

ICI VIEWPOINTS

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## The Comprehensive Regulatory Framework Around IRAs

By Mary Podesta and Elena Barone Chism

We occasionally encounter the puzzling misperception that individual retirement accounts (IRAs) are under-regulated—as in this [recent \*Wall Street Journal\* story](#).

The truth is, IRA investors benefit from a comprehensive regulatory framework, one that governs the IRA itself, IRA providers, and, in most cases, the investments that are held within the account.

To help dispel any misperceptions, let's review a few basics of the IRA regulatory framework.

### IRA Assets Are Held by Regulated Custodians and Trustees

Legally speaking, an IRA typically is a trust arrangement: the account is held in trust for the owner by a trustee or custodian. In most cases, the custodian will be a bank or a nonbank financial services firm. Each of these types of custodians is subject to a strong set of regulations:

- **Banks:** The Federal Deposit Insurance Corporation regulates bank custodians and generally treats them as fiduciary trustees.
- **Nonbank custodians:** The Internal Revenue Service regulates nonbank IRA custodians. Any nonbank trustee or custodian must prove to the IRS that it can meet a set of regulatory requirements. One of those requirements is the ability to act within accepted rules of fiduciary conduct by demonstrating business continuity and having an established location, fiduciary experience, fiduciary procedures, and financial responsibility. A nonbank trustee or custodian must also prove that it has procedures that support administration of its fiduciary powers, such as annual audits of its books and records.

There also can be individual retirement annuities, where the annuity contract must be issued by an insurance company, which is subject to state regulation.

### IRA Investors Benefit from Investor Protections

When they choose an investment that suits their needs, IRA investors benefit from the regulations around those investments. Take mutual funds, for example, where 47 percent of IRA assets were invested as of the first quarter of this year. As described in more detail [here](#), mutual funds are subject to a robust, comprehensive system of regulation. Mutual fund assets are held under strict custody, preventing Ponzi schemes, and the value of their assets is marked-to-market every day, following strict pricing procedures. Funds must operate with a simple capital structure and very limited use of leverage—avoiding the hazards that tripped up some other financial products during the recent financial crisis. These protections are backed by stringent disclosure requirements and overseen by independent directors serving as watchdogs for the interests of investors.

Other IRA investments include deposits (regulated by state or federal banking authorities) and annuities (regulated by state insurance commissions). The remaining assets are in a variety of investments, such as ETFs, closed-end funds, stocks, bonds, and commodities—all of which are under the jurisdiction of securities and commodities regulators. It is also possible to hold real estate, private businesses, or other non-traditional assets that may fall outside of state and federal regulation. While no comprehensive data are collected on non-traditional investments held in IRAs, they appear to be a small portion of total IRA assets.

When an IRA owner consults a financial planner, adviser, or broker in investing the assets of an IRA, the planner, adviser, or broker

may have fiduciary obligations or be subject to the other rules of practice.

- **Investment advisers** are regulated and subject to fiduciary obligations to clients either under the Investment Advisers Act of 1940 or state adviser laws or both. These standards, meant to prevent advisers from overreaching or taking advantage of a client, require them to act in the client's best interest. The Advisers Act also imposes obligations on advisers relating to fees and advertising.
- **Brokers** are subject to rules of fair practice and advertising under the jurisdiction of the Financial Industry Regulatory Authority. Securities recommendations of brokers must be suitable and appropriate for the customers, and brokers must disclose conflicts of interest on a transactional basis.

### **Regulatory Reforms Are Ongoing**

Regulators in Washington continue to examine ways to protect retirement savers. One notable effort concerns the application of fiduciary duties. Last fall, the Department of Labor proposed a major rewrite of the definition of fiduciary under the Employee Retirement Income Security Act (ERISA). Separately, the SEC is contemplating the results of a Dodd-Frank Act–mandated study on the standard of care for broker-dealers providing investment advice to retail customers. In that study, SEC staff recommended a universal fiduciary duty be applied to broker-dealers and investment advisers. ICI has commented on both the [DOL fiduciary proposal](#) and the [SEC's standard of care study](#).

### **ICI Resources**

For more on IRAs and their regulation, we suggest the following links:

- [Highlights from ICI's 2011 IRA Research and Policy Summit](#)
- [ICI Testimony for Department of Labor Hearing on Fiduciary Definition Proposal](#)
- [ICI Testimony for ERISA Advisory Council Working Group on Approaches for Retirement Security in the United States](#)
- [ICI Data on the U.S. Retirement Market First Quarter 2011](#)

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