Information Memo
Risk Assessment Unit

NYSE Regulation

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ATTENTION: CHIEF EXECUTIVE OFFICER/MANAGING PARTNER, COMPLIANCE AND LEGAL DEPARTMENTS

TO: ALL MEMBER ORGANIZATIONS

SUBJECT: REMINDER CONCERNING SUPERVISORY OBLIGATIONS WITH RESPECT TO ROLLOVER INDIVIDUAL RETIREMENT ACCOUNTS

INTRODUCTION

Increasingly, 401(k) plans play a significant role in individuals' planning for retirement. Because the Pension Protection Act of 2006 permits employers under certain circumstances to automatically enroll employees in 401(k) plans and other defined contribution plans, this trend seems poised to continue. Participation in 401(k) plans may further increase as a result of decisions by some major companies to freeze pension plans. Consistent with the emerging importance of 401(k) plans, many member organizations of the New York Stock Exchange LLC (the "NYSE") offer rollover individual retirement account ("rollover IRA") services to retail investors, actively soliciting individuals' assets held in 401(k) plans. Frequently, an individual's rollover IRA consisting of 401(k) plan assets will contain a significant percentage of his or her retirement assets and, in some instances, entire net worth.

Rollover IRAs offer benefits to investors, such as the ability to withdraw assets from one or more employer plans without tax penalties for consolidation in a single account. Rollover IRAs also may afford a greater array of investment options. However, the Division of Enforcement of NYSE Regulation, Inc. ("NYSE Regulation") has noted an increase in customer complaints concerning investments in rollover IRAs. Accordingly, NYSE Regulation is issuing this Information Memo to remind NYSE member organizations of their supervisory responsibilities with respect to rollover IRAs. In addition, this Information Memo suggests examples of sound practices for monitoring and reviewing such accounts.[1]

CURRENT REGULATORY REQUIREMENTS

As part of the due diligence and suitability requirements relating to customers' transactional activity imposed by NYSE rules, transactions effected in a rollover IRA must be consistent with the customer's stated investment objectives, investment experience, and financial resources. Therefore, in order for a registered representative ("RR") to evaluate the appropriateness of a rollover IRA transaction for his or

[1] Member organizations should consider the relevance of the guidance expressed in this Information Memo to other account types and/or securities, particularly with respect to any retirement planning options offered by them. The guidance presented in this Information Memo should not be understood to pertain exclusively or uniquely to IRAs. Cf. NYSE Information Memo 06-12 (Mar. 17, 2006) ("While this Information Memo deals specifically with market-linked CDs, many of the responsibilities discussed are generally applicable to other products.")

her customer, the RR must conduct reasonable diligence and comply with the “know your customer” obligations of NYSE Rule 405.

Every member organization must supervise and control each of its business activities pursuant to NYSE Rule 342. Therefore, if a member organization offers rollover IRAs to individuals, the member organization is required to supervise the transactional activity in those accounts.

The customer protections of suitability, due diligence, and supervision are critically important for rollover IRA investors. Individuals in today’s workforce have longer life expectancies than those of previous generations. Their retirement goals may encompass funding several decades of retirement. However, rollover IRA investors may have little or no investment experience and only limited financial resources apart from their 401(k) assets. This makes them particularly vulnerable: were their assets to be invested without regard to their stated investment objectives and financial resources and to decline, such individuals, depending on their ages, may not have sufficient opportunity to replace the lost funds. Moreover, the suitability analysis required when an unsophisticated investor has a need for a prolonged, substantial income stream is complex.

As a result, ongoing reviews of rollover IRA transactional activity are important to a member organization’s performance of its supervisory responsibilities as to such accounts. Indeed, certain customer complaints and investigations involving rollover IRAs seen by NYSE Regulation have involved prolonged periods of allegedly unsuitable or inappropriate investment activity coupled with persistent large declines in account value. Consequently, early detection and intervention by a member organization where the transactional activity in a rollover IRA appears questionable or unsuitable for the accountholder would benefit the investor by potentially limiting avoidable losses. In addition, member organizations would benefit in that they would mitigate regulatory, litigation, and reputational risk.

SUGGESTIONS FOR SOUND SUPERVISORY PRACTICES

How a member organization should perform its supervisory obligations relating to rollover IRAs is a question for the member organization’s business judgment, which should be exercised consistently with NYSE Rule 342. Reasonable supervision will vary from organization to organization, as well as based on the customer’s sophistication and financial position. Nonetheless, member organizations may wish to consider whether any of the following risk-based practices would enhance their supervisory systems in a meaningful, cost-effective way. None of these practices is required. Moreover, none is a panacea or a safe harbor. NYSE Regulation is presenting them for consideration because they may have prevented violative conduct alleged in recent customer complaints and investigations.

Training

Providing specialized training or continuing education programs for RRs who service rollover IRA customers may be a sound practice. Such training or education may focus on, for example: the “know your customer” requirement of NYSE Rule 405, and practical approaches to assessing a customer’s financial goals, financial resources, and risk tolerance; how to communicate effectively with unsophisticated investors; investment allocation strategies for retirement; asset preservation strategies; tax implications of various retirement options; and discussions pertaining to recent customer complaints, arbitration filings, and regulatory actions involving allegations of improper trading of retirement assets.

Review of Marketing Efforts

Member organizations may permit their RRs to make targeted marketing presentations or sales pitches concerning rollover IRAs to individuals with assets in 401(k) plans. In some instances, these presentations are directed to employees of a particular company and occur on company premises. Member organizations should be mindful that their general supervisory obligations as to RRs’ sales practices extend to the conduct of such meetings and RRs’ representations concerning their “expertise” in particular areas. Regard should also be had to the “general standards” set forth in NYSE Rule 472(i). Any representation made by an RR concerning his or her experience with retirement assets must be factual, not misleading, and approved by the member organization. The representations made by RRs should be evaluated in light of their experience level. In addition, NYSE Rule 472(l), which governs “other communications activities,” such as “conducting seminars,” requires that “[m]ember organizations must establish specific written supervisory procedures applicable to . . . employees who engage in these types of communication activities. These procedures must include provisions that require prior approval of such activity by a person designated under the provisions of Rule 342(b)(1).”

Depending on the circumstances, a member organization may decide, as a matter of sound risk management, to impose enhanced supervision on certain marketing presentations or sales pitches relating to rollover IRAs. Many factors may affect a member organization's judgment as to how much supervision an RR reasonably should be afforded when he or she targets potential rollover IRA investors for a marketing presentation or sales pitch. They include an RR's level of securities industry experience, marketing experience, licenses, training, and complaint and disciplinary history. If warranted, enhanced supervision may include having the branch office manager or another designated supervisor follow up with customers who, subsequent to a presentation or sales pitch, roll over their 401(k) plan assets into IRAs with the member organization.

Unique Coding of Accounts

As noted above, some member organizations permit RRs to engage in targeted solicitations of a particular company's present or former employees with assets in 401(k) plans. Member organizations may consider coding or tagging any rollover IRAs opened by those individuals, so as to render them identifiable by company. Among other things, this would permit comparative supervisory reviews of the accounts. Such reviews may facilitate the detection and prevention of unsuitable transactional activity or other violative conduct spanning multiple customers' accounts.

Specialized Exception Reports and Surveillances

Member organizations may determine that implementing specialized surveillances and exception reports for reviewing transactional activity in rollover IRAs would be a sound practice. For example, a member organization may consider creating a surveillance tool that would monitor for transactions in securities deemed by the organization to be potentially inappropriate for rollover IRA investors depending on their investment objectives. An example would be transactions involving tax-exempt securities, which may not be appropriate for tax-deferred accounts such as IRAs. Similarly, a member organization may wish to evaluate whether its standard concentration and turnover analyses are appropriate for rollover IRAs. Some member organizations may determine that distinct exception reports utilizing more stringent parameters would be a worthwhile tool. In addition, a member organization may wish to surveil for significant decreases in the net asset values of rollover IRAs, perhaps utilizing a lower standard for the percentage change in value that would trigger a review than the standard generally applicable to other accounts. Such targeted surveillances and exception reports may assist the branch office manager or other designated supervisor to identify the transactional activity in rollover IRAs meriting further review. In addition, they may assist the member organization in monitoring or auditing whether its designated supervisors are reasonably performing their obligations to review rollover IRA transactional activity.

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