THE NORTH PIERspective

Fiduciary Commentary

Summer 2014

Fiduciary Management

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By: Brant Griffin - August 06, 2014

Inherited IRA Caution

Retirement accounts can be among savers' most valuable assets, intended to provide income and security throughout one's lifetimes and often enduring beyond. However, many savers may not know that the retirement savings they intend to gift to heirs can become completely exposed to the claims of creditors in bankruptcy. While these retirement assets benefit from certain protections while the saver is alive, a breach can open, exposing the account to liability after death.

Many experienced investors have a great deal of confidence in the retirement system. Perhaps, the exact origin for this confidence is elusive, but nonetheless - it exists. Thus, there is an expectation from investors that these vehicles provide benefits beyond simply being a bucket to defer current income and accumulate retirement savings. For most people, retirement plans are the vehicles of choice, providing one of the surest ways to advantageously grow and protect wealth. Asset protection ranks among the benefits that resonates most with retirement plan investors and imparts confidence in them. Safeguards embedded in ERISA and other select laws, shield investors assets in these plans from the claims of creditors in bankruptcy proceedings and even lawsuits in certain circumstances.

Recently, there has been an increase in regulatory scrutiny to these long-standing practices in the financial services There is a chink in this asset protection's armor however, which is often brought to the forefront in the bankruptcy process. A recent, unanimous Supreme Court decision in Clark v. Rameker perfectly illustrates the asset protection "loophole" that many investors don't understand or plan for.

As background, in 2010 the Clarks filed for bankruptcy and cited Mrs. Clark's inherited IRA as exempt from the bankruptcy estate. However, the bankruptcy trustee and creditors of the couple's estate had challenged the claim stating that the inherited IRA was not considered "retirement funds" and therefore, was not an exempt asset. The case went to the Supreme Court where it was found that the IRA, which she inherited directly from her deceased mother, was not eligible for protection from creditors in bankruptcy. The Court detailed specific differences between the characteristics of inherited IRA accounts and traditional retirement assets, setting further precedence as to why such assets are not exempt from bankruptcy claims. Among the cited differences:

- Inherited IRA holders cannot invest or make additional contributions into the account.
- The tax code requires inherited IRA owners to withdraw money from the account by either:
    a) Taking a lump sum distribution within 5 years after the owner's death; or
    b) Taking minimum annual distributions each year.
- Inherited IRA holders may take all of the money out at any time and for any purpose without penalty. (Roth and traditional IRA owners are subject to a 10% penalty for withdrawals before age 59½.)

The basis of the distinction had previously been defined by other U.S. courts. In their decisions, inherited IRA accounts were identified as not funded by the debtor and consequently, were not "retirement funds" of the account owner.

Thus, the rules applicable to retirement plans that exempted these assets from attachment in bankruptcy do not apply. Traditionally, retirement funds have enjoyed protection from creditors in different ways. Qualified retirement plans subject to ERSIA, such as 401(k)'s, 403(b)s and defined benefit plans are explicitly identified in the law as not permitted to "be assigned or alienated." This language allows these assets to be excluded from a debtor's bankruptcy estate without limitation. The legal protection covers all forms of creditor judgment whether it's a bankruptcy or lawsuit, except when those creditors are former spouses or the IRS (but of course!).

Non-ERISA retirement accounts, such as IRAs (including Roth IRAs) are subject to different rules. Historically, the rules governing non-ERISA retirement accounts' creditor protection was subject to varying laws depending on the retirement plan type and the state jurisdiction of the account owner. The *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* (BAPCPA) sought to simplify the creditor protection rules for non-ERISA plans by consolidating their differences and forming a common veil of protection. As a result, BAPCPA created parity between ERISA's qualified plans and non-ERISA plans such as Simplified Employee Pensions (SEPs) and Simple retirement accounts (Simple IRAs) by providing a full exemption from a debtor's bankruptcy estate. The law provided further relief for protection *up to* $1 million by statute (periodically adjusted by a cost-of-living adjustment factor – it is $1,245,475 as of 2013) in a traditional and Roth IRA from bankruptcy proceedings. Eligible rollovers into an IRA account from a qualified plan retain their protection they enjoyed prior to rollover without limitation. *It is important to note that creditor claims outside of bankruptcy court are determined by state law, which varies widely.*

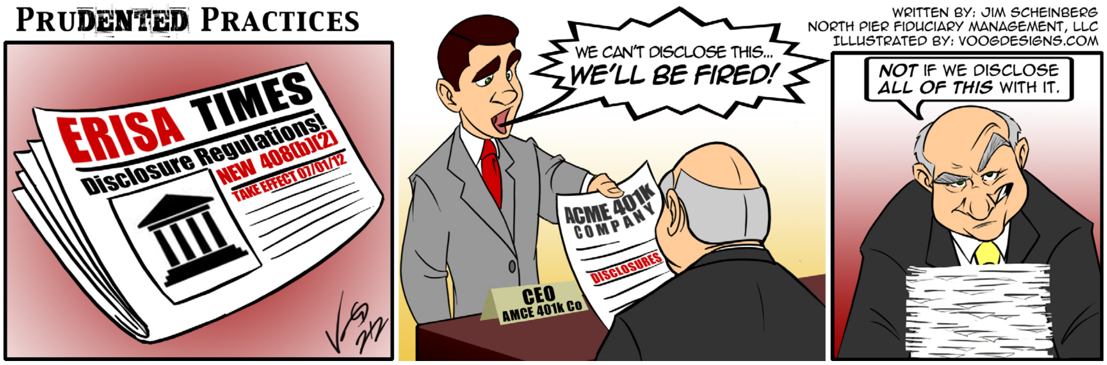
Furthermore, BAPCPA clarified the rules relating to owner-only (and/or owner and spouse only) retirement plans. These plans cover only 100% owners or one or more partners in a business (and their spouses) and were previously treated as if they were not "employee benefit plans," because coverage was not extended to any common law employee(s). With the passage of BAPCPA, the law provided an exemption to the assets of these plans like other qualified plan accounts in federal bankruptcy proceedings. It is important to note that owner-only plans may be subject to attachment by creditors outside of bankruptcy proceedings.

Assets in qualified retirement and non-ERISA plans amount to over $20 trillion dollars nationwide, and a third of all U.S household wealth. Thus investors are appropriately concerned about protecting these savings. While hardly a landmark ruling, the Supreme Court's unanimous decision in Clark v. Rameker, merely confirms what lower courts had ruled previously and what many in the legal community had already inferred from existing law. The ruling does however illustrate the legal gaps in creditor protection that inherited IRA accounts are exposed to. If your intent is to leave some portion of retirement savings to individuals after death, it is important to consider that the asset protection *you* enjoyed may not be extended to your beneficiaries. At the very least, careful planning is the rule of the day.

DOL Proposes Regulation Mandating a Guide to 408(b)(2) Disclosures

On March 12, 2014, the DOL issued its long-anticipated proposal to amend regulation 408(b)(2) which mandates the disclosure of compensation paid to service providers to ERISA plans. If adopted, the proposal may require covered service providers to furnish plan sponsors with a "guide" to their disclosures.

The proposal describes the guide as a brief index to the disclosures required by 2012's 408(b)(2) regulations. It reflects the DOL's concerns that plan fiduciaries would be best served by a tool assisting them in identifying and clarifying the disclosures. The DOL's findings suggested that plan fiduciaries, especially of small and midsized organizations, had difficulty obtaining the disclosures in an understandable format. Further, the DOL was concerned that some covered



service providers were using lengthy, and in some cases even multiple documents (perhaps purposely) in fulfilling their disclosure requirements. Not only is it difficult for the untrained fiduciary to evaluate these documents as they are written, but when they are presented in a disjointed manner, it compounds the difficulty.

North Pier feels that this is an appropriate remedy to regulations 408(b)(2) which while well intentioned, has been recognized to not produce their intended results. When engaged to review sponsor's 408(b)(2) disclosures, North Pier has seen a multitude of formats, locations and language used to describe the plan services and fee structures required of the regulation. These are often not presented logically and typically leave much to be desired. A "roadmap" for the responsible fiduciaries to navigate the disclosure would serve to alleviate some of the burden placed on fiduciaries to review the material.

According to the proposal, the guide must be provided as a separate document from the disclosures and identify the document and page number for each disclosure to allow fiduciaries "to quickly and easily find the… information required by the 408(b)(2) regulation." Furthermore, the guide must "identify a person or office, including contact information, which the responsible plan fiduciary may contact regarding the disclosures provided."

The proposed regulation does not apply to service providers that provide all required disclosures in a "concise, single document." The DOL did not give an indication into what "concise" is, however it is likely that RIAs and other service providers who receive only direct compensation and who can fulfill the disclosure regulation in a single document will be exempt.

Generally, RIAs and TPAs' disclosures are often not lengthy enough to trigger the guide requirement. North Pier believes the largest impact of the new regulations will likely fall to recordkeepers, broker-dealers and dually registered RIAs. On the other hand, the fundamental nature of many recordkeepers' and broker-dealers' extensive and often convoluted business models requires a multitude of disclosures such as service agreements, prospectuses for plan investments, new account forms and revenue sharing disclosures. Thus these providers are likely to bear the greatest burden of this proposal's compliance.

North Pier believes this regulation is a positive development and should serve to assist fiduciaries in performing their duties to evaluate the disclosures under the 408(b)(2) regulations.

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