The North American Securities Administrators Association

Are you an informed investor?

Third-Party Custodians of Self-Directed IRAs and Other Qualified Plans

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While self-directed IRAs can be a safe way to invest retirement funds, investors should understand that third-party custodians have limited duties to investors.

Since the mid-1970s, investors have taken advantage of a provision in the tax code allowing them to contribute money on a tax-deferred basis to an individual retirement account, popularly referred to as an IRA.

To open an IRA account, the investor must find an Internal Revenue Service (IRS)-approved company to act as the account's custodian. Investors open and deposit funds into the account and may invest in opportunities available through the company. A self-directed IRA means you, the customer, have complete decision-making power on your investments in the IRA. Unlike a stock, bond or mutual fund, where others either manage or control the investment, you are in total control of calling the shots.

Occasionally, an investor is approached by a promoter offering an investment opportunity not available through the company that holds the investor's IRA. The promoter directs the investor to transfer funds from the original IRA to a new third-party custodian to facilitate the transaction. A third-party custodian is a company that keeps track of the IRA and completes the required reporting to the IRS in order to keep the money in a tax-deferred status.

Fact & Fiction About Third-Party Custodians

Fiction: A third-party custodian researches and recommends investments.

Fact: A third-party custodian does NOT research or perform due diligence reviews or recommend investments to clients.

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Issued: October 2014

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Fact & Fiction About Third-Party Custodians

Fiction: A third-party custodian has a fiduciary duty to clients meaning it has the investor's best interests in mind.

Fact: A third-party custodian is a passive company that simply serves as an intermediary between the investor and the issuer of an investment.

Fiction: A third-party custodian verifies the accuracy of the information on the investor's statement, including the value of the investment.

Fact: Fraud promoters often state or suggest that self-directed IRA custodians investigate and validate any investment in a self-directed IRA. Self-directed IRA custodians are responsible only for holding and administering the assets in a self-directed IRA. They generally do not evaluate the quality or legitimacy of any investment in the self-directed IRA or its promoters. A third-party custodian only reports the information provided by the issuer and does NOT verify the accuracy of the information. Even though an account statement provided by a third-party custodian may show an increase in the value of the investments in the account, this information has NOT been verified for accuracy by the third-party custodian.

Fiction: The investment is safe because the third-party custodian is a regulated trust company.

Fact: Even though the third-party custodian is a regulated trust company approved by the IRS, its sole obligation is to track and report to the IRS the contributions to and distributions from the account in order to maintain the tax-deferred status of the IRA or qualified plan. Again, the third-party custodian does NO diligence review regarding the investment; therefore, this does not mean the investment is safe or "legitimate."

Fiction: The third-party custodian is responsible for full and accurate disclosures of all details regarding the investment.

Fact: Fraud promoters can misrepresent the responsibilities of self-directed IRA custodians to deceive investors into believing that their investments are legitimate or protected against losses. The third-party custodian's sole responsibility is to report information to the IRS and from the issuer to the investor.

Fiction: The third-party custodian holds the investment funds or assets.

Fact: The third-party custodian is merely the keeper of the deposits to and distributions from the account. The third-party custodian bills the investor for its record keeping services. The custodian does NOT hold the investment funds or assets. The third-party custodian transfers the investment funds directly to the issuer when an investment is made.

The Bottom Line

If you have any questions about third-party custodians of self-directed IRAs or other qualified plans, contact your state or provincial securities regulator. Contact information is available on the website of the North American Securities Administrators Association at www. nasaa.org.

NASAA Informed Investor Alert

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