

A Perfect Storm: Tips for Navigating ERISA Compliance

By: Jason C. Roberts, Esq., AIFA®* and Bonnie Treichel**



Jason Roberts is a partner in the employee benefits group of Reish & Reicher and is the co-chair of the firm's financial services practice group.



Bonnie Treichel is a third-year law student at Pepperdine University.

Sweeping regulatory reforms introduced this year by the Department of Labor (“DOL”), the ongoing wave of class action lawsuits filed against some of the nation’s largest employers and their respective service providers – most of which contain claims for breaches of fiduciary duties owed to plan participants under ERISA and the Supreme Court’s decision to allow plan participants to pursue claims for losses in their individual accounts will pose significant fiduciary risks for both broker-dealers and registered investment advisers (“RIAs”) under the Employee Retirement Income Security Act of 1974 (“ERISA”). Moreover, under the direction of the new Assistant Secretary of Labor, Phyllis Borzi, the DOL has announced that its number one agenda item is the implementation and execution of a “strong, vigorous, comprehensive enforcement policy.” Indeed, DOL has already increased its enforcement staff significantly, and examination of ERISA plan service providers jumped markedly in 2009 and 2010. The agency is also sharing information and actively cooperating with the Securities and Exchange Commission (“SEC”) in examinations designed to detect and prevent prohibited conflicts of interest among service providers, including broker-dealers, investment managers and advisers. The combination of new regulations, increasing enforcement and continuing market volatility is expected to result in greater exposure for broker-dealers and RIAs that provide services to qualified retirement plans, plan participants and individual retirement accounts (“IRAs”).

Sections I and II of this article provide an overview of the current law and an analysis of some common areas of potential exposure for broker-dealers and RIAs. Sections III, IV and V examine each of the DOL’s proposed regulations (fee disclosure under ERISA 408(b)(2), investment advice for plan participants and IRAs, and an expansion of the definition of fiduciary under ERISA) and their anticipated consequences for advisers and their firms. The article concludes by setting forth potential solutions designed to assist firms in determining the most effective course to stay afloat in what is widely expected to be a

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sea change for service providers in the retirement savings marketplace.

While these regulations will undoubtedly present unique, firm-specific challenges, they may also provide considerable opportunities for firms that are the first movers in developing compliant, forward-looking solutions. Indeed, many firms are already experiencing attrition from experienced retirement plan advisers who are looking for more “fiduciary friendly” platforms. Firms that proactively address these issues will not only limit their prospective exposure, they will be well-positioned to retain and attract advisers and retirement assets.

I. Overview of Fiduciary Status under ERISA

While each of the proposed regulations will present specific challenges and opportunities for firms based upon the nature and scope of the services provided, the cumulative effect of all three regulations will, at a minimum, highlight the prohibited nature of many existing arrangements. For example, ERISA requires plan sponsors to manage plan investments prudently. If they do not have the requisite expertise, they are required to hire it. Consequently, many plan fiduciaries look to financial advisers to assist in the selection and monitoring of investment options. If the adviser performs functions that are determined to be fiduciary services under ERISA, he/she must act solely in the best interest of plan participants and beneficiaries, and he/she (as well as

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his/her affiliates) will be prohibited from engaging in certain transactions. It is, therefore, imperative that firms monitor the activities of their advisers to determine whether they may be triggering fiduciary liabilities under ERISA.

ERISA’s definition of fiduciary status is functional, which means that even if an adviser does not acknowledge that he/she is acting as a fiduciary, if the adviser performs fiduciary tasks, he/she will be subject to fiduciary standards and prohibited transaction rules. ERISA provides three ways in which one can become a fiduciary. Section 3(21)(A) of ERISA states that fiduciary status will be triggered by:

- i) exercising any discretionary authority or discretionary control respecting management of such plan or exercising any authority or control respecting management or disposition of its assets, or
- ii) rendering investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or having any authority or responsibility to do so, or
- iii) having any discretionary authority or discretionary responsibility in the administration of such plan.

Generally speaking, most advisers will not be in a position to exercise discretionary authority or control over the management or administration of a plan or plan assets. An adviser who provides instructions directly to the plan’s custodian and/or recordkeeper, however, may be deemed to be exercising discretion over those assets (even if the plan fiduciary and/or the participant has the final word on how the assets are to be invested) and, therefore, may be held to be an ERISA fiduciary.¹ Some courts have also found that advisers exercised actual control over the management and disposition of plan assets when clients merely “rubber stamped” or followed automatically or without consideration, the adviser’s investment recommendations.²

Exercising discretion over plan assets, however, is not a prerequisite to fiduciary status under ERISA. Indeed, the most common way for an adviser to become an ERISA fiduciary is by the rendering of investment advice to the plan’s investment committee and/or participants. Regulation 29 C.F.R. 2510-3.21(c) defines “investment advice” as that term is used in section 3(21)(A)(ii). Under that regulation, an adviser will be deemed to be rendering investment advice if he/she:

- i) renders advice as to the value of securities or other property, or makes recommendations as

- to the advisability of investing in, purchasing, or selling securities or other property; and
- ii) such person either directly or indirectly (e.g., through or together with any affiliate) has discretionary authority or control, whether or not pursuant to agreement, arrangement or understanding, with respect to purchasing or selling securities or other property for the plan; or
 - iii) renders any such advice on a regular basis to the plan pursuant to a mutual agreement, arrangement or understanding, written or otherwise, between such person and the plan or a fiduciary with respect to the plan, that such services will serve as a primary basis for investment decisions with respect to plan assets, and that such person will render individualized investment advice to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.³

Assuming the adviser has no discretionary authority or control over the management of the plan, its assets or administration of the plan, he/she will only be deemed to be a fiduciary if he/she provides investment advice that is: 1) rendered on a regular basis; 2) pursuant to a mutual agreement [written or otherwise]; 3) that such advice will serve as the primary basis for investment decisions; and 4) such advice is individualized investment advice based on the particular needs of the plan. Additionally, to be considered fiduciary advice, the adviser's recommendations must contemplate, among other things, investment policies and strategies, portfolio composition, diversification or similar overarching factors. Investment recommendations alone, therefore, are not fiduciary advice. Consequently, for example, if an adviser can demonstrate that any "advice" rendered to the plan (e.g., assistance in narrowing the number of investment options available to participants) merely relates to the characteristics of investment options generally and does not factor in the needs of the plan or its participants, he/she will not meet the fourth criteria and will not be rendering fiduciary investment advice.

Because ERISA's definition of fiduciary investment advice is more akin to the combination of the services offered by investment advisers, where the overall needs of a plan are considered and where the

advice contemplates investment policies and strategies that are individualized to the needs of the plan and the participants, it is more likely that investment adviser representatives ("IARs") (as opposed to registered representatives ("RRs")) will be determined to be providing fiduciary services. Indeed, an examination of the legislative history of section 29 C.F.R. 2510-3.21(c) reveals that certain activities relating to the traditional services of broker-dealers were given special consideration and excluded from the definition of "investment advice."

On August 8, 1975, the DOL published a proposal to adopt a regulation designed to clarify the definition of the term "fiduciary" as set forth in section 3(21)(A) of ERISA.⁴ Paragraph (c)(1) of the proposed regulation provided that:

"A person shall be deemed to be rendering 'investment advice' to an employee benefit plan within the meaning of section 3(21)(A) (ii) of [ERISA], if – (i) such person renders advice to the plan as to the value of securities or other property, the advisability of investing in, purchasing, or selling securities or other property, *or the availability of securities or other property or of purchasers or sellers of securities or other property*; and (ii) Such person either directly, indirectly, or through or together with any affiliate or affiliates, or any affiliate of such person – (A) has discretionary authority or control, whether or not pursuant to agreement or arrangement, with respect to purchasing or selling securities or other property for the plan; or (B) renders any advice described in paragraph (c)(1)(i) of this section on a regular basis to the plan pursuant to an agreement, arrangement or understanding, written or otherwise, that such services will serve as a primary basis for investment decisions with respect to plan assets, and that such person will render individualized investment advice to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments." (Emphasis added.)

On October 31, 1975, after receiving written comments and holding a public hearing on the proposed regulation, the DOL published its final rule

omitting the language from the above-referenced definition pertaining to the rendering of advice on the “availability of securities or other property or of purchasers or sellers of securities or other property.” The preamble to the final regulation explains the removal of the proposed language by stating,

“It was noted in the letters of comment that advice on the availability of securities or other property or of purchasers or sellers of securities or other property is often merely an integral part of the execution of transactions rather than the provision of investment advice. Accordingly, paragraph (c)(1) of the regulation has been modified to remove this type of information for the definition of the term ‘investment advice.’” (Emphasis added.)⁵

Based upon the foregoing, if an RR limits his/her services to advising a plan solely with respect to the *availability* of securities or purchasers or sellers of securities and does not provide individualized advice on a regular basis that is intended to serve as the primary basis of investment decisions with respect to plan assets, he/she will not be deemed to be providing “investment advice” that would give rise to fiduciary status under ERISA. Because an IAR is not typically involved in the execution of transactions, the extent to which an IAR is able to rely on the exemptions from the definition of fiduciary advice under ERISA that extend to broker-dealers and their RRs is unclear.

II. Consequences of Fiduciary Status under ERISA

If an adviser is deemed to be rendering fiduciary advice, careful consideration must be given to determine whether he/she is able to affect his/her own compensation (and/or the compensation of an affiliate). ERISA section 404 places a number of limitations on fiduciaries, and those who do not comply could become personally liable for losses arising from a fiduciary breach. Section 406(b) further prohibits a fiduciary from engaging in certain transactions with plans and plan participants.⁶ Generally speaking, a fiduciary cannot use the authority, control, or responsibility, which makes him/her a fiduciary, to cause the plan to enter into a transaction involving the provision of services

when he/she (or an affiliate) has an interest in the transaction that may affect the exercise of his/her best judgment.

Investment advice providers that receive variable compensation, either directly or indirectly from investment manufacturers, may have an incentive to recommend investments that pay higher compensation to the adviser (and/or an affiliate of the adviser). Thus, in the absence of a statutory or administrative exemption, only those advisers operating in a “pure” level fee environment, where the only compensation received by the adviser (or by any affiliate or other person in whom the adviser has an interest) is the fee that is being charged for the advice, may provide fiduciary advice without engaging in a prohibited transaction.

RRs are particularly at risk because, as previously discussed, they are often put in a position to be asked for, and in fact do provide, individualized advice to plan sponsors and/or plan participants. Given that most RRs receive ongoing compensation from the plan investments (e.g., 12b-1 fees) that may not be level across all investments, the provision of investment advice can trigger significant personal liabilities under ERISA, including disgorgement, excise taxes, etc. Even if the RR can demonstrate that his/her compensation does not vary based upon the investments recommended, he/she may nevertheless engage in a prohibited transaction if he/she provides investment advice that results in additional compensation paid to his/her broker-dealer or an affiliate (i.e., proprietary mutual funds, group variable annuity general accounts, etc.).

Another area of potential fiduciary risk for broker-dealers and RIAs relates to what the DOL refers to as “cross-selling” (using existing clients, plan participants and beneficiaries in this case, to market additional services or products, including IRA rollovers). If the adviser is determined to be a fiduciary (e.g., by providing investment advice to participants concerning plan assets), he/she will be subject to significant limitations when marketing and providing these additional services.

The preamble of the final rule for the 2009 investment advice regulation (which was later withdrawn and reintroduced in 2010) reiterates the DOL’s position previously stated in Advisory Opinion 2005-23A (“AO 2005-23A”) addressing the issue of whether or not the recommendation that a participant take a distribution from his 401(k) plan

and roll the funds to an IRA was subject to the fiduciary standards and prohibited transaction rules of ERISA. In AO 2005-23A, the DOL said that the person making the recommendation would not be treated as an ERISA fiduciary to the plan, even where he/she offered investment advice with respect to the investment of funds in the IRA. However, to the surprise of many, the DOL went on to say that if the adviser was already a fiduciary to the plan, then making a recommendation to take a distribution, advising on how to invest the funds in the IRA or even answering questions about these matters would be subject to both ERISA's fiduciary responsibility rules and the restrictions of the prohibited transaction rules because this activity may amount to the exercise of discretion over the management of the plan. Consequently, a fiduciary adviser who offers rollover services and engages in other "cross-selling" practices may engage in a prohibited transaction by receiving additional compensation for such services. In this regard, the DOL went on to state that "[b]ecause a fiduciary adviser, in making recommendations related to the taking of a distribution or the investment of amounts so withdrawn from the plan, may violate ERISA section 404(a)(1) and/or 406(b)(1), authorizing plan fiduciaries, in carrying out their duties under section 404(a)(1) in selecting and periodically reviewing the adviser, may need to understand the extent to which such recommendations will be made." It also pointed out that the exemption for providing investment advice to participants and IRA beneficiaries (discussed in detail below) does not provide relief to the prohibition against a fiduciary using plan assets for his/her own benefit.

The fact that the DOL felt compelled to reiterate its position in this regard signals that those who serve as fiduciaries to plans have additional hurdles to overcome in seeking to capture rollovers or provide services or make recommendations on investments held

outside of the plan. Given the current debate over the disclosure and reasonableness of fees and conflicts for retirement plan service providers, "cross-selling" is expected to become an area of heightened scrutiny in future DOL and/or SEC examinations. On the other hand, if the adviser's activities do not give rise to fiduciary status, he/she is free to solicit additional services and "capture" IRA rollovers.

The graph below represents the risk levels associated with this activity and highlights that this risk is the highest when the producer provides individualized investment advice to plan participants.

As discussed, the proposed regulations addressed in detail below will present unique challenges and opportunities for firms depending upon the nature and scope of the services offered. More importantly, perhaps, is the fact that the cumulative effect of those regulations is expected to reveal the prohibited nature of the many existing arrangements (including but not limited to those referenced above) between advisers and their ERISA clients. The following sections examine each of the proposed regulations and set forth best practices for firms to remain compliant and mitigate fiduciary risk to the fullest extent practicable.

III. Fee Disclosure and Reasonable Contracts under ERISA 408(b)(2)

Under ERISA section 406(a)(1)(C), there is a general prohibition on the furnishing of goods, services, or facilities between a plan and a party in interest to

Prohibited Transaction Risk Re: Cross-Selling/Rollovers

	Most Protection	Proceed with Caution	Most Risk
Is the Producer Rendering Investment Advice to the Plan?	No. Individualized advice is not provided to the plan; the producer provides only non-fiduciary support. For maximum protection outsourcing should be considered.	Yes. For maximum protection outsourcing should be considered.	Yes. Rollover and cross-selling activity should be carefully monitored to ensure it does not give rise to a prohibited transaction.
Is the Producer Rendering Investment Advice to Plan Participants?	No. Participant advice is outsourced to independent third party; producer's role is limited to investment education and standardized materials are used.	No. Participant advice is outsourced to independent third party; producer's role is limited to investment education and standardized materials are used.	Yes. The producer should refrain from servicing rollovers or engaging in other cross-selling activity and existing arrangements should be examined for compliance.

the plan. As a result, a service relationship between a plan and a service provider would constitute a prohibited transaction, because any person providing services to the plan is defined by ERISA to be a “party in interest” to the plan. However, section 408(b)(2) of ERISA exempts certain arrangements between plans and service providers that otherwise would be prohibited transactions under section 406 of ERISA. Specifically, section 408(b)(2) provides relief from ERISA’s prohibited transaction rules for service contracts or arrangements between a plan and a party in interest if the contract or arrangement is reasonable, the services are necessary for the establishment or operation of the plan, and no more than reasonable compensation is paid for the services. In regards to the reasonableness of the contract or arrangement, the exemption merely states “[it] is not reasonable unless it permits the plan to terminate without penalty on reasonably short notice.”⁷

Thus, while plan fiduciaries are obligated to obtain information about fees and conflicts of interests, the current ERISA section 408(b)(2) lacks more specific guidelines for how and to what extent that information is to be provided. Further, under the current provisions, it is unclear as to whether service providers who are not ERISA fiduciaries are obligated to provide the information that the DOL believes plan fiduciaries need in order to evaluate whether a provider’s fees are reasonable.⁸ The DOL found this ambiguity to be problematic and believed that by amending ERISA section 408(b)(2), “plan fiduciaries would benefit from a clear and uniform regulatory standard for disclosure.”⁹

On July 15, 2010, the DOL issued its final regulation requiring covered service providers to satisfy certain disclosure requirements in order to qualify for the statutory exemption for services under ERISA section 408(b)(2). Specifically, it establishes a requirement that, in order for certain contracts or arrangements for services to be reasonable, the covered service provider must disclose specified information to a responsible plan fiduciary, defined as a fiduciary with authority to cause the plan to enter into, or extend or renew, a contract or arrangement for the provision of services to the plan. A “covered service provider” is a service provider that enters into a contract or arrangement with the covered plan and reasonably expects to receive \$1,000 or more in compensation, direct or indirect, to be

received in connection with providing one or more specified services.

The first category of covered service providers includes those providing services as an ERISA fiduciary or as an investment adviser registered under either the Investment Advisers Act of 1940 (Advisers Act) or any State law. The second category includes providers of recordkeeping services or brokerage services, and the third includes those providing specified services when they expect to receive “indirect” compensation or certain payments from related parties. The services included in this category are accounting, auditing, actuarial, appraisal, banking, consulting (i.e., consulting related to the development or implementation of investment policies or objectives, or the selection or monitoring of service providers or plan investments), custodial, insurance, investment advisory (for plan or participants), legal, recordkeeping, securities or other investment brokerage, third party administration, or valuation services provided to the covered plan.

The final regulation requires covered service providers to disclose the following information to a responsible plan fiduciary, reasonably in advance of the date the contract or arrangement is entered into (and extended or renewed), in writing –

- *Services.* A description of the services to be provided pursuant to the contract or arrangement;
- *Status.* If applicable, a statement that the provider, an affiliate, or a subcontractor will provide, or reasonably expects to provide, services as a fiduciary and/or an investment adviser registered under the Advisers Act or any State law;
- *Compensation.* A description of all direct and indirect (i.e., commissions, 12b-1 fees for designated investment alternatives, etc.) compensation received by the provider, an affiliate, or a subcontractor in connection with the services – the disclosure of indirect compensation must identify the services for which such compensation will be paid and the payers and recipients of such compensation (including the status of a payer or recipient as an affiliate or a subcontractor); and
- *Compensation for Termination.* A description of any compensation that the provider, an affiliate, or a subcontractor reasonably expects to receive in connection with termination of the contract or arrangement, and how any prepaid

amounts will be calculated and refunded upon such termination.

Any changes to this information must be disclosed by the provider as soon as practicable, but not later than 60 days from the date on which the provider is informed of such change. Any additional information requested by the plan fiduciary related to compensation received by the provider, which is necessary for the plan fiduciary to comply with reporting requirements under Title I of ERISA, must be disclosed no later than 30 days following the receipt of a written request. A description or an estimate of compensation may be expressed as a monetary amount, formula, percentage of plan assets, or a per capita charge for each participant or beneficiary or, if the compensation cannot reasonably be expressed in such terms, by any other reasonable method. Lastly, the final regulation provides for a safe harbor for plan fiduciaries when a covered provider fails to disclose the required information provided, however, that the plan report certain information about that provider to the DOL.

The disclosures must be delivered by July 16, 2011, regardless of whether the contract or arrangement was entered into prior to such date. The impact of this regulation could be substantial for many firms, as non-compliance with the disclosure and delivery requirements will result in the arrangement being a prohibited transaction and can lead to disgorgement, excise taxes, personal liability, etc.

The final regulation is expected to disproportionately affect broker-dealers. As discussed, given that RRs, as well as their firms, receive ongoing, indirect compensation from investment providers in the form of un-level 12(b)(1) fees, for example, broker-dealers whose RRs are determined to be providing investment advice will be at risk for potential prohibited transactions when that compensation is disclosed in writing. Although the burden is on the plaintiff to prove that the RRs are providing fiduciary investment advice, firms should implement appropriate safeguards to monitor and supervise this activity at the plan and participant level.

Additionally, many plan sponsors will be surprised to learn of the nature and extent of the compensation paid to their adviser out of the expenses charged against their participants' investments. Plan sponsors that may have thought they were, or in fact actually were, receiving investment advice

from their RRs will likely require the RR to explain his/her value proposition in light of the perceived or actual reduction in services. Firms should begin implementing strategies to assist their advisers in preparing a response to the above-referenced issues and, in demonstrating their value, to justify the receipt of ongoing compensation paid out of plan assets. Specific recommendations in this regard are set forth below in Section VI.

IV. Investment Advice: Plan Participants and Individual Retirement Accounts

Seeking to increase access to professional investment advice, the Pension Protection Act ("PPA") was passed in 2006, adding two sections to ERISA: 408(b)(14) and 408(g), to allow otherwise conflicted advice providers an exemption to provide advice to plan participants.¹⁰ On January 21, 2009, the DOL published a final rule in the Federal Register implementing the advice provisions contained in the PPA.¹¹ After publication on March 23, 2009, however, the Final Rule was later revoked by the DOL on November 20, 2009¹² due to comments received by the DOL that raised "significant is-

The DOL is ... sharing information and actively cooperating with the Securities and Exchange Commission ("SEC") in detecting and preventing undisclosed and/or otherwise prohibited conflicts of interest among service providers, including broker-dealers and RIAs.

sues of law and policy."¹³ In order to address these comments, the DOL introduced a proposed rule on March 2, 2010 to replace the previously revoked rule. The new Proposed Rule sets forth two exemptions from the prohibited transaction rules of ERISA and the Internal Revenue Code (the "Code") that prohibit investment advice fiduciaries from recommending investments that could affect their compensation or the compensation of an affiliate (e.g., broker-dealer, investment managers, etc.). The comment period ended on May 5, 2010,

and the DOL is expected to finalize the regulation this year.

Under the new Proposed Rule, advisers that are affiliated with firms that receive un-level compensation have two options: 1) provide advice through an eligible investment advice arrangement that requires all compensation received by the adviser and the firm through which he/she is rendering the advice to be level (but does not require the compensation of affiliates of the advice provider, e.g., the broker-dealer, product manufacturer, etc. to be level); or 2) provide advice through a computer model that is certified to be unbiased in favor of one investment option over another. Under either arrangement, specific procedural safeguards must be followed to comply with the exemption, and the adviser must submit to an annual audit. If the adviser does not have any affiliates or the affiliates do not receive additional un-level compensation, then the exemption is not necessary.

Although the regulation is not expected to be effective until 2011, the consequences of the rule could be substantial for firms. The regulation is

ERISA section 404 places a number of limitations on fiduciaries, and those who do not comply could become personally liable for losses arising from a fiduciary breach.

expected to highlight the prohibited nature of existing conflicted advice arrangements – a primary concern when broker-dealers receive un-level 12b-1 fees and their representatives render ongoing advice (whether rendered inadvertently or otherwise) – as such arrangements give rise to violations of ERISA and the Code. Other potential areas of exposure may include the choice of share classes in IRAs, revenue sharing arrangements, inadequate policies and procedures to detect and prevent prohibited transactions, gaps in errors and omissions coverage for fiduciary services, etc.

Firms should determine whether the exemption is necessary and, if so, begin developing the requisite agreements, disclosures and procedures. Affected firms should also be prepared to assist their advisers

in understanding the requirements of the exemption and in following firm-specific compliance procedures relating to providing services under the exemptions. Specific recommendations in this regard are set forth below in Section VI.

V. Expanding the Definition of Fiduciary under ERISA

On December 7, 2009, the DOL announced on the Employee Benefit Security Administration (“EBSA”) website that it was planning to expand the definition of fiduciary under ERISA. Although the website did not provide specifics, the proposed rule is expected to be published by August 2010. The DOL believes that the regulatory definition of “fiduciary” set forth in Section I above “may inappropriately limit the types of investment advice that should give rise to fiduciary duties on the part of the investment adviser.”¹⁴ The DOL has expressed concern that, in past lawsuits, many defendants used the technical wording of the regulation to argue that they were not acting as a fiduciary and, as such, avoided liability for activities that may have resulted in fiduciary breaches or prohibited transactions. The DOL believes that the proposed rule should take into account the current investment advice practices in the industry in order to reflect in the rule the actual relationship between investment advisers and plan participants. As a result, the activities of advisers are expected to become subject to even greater scrutiny, and arrangements that may have been permissible under a more limited definition of fiduciary could subject the adviser and the supervising firm to fiduciary breach claims and prohibited transaction penalties.

VI. Charting the Course towards Compliance

In light of the foregoing, firms should consider taking action prior to the regulations becoming effective. Indeed, many firms may find that significant organizational and/or operational changes are required to achieve compliance with the new mandates. Even the development and deployment of new due diligence, compliance and supervisory procedures can take months to implement and effectively communicate to affected personnel. The following list provides initial steps that firms, both large and small, can take

in order to begin working towards compliance with the wave of new regulations.

- Identify all advisers and accounts that are subject to the regulations;
- Determine the scope of services to be offered (i.e., commission vs. fee-based, fiduciary vs. non-fiduciary, investment advice vs. education);
- Determine whether any services will be offered pursuant to an exemption;
- Reconcile all services with existing 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 due diligence on and narrow the list of “approved” service providers (recordkeepers, TPAs, etc.);
- Examine compensation arrangements (for ERISA and IRA accounts), including solicitor and referral payments, the availability of alternative share classes, etc. and, if applicable, develop procedures to eliminate conflicts of interest by meeting the level compensation requirements when rendering fiduciary services;
- Implement procedures to address “cross-selling” and IRA rollovers (an area in which the DOL has expressed concern and is expected to increase enforcement efforts);
- Consider developing solutions to outsource fiduciary services (e.g., plan and participant-level investment advice) and to address the

RRs’ receipt of ongoing compensation in the absence of such services (i.e., by creating more robust investment education programs with an emphasis on increasing participation and contributions and a goal of ensuring retirement readiness); 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 the proactive and preventive steps listed above, it is possible for the regulations to serve as an opportunity for broker-dealers and RIAs to not only increase revenues but to attract and retain advisers who focus on providing retirement-related services. Because these issues contemplate changes to sales, operations, compliance, supervision and legal structures, it may be necessary to develop an internal “task force” to ensure that all of the intended and potential unintended consequences are addressed across all affected areas of the firm. Large firms that have the in-house expertise and/or the budgets to engage qualified experts should consider establishing firm-specific solutions to the issues outlined above (e.g., standardized proprietary training, benchmarking and reporting tools). Small and mid-sized firms may need to consider outsourced or “off-the-shelf” programs designed to assist with developing and maintaining compliant and profitable solutions to effectively service the expanding retirement savings market.

ENDNOTES

* Jason Roberts is a partner in the employee benefits group of Reish & Reicher and is the co-chair of the firm’s financial services practice group. He counsels broker-dealers, registered investment advisers (RIAs), hedge funds, private equity funds, retirement plan sponsors and plan providers in ERISA and investment-related matters. Jason represents clients and serves as an expert witness in federal and state court at the trial and appellate level and in arbitrations before FINRA. He also counsels clients involved in government enforcement proceedings and employment disputes. 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). He was recently named as a “Rising Star” in the 2010 edition of Super Lawyers magazine and became a founding lecturer for the Retirement

Adviser University at UCLA’s Anderson School of Management.

** Bonnie Treichel is a third-year law student at Pepperdine University. Bonnie is a fellow of the Geoffrey H. Palmer Center for Entrepreneurship & the Law at Pepperdine and a Literary Citation Editor for the *Journal of Business, Entrepreneurship and the Law*. She is currently a law clerk at Wood Smith Henning & Berman. Bonnie received a B.S. from Truman State University in Political Science, with a minor in Business Administration.

¹ Schetter v. Prudential-Bache Securities Inc., 695 F. Supp. 1077, 10 Employee Benefits Cas. (BNA) 1190 (E.D. Cal. 1988); Stanton v. Shearson Lehman/American Exp., Inc., 631 F. Supp. 100, 7 Employee Benefits Cas. (BNA) 1579, 7 Employee Benefits Cas. (BNA) 1584 (N.D. Ga. 1986); Jones v. O’Higgins, 11 Employee Benefits

Cas. (BNA) 1660, 1989 WL 103035 (N.D.N.Y. 1989).

² Procacci v. Drexel Burnham Lambert, Inc., 1989 WL 121984 (E.D. Pa. 1989); Stanton v. Shearson Lehman/American Exp., Inc., 631 F. Supp. 100, 7 Employee Benefits Cas. (BNA) 1579, 7 Employee Benefits Cas. (BNA) 1584 (N.D. Ga. 1986); Reich v. McManus, 883 F. Supp. 1144, 19 Employee Benefits Cas. (BNA) 1058, 19 Employee Benefits Cas. (BNA) 1417 (N.D. Ill. 1995).

³ DOL Interpretive Bulletin 96-1 clarifies that providing information defined as “investment education” will not be considered “investment advice” that would give rise to fiduciary status and potential liability under ERISA for investment decisions of plan participants and beneficiaries.

⁴ See 29 CFR 2510.3-21 - Proposed Regulation

Regarding the Definition of the Term "Fiduciary" October 31, 1975. The IRS concurrently proposed 26 CFR 54.4975-9 designed to clarify the term "fiduciary" as set forth in section 4975(e)(3) of the Internal Revenue Code.

⁵ Regulation 29 C.F.R. 2510-3.21(d) further evidences the DOL's position in this regard as it relates to services performed by RRs and broker-dealers. This regulation sets forth guidelines under which a broker-dealer, reporting dealer or bank may execute transactions in securities on behalf of employee benefit plans without becoming a fiduciary with respect to such plans. Paragraph (d) states that, "[a broker-dealer]... shall not be deemed to be a fiduciary, within the meaning of section 3(21) (A) of the Act, with respect to an employee benefit plan solely because such person executes transactions for the purchase or sale of securities on behalf of such plan in the ordinary course of its business as a broker, dealer, or bank, pursuant to instructions of a fiduciary with respect to such plan, if: (i) Neither the

fiduciary nor any affiliate of such fiduciary is such broker, dealer, or bank; and (ii) The instructions specify (A) the security to be purchased or sold, (B) a price range within which such security is to be purchased or sold... (C) a time span during which such security may be purchased or sold (not to exceed five business days), and (D) the minimum or maximum quantity of such security which may be purchased or sold within such price range... or the value of such security in dollar amount which may be purchased or sold..." It is also worth noting that the preamble to Regulation 29 C.F.R. 2510-3.21(d) reveals the DOL's intent to exempt broker-dealers who merely clear securities transactions involving plan assets when such transactions are initiated by other unrelated broker-dealers. See 29 CFR 2510.3-21 - Proposed Regulation Regarding the Definition of the Term "Fiduciary" October 31, 1975.

⁶ Section 4975 of the Internal Revenue Code applies similarly to the rendering of investment

advice by a fiduciary to an individual retirement account ("IRA") beneficiary.

⁷ Reasonable Contract or Arrangement Under Section 408(b)(2) – Fee Disclosure, 72 Fed. Reg. 70,989 (2007).

⁸ Reasonable Contract or Arrangement Under Section 408(b)(2) – Fee Disclosure, 72 Fed. Reg. 70,995 (2007).

⁹ Reasonable Contract or Arrangement Under Section 408(b)(2) – Fee Disclosure, 72 Fed. Reg. 70,995 (2007).

¹⁰ The PPA also added parallel provisions to the Internal Code of Revenue ("Code") under Code sections 4975(d)(17) and 4975(f)(8).

¹¹ See Investment Advice – Participants and Beneficiaries, 74 Fed. Reg. 3,822 (2009).

¹² See Investment Advice – Participants and Beneficiaries, 74 Fed. Reg. 60,156 (2009).

¹³ See Investment Advice – Participants and Beneficiaries, 75 Fed. Reg. 9,360 (2010).

¹⁴ See Investment News, available at <http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20091223/FREE/912239983>.

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