About The Wagner Law Group

The Wagner Law Group, A Professional Corporation, is a nationally recognized ERISA and employee benefits; estate planning; employment, labor and human resources practice. Established in 1996, The Wagner Law Group has 20 attorneys, five of whom are AV rated by Martindale-Hubbell as having very high to preeminent legal abilities and ethical standards. The firm has one of the largest ERISA groups in the country. The practice is national in scope with clients in more than 45 states and several foreign countries. In 2012 its principal, Marcia Wagner, was voted 21 of the 100 most influential people in the 401(k) industry by 401(k) Wire, an industry publication.