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ERISA COMPLIANCE: AN ACTIONABLE APPROACH FOR INVESTMENT ADVISERS TO CONSIDER WHEN ADDRESSING NEW AND CHANGING REGULATORY REQUIREMENTS

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Sweeping and numerous regulatory initiatives, which have recently been introduced by the Department of Labor (DOL), are scheduled to become effective in 2011 and 2012. It is imperative that affected firms begin preparing for the coming changes, as the penalties for non-compliance under the Employee Retirement Income Security Act of 1974, as amended (ERISA), are significant and could subject firms to disgorgement, excise taxes and personal liability. The most impactful regulation for RIAs is the DOL's interim final regulation under ERISA 408(b)(2). By January 2012, this regulation will require all providers of investment advisory services to ERISA plans to provide detailed written disclosures to their clients concerning all services to be provided and any direct and indirect compensation received in connection with such services, regardless of whether the contract or arrangement was entered into prior to such date. Consequently, compliance with the 408(b)(2) regulation requires affected firms to develop program-specific controls for new business and retrofit or migrate their existing business. The impact of this regulation alone is substantial, as many firms have not historically employed the necessary expertise to identify and remediate potential gaps in ERISA compliance. Most RIAs have an advantage over traditional broker-dealers, as they have already been working on a level fee and transparent contractual basis. However, these new regulations are going to require RIAs to amend existing contracts, adjust work flow processes and enhance their value proposition in order to differentiate and compete in this new environment.

Indeed, even firms that have already undertaken to develop compliant programs are reporting difficulties in identifying affected accounts or otherwise bringing their existing ERISA-covered services into compliance with the new requirements. To make matters worse, in October 2010, the DOL proposed a regulation that will significantly expand the nature and scope of services that will give rise to fiduciary status under ERISA. Given that ERISA places a number of additional restrictions on fiduciary service providers, firms must factor the potential impact of the broader definition into their existing ERISA compliance strategy. The remainder of this article sets forth some foundational questions and action items for firms to consider when seeking to identify and implement the necessary organizational and/or operational changes that may be required to comply with the new regulations.

(1) **Are all "covered" accounts identified?** As discussed, many firms have reported difficulty in identifying all of the accounts potentially affected by the new regulations. For example, it is common for broker-dealers to receive aggregated data from recordkeepers for all compensation received on assets held away. Nevertheless, the 408(b)(2) regulation requires the disclosure of client-specific services and fees. Affected firms should determine whether and to what extent existing data feeds may be segregated to provide information for each covered client and begin developing an account "coding" mechanism so these accounts can be more easily identified in the future.

(2) **Where and how to obtain disclosure data?** Firms should examine their books and records to identify relationships that may give rise to new or different reporting requirements. For held away business, it may be possible to obtain

more detailed information, at more regular intervals, on compensation received in connection with ERISA-covered services. Because the ability to provide certain data will vary from provider-to-provider, affected firms should begin consulting with their approved providers to determine which firms are capable of supplying data in a manner that facilitates the identification and reporting of relevant information. It may be necessary to survey the firm's producers to determine whether or not the firm has identified all covered accounts and that the required information can be obtained, verified and reported in the disclosures.

(3) **How will services be articulated?** The 408(b)(2) regulation requires covered service providers to specifically disclose the nature and scope of their services. While seemingly benign, this requirement can prove extremely difficult in cases where there is no service agreement in place between the firm and the ERISA client. For example, most broker-dealers do not have written agreements with their plan sponsor clients, as the compensation received in connection with customary services provided by registered representatives is commonly paid by the plan's recordkeeper or custodian from fees built into the plan's investments. Many broker-dealers, consequently, will be faced with determining the services they will support based upon the needs of their clients, the sophistication of their producers and their compliance and supervisory resources.

Firms that elect to take a conservative approach by limiting the approved services may find their producers at a competitive disadvantage, as plan sponsors will evaluate the enumerated services against those offered by other service providers to determine the reasonableness of the arrangement. Firms that take a more expansive approach to articulating their services may find difficulty in supporting the proffered services, as compliance with ERISA requires an assessment of ERISA-specific concerns affecting the firm as a whole (due diligence, operations, compliance, supervision, etc.). A sustainable strategy will, therefore, largely depend upon the firm's ability to align objectives with current resources. Because most small and mid-sized firms do not employ internal ERISA expertise, their ability to support more complex or unique ERISA-covered services will likely be a function of their ability to leverage technology and third-party resources.

(4) **What is the nature and scope of fiduciary liability under ERISA?** As discussed, ERISA places a number of additional limitations and obligations on those who provide fiduciary services. In addition to acting solely in the best interest of plan participants and beneficiaries, ERISA requires fiduciary service providers to be free from conflicts of interest or otherwise comply with specific safeguards set forth in various prohibited transaction exemptions. If these standards cannot be met, it is imperative for firms to ensure that any services they intend to offer do not give rise to fiduciary status under ERISA.

The most common way for financial service providers to become ERISA fiduciaries is to render investment advice for compensation. ERISA currently provides a five-part test to determine whether or not advice or recommendations

are considered fiduciary investment advice. Additionally, as previously mentioned, the DOL has proposed a new definition of investment advice that would dispense with some of those factors and expand the types of activities that could give rise to fiduciary status. Firms should carefully examine both the current and proposed regulations to determine whether or not their approved services may subject them to a heightened standard of care or otherwise prohibit certain transactions.

If a firm is unable to eliminate prohibited conflicts of interest or support the provision of fiduciary investment advice to ERISA clients, it is crucial to understand the implications of implementing policies that seek to limit the services they intend to offer. Because most plan fiduciaries do not possess the necessary investment-related expertise to prudently manage plan investments, they rely on advisers for support. The new disclosures, however, will put plan fiduciaries on notice of any limitations imposed on their adviser by their supervising firm, and they may be surprised to learn that they will no longer be receiving ongoing "investment advice." Moreover, if the plan fiduciaries fulfilled their duty to prudently select their adviser, they would have evaluated his/her compensation in light of the services he/she actually provided. To the extent those services included investment advice (either at the plan or participant level), plan fiduciaries may seek to have their adviser lower his/her compensation to reflect the fact that the service is no longer available.

Affected firms should, therefore, be prepared to offer up solutions to plan fiduciaries who seek specific guidance on plan investments and to demonstrate the value of their non-fiduciary services. Fortunately, the industry has begun to respond, and many providers now offer access to investment advice through unaffiliated, "remote" advisers. There are also a number of advisers that have the ability to provide advice remotely through arrangements that are independent and not tied to a particular platform or provider. By evaluating the availability and appropriateness of these options, advisers can assist plan fiduciaries in implementing and overseeing third-party advisory services. If the adviser has a well thought-out solution in hand where he/she will play an active role, it is less likely that the plan will look to hire another adviser.

The foregoing questions are meant to serve as a foundation for firms that are seeking to reassess their ERISA strategies. There are a number of additional questions that will naturally arise out of the firm's preliminary analysis.

RIAs need to review and most likely amend their own advisory agreements and disclosures as well as any contracts with third-parties (i.e., solicitor agreements, tri-party arrangements with investment managers, etc.). It is critical to not only identify what services are to be rendered by the adviser and/or third-party service providers but also what services will not be provided by the adviser. Firms will also need to clearly identify fiduciary versus non-fiduciary services. Fiduciary services generally include the following: IPS development and/or review; investment selection and monitoring; recommendations for model portfolio

allocations and rebalancing; and participant investment advice. Non-fiduciary services typically include: plan design consulting and/or review; vendor search and fee benchmarking services; plan committee education and compliance assistance; and participant investment education and enrollment support. Many advisory agreements were repurposed to cover services provided to qualified plans from asset management contracts and, therefore, have inadequate ERISA-related disclosures. Additionally, many existing advisory agreements do not accurately reflect the services being delivered by respective parties, and given the increased scrutiny around cross-selling and IRA rollovers, firms should consider adding preemptive disclosures – perhaps to both the Form ADV Part II and new account forms for IRAs.

These new regulations are changing the traditional service paradigm. While most plan sponsors rely on their advisers and brokers for investment selection and monitoring, fee substantiation and disclosure requirements are forcing firms and producers to expand and define their services. Consequently, we are seeing an emerging bifurcation whereby RIAs may want to offer two service platforms for advisers: one that provides the ability to outsource fiduciary services (e.g., investment management at the plan and participant level) to approved third parties; and a second option that allows advisers, who have demonstrated proficiency in servicing qualified plans through experience or maintaining an appropriate designation (i.e., AIF, CRPS, TRAU, etc.), to render fiduciary services directly to the plan and/or plan participants.

In any event, advisers should be prepared to effectively articulate the value add of their non-fiduciary services, obtain a deeper understanding of new and changing compliance requirements and, in order to maintain their competitive positioning, explain plan fees from all service providers and how they benefit the plan and its participants.

Broker-dealers, insurance companies and providers selling directly to plan sponsors will challenge RIAs by virtue of their market presence and "manufactured" products. Registered representatives and insurance agents will likely be limited to providing non-fiduciary services, and RIAs will be forced to demonstrate the value of their investment recommendations and advice above-and-beyond alternative arrangements utilizing institutional, third-party investment managers with formidable track records and industry recognition.

The following action items present a generic "roadmap" and additional details for firms to consider when developing and deploying successful ERISA-related programs:

- Identify all advisers and accounts that are subject to the regulations;
- Determine the scope of services to be offered (i.e., fiduciary vs. non-fiduciary, investment advice vs. education);
- Determine whether any services will be offered pursuant to an exemption;
- Reconcile approved services with errors and omissions coverage;
- Amend service agreements, disclosure documents and procedures to conform to the new standards with respect to content, format, delivery, etc.;

- Conduct additional due diligence on approved service providers (recordkeepers, TPAs, etc.) and determine whether responsibilities are properly allocated and that required data is capable of being provided;
- Examine third-party agreements, including solicitor arrangements, and develop procedures to eliminate or manage conflicts of interest;
- Consider outsourcing fiduciary services (e.g., plan and participant level investment advice); and
- Establish procedures for communicating any changes to procedures, disclosures, etc. and implement firm-specific training for affected advisers and their supervisors.

By acting now and taking proactive and preventive steps to reevaluate and retool ERISA compliance strategies, it is possible for the new regulations to serve as an opportunity for affected firms to not only increase revenues, but also to attract and retain advisers that specialize in providing retirement-related services. For more information about developing a firm-specific approach to ERISA compliance, please contact Jason C. Roberts, Founder and CEO of the Pension Resource Institute, LLC (PRI), at jroberts@pension-resources.com or Amy Glynn, Founder and President, at aglynn@pension-resoureces.com.

ABOUT PRI

Bringing together 75 years of proven expertise, ranging from executive, legal and compliance to operation, sales and distribution, PRI works with broker-dealers, RIAs, investment managers, recordkeepers and TPAs to build profitable and sustainable solutions in the qualified marketplace. PRI's consulting clients receive individualized, comprehensive guidance and ongoing support from experienced consultants representing all aspects of sales, service, distribution and supervision. Integrating both securities and ERISA compliance, the PRI team is able to deliver "best practice" approaches for achieving the specific goals of each client with an emphasis on effective implementation and efficient oversight – both of which are fundamental to the development of competitive and sustainable fee- and commission-based strategies in today's technical, ever-changing regulatory environment. From due diligence to supervision, the PRI team also provides actionable education to home office personnel and advisers that provide services to ERISA-covered plans and plan participants.

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Jason C. Roberts is the Founder and CEO of the Pension Resource Institute (PRI) providing strategic consulting and training to retirement plan service providers (broker-dealers, RIAs, investment managers, recordkeepers, TPAs, etc.) and fiduciary education to plan sponsors. He is primarily responsible for tactical planning and business development at PRI and actively leads many of PRI's consulting projects.

Prior to founding PRI, Jason was a partner and co-chair of the Financial Services Group at Reish & Reicher – a leading ERISA law firm – where his practice focused on employee benefits and securities regulation. He counseled broker-dealers, RIAs, hedge funds, private equity funds, retirement plan sponsors and plan providers in ERISA and investment-related matters. Jason was frequently retained as an expert witness on fiduciary claims and represented clients in federal and state court at the trial and appellate level (including the U.S. Supreme Court) and in arbitrations before FINRA. He also counseled clients involved in government enforcement proceedings.

Jason was recently included in 401kWire's 2011 list of the 100 Most Influential People in Defined Contribution, and he currently serves on the steering committee for the American Society of Pension Professionals and Actuaries (ASPPA) 2011 and 2012 401(k) Summits. Jason also serves on the Investment Fiduciary Leadership Council's (IFLC) Task Force on Fiduciary Standards for Endowments & Foundations and is a co-director of IFLC's Southern California Fiduciary Roundtable.

Jason has published numerous articles on fiduciary best practices, ERISA compliance and securities regulation. He is a nationally-recognized speaker on issues such as fiduciary compliance, the efficacy of retirement savings programs and service provider due diligence and disclosure requirements. Jason is frequently quoted and interviewed by both professional and public publications, including *The Wall Street Journal, InvestmentNews, Dow Jones News, Registered Rep. Magazine, Ignites, PLANSPONSOR Magazine, PlanAdviser Magazine, Institutional Investor, Fund Action, and FSI Voice*.

Jason received his B.S.B.A. in Finance & Banking from the University of Missouri and his J.D. from the University of California, Los Angeles (UCLA) School of Law. He is a graduate of FINRA's Compliance Boot Camp and has obtained the designation of Accredited Investment Fiduciary Analyst™ from the Center for Fiduciary Studies.

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Amy Glynn is President and Founder of the Pension Resource Institute, a nationwide consulting firm founded to assist organizations in establishing efficient, compliant and profitable strategies in the qualified marketplace. Amy leads the firm's initiatives as they relate to developing and deploying sustainable sales and distribution. In addition, Amy leads the development and implementation of adviser-based sales and distribution strategies.

Amy has been in the 401(k) and pension marketplace for over 20 years, and in 2010, Amy was ranked #39 on 401kwire.com's list of the top 100 most influential people.

From 2008 until 2010, Amy served as Director of Retirements for indie hybrid firm, Commonwealth Financial Network (CFN), leading the firm's efforts to support advisers in all aspects of the marketplace, both individual and workplace. At CFN she: re-architected and developed the firm's strategic direction in the qualified marketplace and its integration with the nonqualified marketplace for both broker-dealer and RIA business lines; built the industry's first universal fee-based Retirement Plan Consulting Program contractually supporting co-fiduciary investment advisory services at both plan sponsor and participant levels; developed and implemented compliance protocols across the organization; led the oversight and development of adviser training, sales and business development; built a web-based resource center; implemented diligence on 30-plus providers; rebuilt a team with a staff of 7, averaging 11 years industry experience and doubled the firm's qualified fee-based activity.

Prior to joining CFN, Amy ran a successful consulting organization integrating ERISA practices into existing businesses. She has also served as vice president of institutional retirement plan sales at New York Life; founded a web-based job placement and career resource center for women; was named Start-Up of the Year in Women's Business Journal in 2000; and she led the #1-producing retirement plan division in the country at Smith Barney for five consecutive years.

Amy is frequently a keynote speaker and panelist in the industry and has been published and quoted in the following publications: *WorkingWoman, Women's Business Journal, Boomer Magazine, Registered Rep. Magazine, PlanAdviser Magazine, PLANSPONSOR Magazine* and *InvestmentNews*.

Amy is a graduate of Colgate University with a B.A. in English and Women's Studies, a member of the American Society of Pension Professionals and Actuaries and on the Board of the Women in Pensions Network.