Compensation and Conflicts of Interest in ERISA Plans

By Pete Swisher

This article addresses who can get paid from ERISA-covered retirement plans, how much, in what form, and by whom. Disclosure is not the focus: the emphasis is on the many ways that fiduciaries, service providers, and other parties in interest may be compensated and the circumstances under which the compensation is permissible.

Background: Of Elephants and Mathematicians

Consider the simplest of financial transactions circa 220 BCE: the king sells a prize war elephant for a bar of gold but has no way of knowing whether the gold is pure. He therefore retains the services of a naked mathematician with a bathtub, who ducks underwater with the gold, pops up and cries, "Eureka!" and pronounces the gold pure. The king gets a known quantity of gold, which he holds in his hand before entrusting it to the royal vault, the buyer gets an especially fine war elephant that he can immediately take out for a test massacre, and both parties are happy. More to the point, they both get to touch the goods and the money and know they are not being cheated.

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Think of the Department of Labor (DOL), the Securities and Exchange Commission (SEC), and the Financial Industry Regulatory Authority (FINRA) as a bunch of naked mathematicians: disturbing, yet necessary. No one ever gets to touch the gold anymore. War elephants are scarce and illiquid, and generally obtainable only through complex partnerships with many layers of intermediaries. Modern financial products, like illicit war elephant partnerships, consist of a stunning number of layers, each with many opportunities for skimming fees. Some percentage of the time, the *opportunity* for unfair skimming actually *results* in such skimming: it is statistically unavoidable. And the greater the complexity of the product and the transaction, the harder it is for the mathematicians to make sure the gold is pure.

The story of compensation in an ERISA plan is, to a degree, a story of complexity. Instead of the straightforward exchange of a tangible product for a lump of gold, plan assets consist of modern financial products, of which even the simplest is remarkably complex and prone to mischief, and must be exchanged through complex markets. The rules to protect those assets are therefore also complex, as befits the nature of the products and the markets.

The goal of this paper is to provide an overview of the rules governing compensation in ERISA retirement plans and highlight some of the difficulties caused by the incompleteness of the regulatory portfolio.

Rules Governing Compensation in ERISA Plans

Compensation Simplified: It Is Not Allowed

Compensation is forbidden in ERISA plans. The provision of services is also forbidden, doubly so for fiduciaries. [ERISA §§ 406(a)(1)(D) and 406(b)(3)] In fact, there is a fundamental difference between ERISA fiduciary compensation and compensation for virtually every other product, service, or profession in the US:

- ERISA fiduciary compensation must be "revenue neutral";
- The compensation for doctors, lawyers, accountants, grocers, Wal-Mart, and virtually everyone else need not be revenue neutral.

The subject of what "revenue neutral" means is addressed below, but the simple version is that fiduciaries must not have the potential to benefit from their own choices and recommendations, such as through variable levels of commission or revenue sharing in recommended investments. To see how this differs from nearly all other forms of commerce in the US, consider the example of medical doctors.

Doctors are among our society's most trusted and respected "fiduciaries"—those entrusted with others' care. Yet a doctor often loses money diagnosing a patient but makes a great deal of money administering expensive treatments. There is an inherent conflict of interest in this arrangement, yet most Americans do not seem to mind (although the mismatched incentives in the medical system are certainly the cause of some debate). Overall, we still trust our doctors. This is an interesting philosophical point in itself, but the fact is that ERISA fiduciary compensation is different from compensation for other persons and businesses, even professionals such as doctors and lawyers.

The difference lies in the statutory scheme: unlike investment advisor and securities law, which prohibit certain specified types of behavior and conflicts of interest, ERISA essentially prohibits everything unless a specific exemption applies. Stated another way, *ERISA forbids everything but specifies exceptions, whereas most other laws allow everything other than what is specifically forbidden.* This leads to some interesting and sometimes nonintuitive outcomes, such as the fact that the provision of services causes one to be prohibited from providing services. (That is, a service provider is a party in interest under ERISA Section 3(14)(b), and parties in interest are prohibited from providing services under ERISA Section 406(a)(1)(C).)

Statutory Guidance

The following parts of ERISA are those most relevant to compensation:

- Section 3(14), definition of party in interest (service providers, fiduciaries, sponsors, etc.)
- Section 403(c), the first part of the Exclusive Purpose rule:

  > …the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and *defraying reasonable expenses* of administering the plan… (Emphasis added.)

- Section 404(a)(1), especially (a)(1)(A)(ii), the second part of the Exclusive Purpose rule:

  > …a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—(A) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) *defraying reasonable expenses* of administering the plan… (Emphasis added.)

- Section 406(a), the prohibited transactions for any party in interest, whether a fiduciary or not:

  > …A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—(A) sale or exchange, or leasing, of any property between the plan and a party in interest; (B) lending of money or other extension of credit between the plan and a party in interest; (C) furnishing of goods, services, or facilities between the plan and a party in interest; (D) transfer to, or use by or for the benefit of a party in interest, of any assets of the plan; or (E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 1107(a) of this title…

- Section 406(b), perhaps the most important statutory provision for purposes of the fiduciary compensation discussion, which says that a fiduciary may not:

  1. Deal with the assets of the plan in his own interest or for his own account [*the self-dealing provision*];
  2. In his individual or any other capacity, act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries [*the conflict of interest provision*];
  3. Receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan [*the anti-kickback provision*].

- Section 408, statutory exemptions to the prohibited transactions. The exemptions are numerous. The best known and perhaps most important is Section 408(b)(2), exemption for provision of services and receipt of compensation for those services, which is the source for the DOL's new Section 2550.408b-2(c) regulation. Other exemptions allow for provision of ancillary services by banks or broker/dealers, participant loans, and investment advice for participants.
- Section 408(c)

> …Nothing in section 1106 of this title shall be construed to prohibit any fiduciary from—
>
> (1) Receiving any benefit to which he may be entitled as a participant or beneficiary in the plan, so long as the benefit is computed and paid on a basis which is consistent with the terms of the plan as applied to all other participants and beneficiaries;
>
> (2) Receiving any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan; except that no person so serving who already receives full time pay from an employer or an association of employers, whose employees are participants in the plan, or from an employee organization whose members are participants in such plan shall receive compensation from such plan, except for reimbursement of expenses properly and actually incurred; or
>
> (3) Serving as a fiduciary in addition to being an officer, employee, agent, or other representative of a party in interest…

- Section 409: Liability for breach of fiduciary duty. A fiduciary who breaches his duty

> …shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary…

- Section 502(i), civil penalties for prohibited transactions (20 percent first tier, 100 percent second tier).

Internal Revenue Section 4975, which mirrors almost precisely ERISA's prohibited transaction rules, is also pertinent because it contains provisions for an excise tax to be paid by a party in interest who commits a prohibited transaction, separate from the civil penalty the DOL may impose under ERISA Section 502(i).

Guidance from the DOL

There is a robust history of DOL guidance that touches upon compensation. Conspicuously absent from this guidance is a definition of "compensation" itself, and the focus is on when compensation is prohibited and under what circumstances it is not. The majority of the guidance, therefore, concerns prohibited transactions. A sampling of relevant guidance is discussed below.

The 408b-2 Regulation

Our primary regulatory guidance on compensation is DOL Reg. Section 2550.408b-2, as recently amended by the new Section 2550.408b-2(c) "reasonable contract or arrangement" expansion of the long-standing rule (which we shall call the "408b-2 Regulation"). The basic provisions of the statute are that the service must be necessary, the compensation must be reasonable, and the contract or arrangement must be reasonable. Of particular interest in the compensation discussion is Section 2550.408b-2(e), "transactions with fiduciaries." Here are some key excerpts:

> Fiduciaries have 'a duty of undivided loyalty' and the PT rules are imposed 'to deter them from exercising the authority, control, or responsibility which makes such persons fiduciaries when they have interests which may conflict with the interests of the plans for which they act. In such cases, the fiduciaries have interests in the transactions which may affect the exercise of their best judgment as fiduciaries. Thus, a fiduciary may not use the authority, control, or responsibility which makes a person a fiduciary to cause a plan to pay an additional fee to such fiduciary (or to a person in which a fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary)…' The same thinking applies whether the compensation is direct or indirect.

The Regulation includes examples of how the rules are to be applied. For example:

- A fiduciary proposes to provide a new service for an additional fee and the sponsor as named fiduciary approves: this is allowed.
- A fiduciary advisor to a plan recommends purchasing life insurance and proposes to sell the policies to the plan for a commission, subject to full disclosure of compensation. This is prohibited, but may be allowed if the conditions of Prohibited Transaction Exemption (PTE) 84-24 are met.
- A nonfiduciary salesperson wants to sell insurance policies to the plan: not a problem. The prohibitions against self-dealing, conflicts of interest, and kickbacks only apply to fiduciaries.

- Charlie is a fiduciary service provider and hires Frank, the business owner and named fiduciary, to provide actuarial services to the plan (which provides benefits to Frank and his employees) for which Frank will receive a fee. Both Charlie and Frank have committed PTs: Frank because he used his authority as a named fiduciary to get paid, and Charlie (who was involved in the hiring decision) was not independent for purposes of hiring him; Charlie, because he had an interest in hiring Frank that affected his best judgment as a fiduciary.
- Frank hires his son to be the TPA. Not allowed.
- But a bank director can provide services to the bank so long as he recuses himself from the discussion and decision-making; he cannot hire himself, but this does not prohibit him from being hired by the plan independently.

The 408c-2 Regulation

DOL Reg. Section 2550.408c-2(b)(2) (the "408c-2 Regulation") includes an important point:

> …'reasonable compensation' does not include any compensation to a fiduciary who is already receiving full-time pay from an employer or association of employers (any of whose employees are participants in the plan) or from an employee organization…

Note that this prohibition applies only to compensation paid by the plan. For example, a doctor is paid $6,000 by his medical practice partners (not by the plan) to serve as trustee: this is allowed.

The Investment Advice Regulations

PPA 2006 amended ERISA to include a statutory exemption under Sections 408(b)(14) and (g) to allow investment advisors who are not fully revenue neutral in accordance with the Frost model (as discussed below) to provide fiduciary investment advice to participants if certain conditions are met. The DOL subsequently published detailed investment advice regulations. As a practical matter no one is using this exemption so it is not covered here. [For a discussion of the exemption, *see* Swisher, *401(k) Fiduciary Governance: An Advisor's Guide*, Third Edition, Chapter 8.]

Advisory Opinions

Two stand out: the Frost and Aetna letters, Advisory Opinions 1997-15A and 1997-16A, respectively. The "Frost model," as it has come to be known, requires a fiduciary who is receiving indirect compensation to account for any such compensation and return it to the plan as either a dollar-for-dollar fee offset, with any excess returned to the plan as a credit, or simply as a direct credit. Frost has become our primary guidance on revenue neutrality, and is our primary guide for how fiduciaries must be compensated. The Frost model and other guidance from the DOL gives us a picture of fiduciary compensation: fiduciaries must receive compensation that does not vary, or even have the potential to vary, based on the fiduciaries' choices or recommendations.

The Aetna letter, by contrast, gives us the "Aetna model," in which the DOL confirms that a nonfiduciary need not have revenue neutral compensation. Variable and indirect compensation are allowed.

There are a number of other Advisory Opinions that provide excellent insight into how fiduciaries must be compensated, including Adv. Opn. 91-37A, known as the "Greyhound letter," and Adv. Opn. 79-72A, the "Iron Range letter."

The Deseret Letter and IRA Rollovers

Advisory Opinion 2005-23A, known as the "Deseret letter," is a bit of a whopper. It touches on a subject that has the full attention of the financial community: IRA rollovers. One of the central questions for broker/dealers, RIAs, and others who serve qualified plans is the extent to which they are permitted to assist participants with assets rolled out of plans that the advisors serve. This is an extraordinarily contentious issue and the current expectation is that the DOL will address IRA rollovers in its reproposed "definition of fiduciary" regulation, which is expected sometime in 2012 or 2013.

The gist of the Deseret letter is that a fiduciary advisor may be committing a prohibited transaction by rolling a participant out of the plan into an IRA that is managed by the advisor for a higher fee. The operative word is "may." The Deseret letter addresses only the questions asked by the company that requested the opinion letter, and raises as many questions as it answers. It is clear, however, that a nonfiduciary may pursue IRA rollovers to his or her heart's content from the DOL's perspective. This has caused some in the advisory community to question the public good in preventing anyone willing to follow fiduciary rules from serving participants, and instead allowing only those who do not choose to accept ERISA's strict standards to provide rollover services. Expect interesting discussions on this point in the near future.

Prohibited Transaction Exemptions

A variety of exemptions provide a means for fiduciaries to receive compensation in ways that would otherwise be prohibited. For example, PTE 84-24 allows fiduciary advisors to sell life insurance and annuity policies to a plan if certain rules are observed, including full disclosure of the commissions. Other exemptions allow for sales of commissioned mutual funds to plans and a variety of brokerage activity.

Case Law on Prohibited Transactions

There is extensive case law offering insight into how courts view the prohibited transaction rules. [For an overview of cases and the insights they offer, *see* Swisher, *401(k) Fiduciary Governance: An Advisor's Guide*, Third Edition, Chapter 8.] Some of the learning points include:

- Courts have viewed the PT rules as preventing certain transactions "*per se*," meaning these are blanket prohibitions.
- Whether participants are harmed or not is considered irrelevant in some cases due to the *per se* nature of PTs.
- On the other hand, some courts have found that there must be a subjective intent to benefit a party in interest for a transaction to be prohibited.
- Failure to have an independent fiduciary approving compensation is viewed as a no-no, in line with DOL Reg. Section 2550.408b-2(e).
- There is nothing wrong with simultaneously serving multiple parties, such as the sponsor, the plan, and a party in interest.
- At least one court views "adverse interests" as merely different interests.
- At least one court disagrees with the DOL and believes a fiduciary may set his or her own compensation so long as it is reasonable.

Summary of Guidance on Compensation

Fiduciary vs. Nonfiduciary Compensation

Nonfiduciaries may be compensated if they meet the conditions of ERISA Section 408(b)(2) and DOL Reg. Section 2550.408b-2. Under the Aetna model, nonfiduciary compensation need not be revenue-neutral: nonfiduciaries may have variable compensation, including variable indirect compensation. Also, according to much of the case law, a fiduciary's conflict need only be *possible* for the transaction to be prohibited; thus, the need for revenue neutrality. Conflicts of interest by nonfiduciaries, by contrast, are permitted.

Fiduciary Compensation Must Be Revenue Neutral

Fiduciaries must still meet the same conditions as nonfiduciaries, but they must also have level compensation in accordance with the Frost model. Fiduciaries must also meet the additional conditions of DOL Reg. Section 2550.408b-2(e): any direct or indirect compensation must be approved by an independent fiduciary. Courts might decide other compensation methods are allowed, but fiduciaries adopt nonrevenue neutral compensation models at their peril.

This concept seems straightforward. It is not.

The Front Lines of the Battle over Compensation: The Definition of "Compensation"

There is no statutory definition of "compensation." If there were such a definition it would belong in ERISA Section 3 and would clear up a number of questions. In the absence of an ERISA definition we can look to standard definitions of compensation in the law, and we can look to the regulators.

Here is a broad definition from the 2010 edition of *Webster's New World Law Dictionary*:

1. Payment for work done.
2. Payment for injury, loss, or otherwise depriving a person of something to which he or she is entitled.

Black's Law Dictionary's discussion of compensation focuses on the second aspect, payment for injury, and refers to "valuable consideration" as another notion of compensation:

> …A valuable consideration is a thing of value parted with, or a new obligation assumed, at the time of obtaining a thing, which is a substantial compensation for that which is obtained thereby…

Explicit in these definitions is the notion of exchange: something of value is given in consideration for something of value received. This distinction is critical to any ERISA compliance effort since, to comply with DOL rules on compensation, we must first agree on what is and is not compensation, and the fact is that we may not agree. What the DOL might consider to be compensation is different from what some practitioners would consider compensation. Some recent DOL guidance has therefore been the source of consternation in the pension community.

An Informal Definition of Compensation from the Preamble to the Final 408b-2 Regulation

The preamble to the Final Regulation at 29 C.F.R. 2550.408b-2 contained the following discussion of how the DOL views compensation for disclosure purposes:

> The Department intends that the concept of compensation to be received by a covered service provider, or its affiliates or subcontractors, 'in connection with' a particular contract or arrangement for services be construed broadly. To the extent a covered service provider reasonably expects that compensation will be received, which is based in whole or in part on its service contract or arrangement with the covered plan, the compensation will be considered "in connection with" such contract or arrangement.

These sentences still do not define compensation but suggest how the DOL views it:

- *"Compensation" to Be Broadly Construed*. Compensation in connection with a particular contract or arrangement is to be broadly construed for purposes of the Regulation.
- *Reasonable Expectation That Compensation Will Be Received*. Compensation will be considered "in connection with" a particular contract or arrangement if both of the following conditions are met:
  - A covered service provider reasonably expects that compensation will be received;
  - The expected compensation is based in whole or in part on the service contract or arrangement with the covered plan.

These sentences raise a number of questions. For example, under what circumstances would a service provider be considered to reasonably expect compensation? If there is merely a possibility of compensation but no certainty, is there a reasonable expectation of compensation? How likely must the prospective receipt of compensation be before there is a reasonable expectation of receipt? To help answer such questions, the above sentences from the Preamble were followed by this example:

The Conference Example

> …a recent report pertaining to conflicts of interest prepared by the Department's Office of Inspector General… identified a fact pattern in which a service provider had not disclosed that certain financial institutions subsidized the cost of attendance at a conference that the service provider offered for its clients. Specifically, to help defray the costs of the conference, plan sponsor attendees paid a registration fee of $850, while the financial institution paid a subsidy fee of $20,000. In this regard, it is the Department's view that, when a covered service provider is engaged to provide consulting services to a covered plan (or plans) and receives subsidies or other remuneration from financial institutions or other parties with respect to whom the service provider may be making recommendations to attending plan sponsors or representatives, such subsidies or remuneration would be compensation received "in connection with" the service provider's contract or arrangement with the covered plan.

This example is problematic for several reasons. First, it can lead to absurdities in the nature of the disclosure. For example, if the recordkeeper has a single fund from Fund Family X in a single startup plan and Family X buys a booth at the conference, is the recordkeeper expected to attribute $20,000 of compensation from Family X to that lone startup plan? Second, it touches on a central issue in the compensation discussion without giving dispositive guidance: the issue of marketing expenditures and a company's right to make such expenditures. For example, is it acceptable for Family X to pay $20,000 on Tuesday, before it has any mutual clients with the recordkeeper, but not on Wednesday when the first mutual client is signed up? Clearly, there is the potential for conflicts of interest in the example; also clearly there is a need for additional guidance with respect to a broad array of common industry practices, many of which are good for participants yet might be called into question by the guidance in the Preamble. This topic is covered in detail in the section below on gifts.

Remember that the 408b-2 Regulation is about disclosure, and the discussion of compensation in the Preamble must therefore be taken in the context of questions as to what must be disclosed in advance of entering a service contract or arrangement. But clearly the Regulation addresses notions of compensation with an apparent intent to include as compensation—perhaps for purposes beyond disclosure—a very broad range of payments or gifts, even though the connection between the payment and the provision of services to a plan might be tenuous.

Of greater importance than the question of what must be *disclosed* is the question of what is *prohibited*. In the conference example in the Preamble, the discussion is focused on what must be disclosed, but the problem for service providers is that virtually all compensation is prohibited unless specifically exempted, and to the degree the interpretation of this ERISA statutory scheme calls into question long-standing industry practices (such as conference fees), there is clearly a need for further guidance. To further explore the DOL view of compensation, we therefore turn attention to gifts.

Rules Concerning Gifts

Business meals and educational opportunities, such as conferences, are routinely given by service providers to advisors and sponsors, or by advisors to sponsors, and even by sponsors to providers. The ubiquity of the practice makes the topic important, because the prohibited transaction rules may forbid even the most innocuous or beneficial gifts. Fiduciaries need to understand the rules and the reality of what the currently accepted practice is and make a reasoned judgment about what practices to employ in the future.

Guidance on Gifts

A gift of any size may be considered compensation and must therefore be treated as such unless there is strong reason to treat it otherwise: that is the simplest summation of how to treat gifts. The available guidance includes the following:

- The prohibited transaction rules;
- The Form 5500 Guidelines for Schedules A and C, which provide *de minimis* reporting thresholds for gifts, but note that just because a gift is not reportable does not mean that it is not prohibited;
- The EBSA Enforcement Manual, which provides guidelines for auditors on *de minimis* thresholds below which the Department will not pursue an inquiry; in general they are similar to the limits used in the Form 5500 guidelines, and again the Department's choice not to enforce does not mean a gift is not prohibited;
- The guidance on soft dollar payments, Technical Release 86-1;
- The anti-kickback rule for ERISA plans in the U.S. Criminal Code, 18 U.S.C. § 1954.

For perspective it may also be instructive to see the rules used by the federal government, including the gift rules for the House of Representatives, the Senate, the Executive Branch, and the Judiciary. Also:

- 5 U.S.C. 7353, Gifts to Federal Employees
- 5 C.F.R. 2635.301, Gifts Between Federal Employees
- 18 U.S.C. 201, Bribery of Public Officials.

Background

A literal reading of ERISA requires fiduciaries to reject all compensation, direct and indirect, monetary or nonmonetary, regardless of value, in the absence of specific exemptions. Yet, clearly, the plan must hire and pay service providers, and fiduciaries frequently encounter circumstances in which acceptance of a gift (such as free training) either causes no harm or is clearly beneficial to participants and beneficiaries. Are all gifts "compensation"? If not, where is the line drawn? When are gifts and compensation allowed, and when not?

In the absence of clarification, it is possible to interpret ERISA as prohibiting all of the following:

- The plan sponsor discusses business with a vendor over lunch, and the vendor pays;
- A recordkeeper pays for a plan's investment advisor to attend an educational conference;
- An employee or coworker of the plan administrator buys lunch for the administrator;
- A nonprofit organization presents a plan sponsor with a plaque naming the sponsor "plan sponsor of the year";
- A plan advisor buys the plan sponsor a fruit basket as a holiday present;
- A plan advisor picks up a free pencil from a vendor's booth at a conference.

Are any of these things wrong? Whether morally wrong or not, are they in fact prohibited? Some of the examples are deliberately silly because they parallel situations for which specific guidance does exist for federal employees. Fiduciaries of retirement plans are in many ways a type of public servant, and there is extensive guidance dictating how public servants must discharge their duties. Here is an excerpt from the Ethics Manual of the U.S. House of Representatives:

> What is it proper to offer to public officials, and what is it proper for them to receive? A cigar, a box of candy,

> a modest lunch . . . ? Is any one of these improper? It is difficult to believe so. They are usually a courteous gesture, an expression of good will, or a simple convenience, symbolic rather than intrinsically significant. Normally they are not taken seriously by the giver nor do they mean very much to the receiver. At the point at which they do begin to mean something, however, do they not become improper? Even small gratuities can be significant if they are repeated and come to be expected . . . . Expensive gifts, lavish or frequent entertainment, paying hotel or travel costs, valuable services, inside advice as to investments, discounts and allowances in purchasing are in an entirely different category. They are clearly improper. . . . . The difficulty comes in drawing the line between the innocent or proper… [From a 1951 report entitled "Ethical Standards in Government", issued by a Senate subcommittee headed by Senator Paul H. Douglas]

All branches of the US government have detailed ethics rules, including policies on gifts. The House of Representatives, the Senate, The Executive Branch, and the Judiciary all have published guidelines covering these issues, and that guidance gives public servants the ability to accept gifts and educational opportunities within specific limits, but *ERISA permits no such thing*. There is a smattering of guidance covering certain issues, but no comprehensive rules such as those for government employees. The difference, again, is in the nature of the statute: everything is prohibited, more or less, unless an exemption applies—and we lack the exemptions.

The notion that private sector fiduciaries should be held to a harsher standard than government employees seems contrary to good sense and, presumably, Congressional legislative intent, but the fact remains that a literal reading of the rules leads to some potentially absurd conclusions. This is an area in which the existing guidance leaves many questions unanswered, so what should a fiduciary do?

Guidance from the EBSA Enforcement Manual

DOL auditors are guided by the EBSA Enforcement Manual, which has a section entitled "Fiduciary Violations Involving Gifts and Gratuities," which reads as follows:

> **12. Fiduciary Violations Involving Gifts and Gratuities**. Investigations may disclose possible fiduciary violations involving a plan fiduciary's acceptance, from a party dealing with the plan, of consideration such as meals, gifts, entertainment, or expenses associated with educational conferences. In such cases, the Investigator/Auditor should determine whether the facts support an allegation that the receipt of gifts, gratuities, or other consideration were for the fiduciary's personal account and received in connection with a transaction or transactions involving the assets of the plan as required for a violation of ERISA § 406(b)(3). The Investigator/Auditor should also determine whether the fiduciary or the plan maintained a **reasonable written policy or plan provision** governing the receipt of items or services from parties dealing with the plan and whether the fiduciary adhered to that policy.
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> Further, for enforcement purposes only, the Investigator/Auditor generally should adhere to the following guidelines:
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> (1) The Investigator/Auditor should treat as insubstantial, and not as an apparent violation of ERISA § 406(b)(3), the receipt by a fiduciary (including his or her relatives) of the following items or services from any one individual or entity (including any employee, affiliate, or other related party) as long as their aggregate annual value is less than $250 and their receipt does not violate any plan policy or provision:
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> (a) gifts, gratuities, meals, entertainment, or other consideration (other than cash or cash equivalents), and
> (b) reimbursement of expenses associated with educational conferences.
>
> (2) The Investigator/Auditor should not treat the reimbursement to a plan of expenses associated with a plan representative's attendance at an educational conference as a violation of ERISA § 406(b)(3) if a plan fiduciary reasonably determined, in advance and without regard to whether such expenses will be reimbursed, that
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> (a) the plan's payment of educational expenses in the first instance was prudent,
> (b) the expenses were consistent with a written plan policy or provision designed to prevent abuse,
> (c) the conference had a reasonable relationship to the duties of the attending plan representative, and
> (d) the expenses for attendance were reasonable in light of the benefits afforded to the plan by such attendance and unlikely to compromise the plan representative's ability to carry out his or her duties faithfully in

accordance with ERISA. The fiduciary's determination should be in writing.

[Chapter 48, Fiduciary Investigations Program *http://www.dol.gov/ebsa/oemanual/cha48.html*]

As a side note, I searched long and hard for a difference between a gift and a gratuity and could find none. This section therefore simply refers collectively to "gifts."

Summary of EBSA Enforcement Manual Guidance on Gifts

- The emphasis is on ERISA Section 406(b)(3), the anti-kickback rule, which says a fiduciary shall not "receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan."
- The auditor therefore determines:
  (a) Did the fiduciary receive consideration for his own account (such as a gift of any amount)?
  (b) Was it from a party dealing with the plan?
  (c) Was the gift in connection with a transaction involving the plan?
- The implication is that a plan is expected to have a "reasonable written policy or plan provision" concerning receipt of items or services from parties dealing with the plan, and to follow that policy.
- There is a *de minimis* limit of $250 (presumably per fiduciary based on a plain reading of the Manual, not per plan, but this is not completely clear) for the following:
  (a) Gifts, gratuities, meals, entertainment, or other consideration (other than cash or cash equivalents)
  (b) Reimbursement of expenses associated with educational conferences.
- Reimbursement to plan assets for educational/conference expenses is permitted beyond the $250 limit only if the expense would otherwise be a reasonable expense of the plan and a number of administrative steps are taken (including having a written policy).

Note that the thresholds above are enforcement thresholds: the DOL is not saying these things are allowed, only that they will not seek enforcement of the PT rules below the thresholds.

Perhaps the most important item worth noting in the Manual is the DOL's position that they expect plans to have a written gift policy. Remember that the DOL decides how it will enforce, but courts decide what laws actually mean. Clearly, there is no statutory (or regulatory) requirement to have a written gift policy: this is just the DOL dictating the circumstances in which it will pursue enforcement. And pursuing enforcement does not mean the DOL will actually end up finding wrongdoing, or if it finds wrongdoing that it will do anything about it: a "no action" letter might be the result even in cases where the DOL believes a fiduciary has technically violated the rules. Nonetheless, the Department's position is clear: absent a written policy, when a fiduciary has received gifts worth $250+, "the book" calls for auditors to consider pursuing an investigation of a violation of ERISA Section 406(b)(3).

Reporting Threshold in the Form 5500

Here is a summary of the *de minimis* reporting threshold for gifts on the Form 5500 Schedules A and C:

- Occasional gifts or meals of insubstantial value are not reportable
- $100 aggregate annually for entire plan, per source
- Each individual gift is less than $50
- Gifts under $10 do not have to be counted toward the $100 limit.

Note that the reporting threshold is lower than EBSA's enforcement threshold.

What Does a Typical Plan Document Have to Say About Gifts?

If a fiduciary wishes to follow the Department's view that a written policy is needed, an easy way to comply would be for the plan document already to contain a provision addressing the issue. But the typical document says only that the plan trustee or fiduciaries are entitled to reasonable compensation so long as that compensation does not constitute a prohibited transaction under ERISA. In the absence of specific document language, the safe practice is for plans to have a separate written gift policy.

Two Approaches: Written Gift Policies vs. Reasonable Judgment

A realistic assessment of how the gift issue is handled among the fiduciaries and service providers of the nation's 718,000 plans is that vendors are constantly seeking to give stuff away to curry favor (because that's what businesses do), and fiduciaries use their best judgment as to whether to accept. As a system, this is actually tough to argue with: we already have PT rules, people have common sense, and they have a pretty good idea when they're crossing a line that is contrary to the interests of participants. The problem is that fiduciaries' idea of reasonable judgment and DOL's idea are almost certainly at odds. Here is a sample of situations to consider.

Common Business Practices That Raise Questions

- Provider makes available to sponsor:
  - Tickets to sporting events
  - An annual client appreciation party with gourmet food and wine
  - A book that she believes the sponsor will find interesting
  - Attendance at an industry conference or event, large or small
  - The travel costs associated with the industry event
  - Entertainment arranged as part of the industry event (shows, golf, etc.)
  - Lunch or dinner at which business is discussed
  - Lunch or dinner at which business is not discussed, but which is not based purely on personal friendship
  - A day golfing followed by beer at the 19th Hole
  - Personal hospitality (dinner at provider's house, perhaps an overnight stay when client is in from out of town)
  - A subscription to an information service that is useful to the plan
- Provider makes the same items available to another provider who is a fiduciary (e.g., the recordkeeper gives stuff to the plan advisor, and the advisor is a fiduciary).

Accepting a meal from a vendor is commonly viewed as being fine. Accepting a lavish dinner with expensive wine at $500 per person is not. Accepting an offer from the plan recordkeeper to pay the administrator's travel expenses to attend an educational conference sponsored by the recordkeeper should arguably be allowed—the plan benefits. And in that example, the expense is one that is arguably payable from plan assets anyway, so it is not controversial, though it may be reportable and the guidance on whether it is prohibited or not is far from clear. But what if the same recordkeeper offers to pay the plan advisor's expenses to a similar conference? Doesn't the plan still win when its advisor gets educated for free?

Using reasonable judgment is a simple philosophy and easy to implement, and this is not an area in which regulators and litigants are likely to bother spending time so long as fiduciaries do in fact exercise sound judgment. But the DOL's position as expressed in the EBSA Enforcement Manual clearly indicates that an informal policy of "we'll use reasonable judgment based on facts and circumstances" is not sufficient for the DOL's purposes, regardless of what a court might find. Fiduciaries therefore rely solely on good judgment at some risk.

The alternative is to establish a written gift policy, just as many large corporations have such policies with respect to corporate business. One approach is simply for the fiduciaries to informally agree that they will follow the corporate policy as appropriate when conducting plan business, with the caveat that ERISA's fiduciary rules naturally take precedence if in conflict with the policy.

There is a catch-22 to having a written gift policy. (As a pension consultant, the subject of gifts is sufficiently convoluted that it reminds me of Milo Minderbinder in the book *Catch-22*, who bought eggs in Sicily for one cent each, sold them in Malta for four and a half cents, bought them back for seven cents, and ultimately sold them to his unit's WWII mess halls for five cents.) Due to the lack of formal guidance, how is the author to know that the policy fits within legal guidelines? And if a policy is written that the DOL finds to allow PTs, the document itself ends up being damaging. Naturally, it would be safe to accept no gifts. Also safe would be to stick beneath the *de minimis* thresholds of both the Enforcement Manual and 5500 reporting. But if you stick to those thresholds, why bother having a policy? And if you have a policy, the only reason for doing so is that you want to exceed the *de minimis* limits, in which case you run the risk that your policy will be deemed noncompliant, and you have no way of knowing because there is no guidance.

What Is a Gift?

The definition of "gift" suffers from the same problem as the definition of "compensation": there is none. Below is sample language a sponsor might include in a Gift Policy that defines "gift" using a synthesis of the ethics rules for our three branches of government.

> "Gift" means any gratuity, favor, discount, entertainment, hospitality, loan, forbearance, or other similar item having monetary value but does not include:
>
> 1. Social hospitality based on personal relationships;
> 2. Modest items, such as food and refreshments, offered as a matter of social hospitality;

3. Greeting cards and items with little intrinsic value, such as plaques, certificates, and trophies, which are intended solely for presentation;
4. Loans from banks and other financial institutions on terms that are available based on factors other than fiduciary status;
5. Opportunities and benefits, including favorable rates and commercial discounts, that are available based on factors other than fiduciary status;
6. Rewards and prizes given to competitors in contests or events, including random drawings, that are open to the public and that are available based on factors other than fiduciary status;
7. Scholarships or fellowships awarded on the same terms and based on the same criteria applied to other applicants and that are based on factors other than fiduciary status;
8. Anything for which market value is paid by the fiduciary; and
9. Any payment, compensation, or reimbursement the acceptance of which is permitted by ERISA's prohibited transaction rules and any applicable exemptions.

Steering a Sensible Course with Respect to Gifts

In order of safest to least safe, here are a fiduciary's options for dealing with gifts:

1. Accept none.
2. Limit gifts to the *de minimis* limits for reporting in the Form 5500 ($100 total).
3. Limit gifts to DOL's *de minimis* limits for enforcement ($250 per fiduciary).
4. Adopt a written gift policy, either as a plan provision or a separate policy, that allows gifts above *de minimis* limits under specified circumstances. Make sure you follow the policy.
5. Adopt an informal policy to use prudent judgment when deciding whether to accept a gift, without having a written policy.

Pros and Cons of Gifts

Author's Opinion: It seems absurd that a vendor cannot buy meals for clients, especially nonlavish meals that serve a business purpose that benefits the plan. It seems absurd for fiduciaries to decline gifts of education or tools that will help the plan. Doing business during lunch is a huge time-saver and a normal human touch—it should be allowed, and no one should have to fool with reporting its value on the Form 5500 or worrying over whether a PT has been committed. In point of fact, the prevailing practice is that such meals are not in fact reported some large percentage of the time. Advisors should be able to embrace gifts of conference attendance and expenses: conferences are educational to advisors and therefore beneficial to their clients. Certainly, gifts can lead to abuse, but that's exactly why more guidance would be helpful: to clarify what is allowed so that plans can cut their costs. And absent that guidance, fiduciaries should be free to exercise reasonable judgment without the burden of reporting or fear of penalty.

However, ERISA Section 406(b)(3), the anti-kickback provision, is fairly clear, and it represents sound policy. Kickbacks are against the public interest, and it makes sense to forbid them. That said, it seems that there should be a better-defined regime with respect to gifts—and compensation in general—that expands the *de minimis* limits and allows certain clearly beneficial gifts, such as business meals and educational expenses, including travel costs and meals.

Certainly this is opinion, but articulating the opinion serves a purpose: service providers and their clients need to be aware that the common practices many of them follow are probably, in the eyes of the DOL, not acceptable. That one means well and feels strongly about the issue and "everyone is doing it" will not help if the DOL or a plaintiff decides to press the issue and wins. Certainly not everyone accepts gifts, but the author's experience is that meals and conferences are a ubiquitous tool, and the vast majority offers or accepts them. So give careful thought to how you handle this issue: bring it out from under the table, examine it carefully, and decide how you will handle it knowing the pros and cons of each approach.

A Path to Certainty

There may be reason to believe the DOL will issue guidance on the subject of gifts in the next few years due to the broad consideration of compensation systems it must necessarily undertake as part of implementing its regime of transparency and accountability reforms. In the meantime, a large plan or service provider that wished to achieve some certainty on this issue could draft a gift policy and seek a PTE or Advisory Opinion to clarify its acceptability to the DOL. In the absence of such an exemption or opinion, the safest course is to stick to the *de minimis* limits or decline all gifts, no matter how beneficial to the plan.

Indirect Compensation Issues

Certain service providers such as some bundled recordkeepers and broker/dealers are at the center of what may be the largest grey area: indirect compensation. Below are examples of items of value received by service providers and issues concerning their treatment.

Payments That Are Clearly Compensation

- Indirect cash payments, such as 12b-1 fees and other revenue sharing tied directly to certain investments or product arrangements
- Other cash payments or items of value offered in exchange for production, such as:
  - Persistency bonuses;
  - Additional cash payments for achieving a certain volume of new sales;
  - Trips and awards for achieving certain sales-related goals.

Payments that are clearly compensation must meet the rules for receipt of compensation, especially the prohibited transaction and disclosure rules. Payments that are not compensation, by contrast, are not subject to any rules that need concern us for purposes of this discussion.

Marketing Expenditures That May Not Be Compensation

Some or all of the following, while clearly having value, are not necessarily compensation by virtue of not being received in connection with an exchange of value related to a plan. The primary argument is that these payments are marketing expenditures by vendors and their receipt is in no way contingent on services in connection with a plan. Vendors work to build relationships with plan sponsors and other service providers in a variety of ways, and some of those ways involve the receipt of items of value by the sponsors and other service providers.

- **Soft Dollar Arrangements Not Contingent on a Business Relationship**. For example, a service provider might offer a Web site with capital markets research as a tool for attracting new business via investment advisors, with access to the site not being dependent on placement of new business. Others might offer analytical tools, such as access to benchmarking or investment analytics, free or at a reduced cost. Whether such payments are "soft dollars" or some other form of payment is a matter of semantics.
- **Conference Attendance Costs**. For example, a recordkeeper offers to host 20 advisors at a conference based on the hope that the advisors will place business with the recordkeeper in the future. Some advisors already have clients who use the recordkeeper but others do not, and attendance is not contingent on current business.
- **Practice Management Tools**. Vendors sometimes offer access to business consulting, such as research reports, seminars, or client satisfaction surveys.
- **Free or Discounted Service Arrangements**. Providers who serve plan sponsors or other service providers often provide discounts or free services in hope of capturing new business. Examples include free publications, access to subject matter experts for seminars, or phone calls.
- **Assistance with New or Prospective Clients**. Providers will generally make assistance available to advisors or other providers to help bring in new business, including making subject matter experts available for on-site visits.
- **Entertainment**. Vendors will seek to build relationships with prospective clients by inviting them to sporting events and other entertainment.
- **Business Meals**. As an ordinary part of the sales process, a service provider will often offer to pay for a meal at which business is conducted.

Soft Dollars

The term "soft dollar payments" could refer to a number of arrangements, but is historically connected with the relatively narrow circumstance in which a plan receives free research, including analyst opinions and attendance at and travel costs in connection with research conferences. In 1986, the DOL issued Technical Release 86-1, in which it offered the following view of soft dollar arrangements:

> …where an investment manager directs brokerage transactions through a designated broker-dealer to procure goods and services on behalf of the plan, and for which the plan would be otherwise obligated to pay, such use of brokerage commissions ordinarily would not violate the fiduciary provisions of ERISA, provided that the amount paid for the brokerage and other goods and services is reasonable, and the investment manager has fulfilled its fiduciary duty to obtain best execution…

This view is not necessarily consistent with other DOL guidance. The premise of the excerpt above is that the potential for soft dollar compensation is not problematic so long as the plan receives as good a deal as it otherwise would have gotten. To see how this approach might be different from other DOL guidance, imagine that the technical release were describing 12b-1 payments rather than soft dollars. The DOL's view on revenue sharing is that receiving it is prohibited unless all payments are accounted for and returned to the plan as a dollar-for-dollar fee offset and/or a credit to the trust based on the "Frost model" of Advisory Opinion 1997-15A. The technical release does not follow the Frost model.

Float

DOL has published guidance on float revenue, which is interest earned by a custodian on plan assets held in cash while awaiting disbursement. See FAB 2002-3 for a checklist for fiduciaries charged with reviewing float arrangements.

Miscellaneous Compensation Issues

Double-Dipping. As ERISA itself and the case law make clear, fiduciaries are permitted to serve multiple parties in multiple roles. Furthermore, a fiduciary is permitted to offer additional services so long as an independent fiduciary gives approval. But questions arise in the following scenarios.

> QDIA Manager Fees. Assume a registered investment advisor (RIA) serves as QDIA manager for a plan for 25bp, which is paid by any participant invested in the QDIA, and is paid an additional 25bp on all plan assets as the advisor. This arrangement may be acceptable so long as the advisor does not provide any participant-level investment advice, but the safer course may be to charge a revenue-neutral fee that includes reasonable compensation for QDIA management.
>
> Management of a Plan with Proprietary Funds. DOL Advisory Opinion 2005-10A, the Country Trust letter, discusses how mutual fund managers may include their own funds in a wrap program on a revenue-neutral basis. Failing to achieve revenue neutrality is prohibited.

Compensating Fiduciaries. Fiduciaries may be compensated so long as the proper conditions are met. For example, a 100 percent business owner cannot be paid for managing the plan from plan assets, but an owner could arguably agree to pay her partner a fee outside the plan for agreeing to handle this responsibility.

Hiring and Paying Friends and Relatives. Friends and relatives are parties in whom fiduciaries have an interest that may impair their best judgment as fiduciaries, in the language of the exemption of Labor Reg. Section 2550.408b-2(e). Fiduciaries whose friends or relatives are under consideration for providing services to the plan should recuse themselves from all deliberations and decision-making.

Service to a Plan by a Member of the Plan Sponsor's Board of Directors. The Section 2550.408b-2(e) exemption allows this: again, the key is recusal.

Vendor Searches and Changes. Is it a fiduciary act to assist an employer with a vendor search? The DOL may think so, as discussed in the proposed amendment to the definition of "fiduciary" which is expected to be reproposed during 2012 or 2013. Since compensation within various products and service arrangements is variable, vendor searches may become problematic for some advisors if such an interpretation prevails. A similar issue is the problem experienced by registered representatives of broker/dealers who have affiliates that provide retirement plan services: selling the firm's proprietary products may prove problematic. To the degree such products include proprietary funds with nonrevenue neutral compensation, it would be difficult for any fiduciary advisor to sell such products in the absence of a new PT exemption.

Compensation of Service Providers to Multiple Employer Plans

As interest in MEPs has grown, so too has interest in understanding who may or may not receive compensation. Conflicting views, expressed with great certitude, are common. Examples of the questions that arise:

- Can a MEP sponsor receive compensation from the plan?
- Can a MEP's named fiduciary, trustee, and administrator receive compensation from the plan?
- Who is responsible for ensuring that MEP fiduciaries' compensation is reasonable?
- Can service providers take a hand in forming a MEP and get paid for serving it?

A detailed discussion of these subjects is beyond the scope of this paper but as a starting point refer to the basic rules, especially DOL Reg. Section

2550.408b-2(e) and ERISA Section 408(c)(2). The short version is that any fiduciary may be paid if the conditions for exemption are met and other rules, including the Section 408(c)(2) prohibitions, are not violated.

The Problem with PT Exemptions as a Solution for Service Providers

Prohibited Transaction Exemptions (PTEs) provide a means of avoiding one sort of trouble—prohibited transactions—but provide no assurance that other forms of trouble are also avoided. A PTE is not a broad fiduciary safe harbor; it is not a blessing of a transaction for all purposes. A party in interest wishing to avoid trouble might therefore follow the conditions to qualify for a prohibited transaction class exemption yet still technically violate the exclusive purpose rule or other Title I requirements.

Consider an absurd example: fiduciary investment advisor A advises plan P on its choice of funds, which currently include Fund X. Because of the uncertainties surrounding small gifts, A and P obtained a PTE from the DOL stating that gifts with values below the thresholds for enforcement in the EBSA enforcement manual are not prohibited based on the terms of P's Gift Policy. A subsequently attends a conference at which X is an exhibitor and is offering free pencils. A goes to X's booth and takes a pencil, which he intends to use for taking notes at meetings of P's investment committee, thereby helping control plan costs by reducing A's cost burden. Is A's taking of a pencil free of risk under ERISA?

Arguably, there is always risk in such cases, but the simple fact is that many gifts are beneficial to participants and help hold costs down and quality up. When vendors, hoping to capture attention and business, offer training, information, goods, and services that advisors or fiduciaries can use to improve the quality of service, decrease the cost, or both, accepting such offers is potentially beneficial to the plan and participants. Yet in this example the following arguments could be made:

- While A's acceptance of a free pencil is not prohibited due to the PTE, it is imprudent and therefore a breach of fiduciary duties under ERISA Section 404(a)(1)(B).
- A's acceptance of the pencil is a violation of the Exclusive Purpose Rule of ERISA Sections 404(a)(1)(A) and 403(c) and the Exclusive Benefit Rule of IRC Section 401(a)(2).

A PTE is not a broad safe harbor for all fiduciary purposes under ERISA; it offers relief only with respect to the prohibited transaction rules.

The Need for a Complete Regulatory Blueprint

Service providers deserve a set of rules that tell them how they may do ethical business with confidence. The current state of affairs for ERISA fiduciary service providers is such that the lack of certainty on questions of grave importance is causing many to pull back from offering fiduciary services, or to severely curtail the extent of fiduciary service. It would seem a desirable goal of public policy to encourage providers to embrace fiduciary status, but without a complete regulatory blueprint for doing so it seems likely that large segments of the industry will continue their strenuous resistance to all things fiduciary. Guidance in a few key areas would be helpful:

- *Definition of Fiduciary.* DOL has announced repeatedly that this re-proposed regulation will be released in 2012, though 2013 may be more realistic due to the vagaries of Presidential elections. The Regulation will form an important starting point for completion of the regulatory portfolio.
- *Safe Harbor and PTE for Fiduciaries Offering Rollover Services.* A trusted advisor to a plan's participants should have a clear path for providing rollover services to participants. Participants should not be forced to seek unknown nonfiduciary salespeople when a known fiduciary advisor is close at hand.
- *Safe Harbor and PTE for Vendor Searches.* To the degree such searches are a fiduciary act, more guidance is needed on what is and is not allowed. Exemptions patterned after the PPA 2006 investment advisor exemptions might work well when applied to searches.
- *Define Compensation.* Draw a distinction between marketing expenses and compensation in connection with a plan's contract or arrangement for services. Draw from existing federal law and ethics rules for government to list specific items that are not compensation.
- *Provide a Safe Harbor and PTE, if Necessary, on Gift Policies.* If a sponsor or advisor were to draft and submit a sensible gift policy, some broad guidance on when such policies will be fiduciary safe

harbors and not prohibited would be good for all parties.

Compensation in an ERISA plan is a complicated animal. A thorough, complete regulatory portfolio is the missing link in allowing service providers to pursue ethical business models with confidence. In the meantime, providers who might otherwise have been eager to embrace fiduciary status and values are holding back.

The Existing Model for Handling Conflicts of Interest in the US: Disclosure and Consent

The reality of the marketplace is that, while change continues apace, as it has for many years, it remains true that only a fraction of the retirement plan marketplace is served solely by revenue-neutral service providers. In the end, this is the focal point of the debate: should all service providers be required to operate solely on a revenue-neutral basis? There are many who believe so, passionately. But the evidence is that virtually our entire economy operates on a different model, and that US citizens are comfortable with this. As someone who has spent the majority of his career as a fee-only, revenue-neutral independent fiduciary, it would be easy for me to put on the white hat and proclaim ERISA revenue neutrality to be the only path to righteousness, but I believe strongly that a diversity of business models serves the public far better than insisting on one single business model. Mandating a fee-only approach would have unintended consequences that increase cost and harm participants.

How Conflicts Are Handled by Registered Investment Advisors

Broadly speaking, RIAs are permitted to have conflicts of interest so long as the conflicts are fully disclosed and clients approve of the arrangement. For example, a financial planner may be acting as a non-ERISA fiduciary in completing a financial plan for a fee, and that plan might call for the purchase of investment and insurance products. There is a conflict of interest here that must be disclosed, but if the client agrees to the arrangement the RIA may sell the client the recommended products. The key is that the arrangement is disclosed and the client consents. Clients have choices: they can go to fee-only planners and buy their products from separate providers, but if they prefer a nonrevenue-neutral planner they are free to choose one. This is the "disclosure and consent" model.

Congress Has Historically Agreed with the Disclosure and Consent Model

ERISA does not purely and exclusively provide for strict revenue neutrality for fiduciaries; it just approaches disclosure and consent a different way. The system of blanket prohibitions of transactions involving parties in interest is supplemented by a robust list of exemptions. There are currently 20 statutory PT exemptions, and a central theme in all of them is that the nature of the conflict must be disclosed in writing and an independent fiduciary must approve the arrangement. [*See* ERISA § 408.]

DOL Has Historically Agreed with the Disclosure and Consent Model

ERISA gives the Secretary of Labor the authority to grant exemptions to the PT rules, and, historically, Secretaries have granted numerous exemptions. For example, the Web site of the Employee Benefits Security Administration of the DOL lists 57 class exemptions granted over the years, in addition to numerous individual exemptions. Again, the common theme is disclosure and consent.

Where Do We Go From Here?

The retirement plan industry has operated for years on a model in which disclosure is weak. As anyone likely to read this article knows, the DOL has acted decisively to change this, and the changes are reshaping the way qualified plan business is done. The next step is for the DOL to update its views on who is and is not a fiduciary, and this guidance is expected in 2012 or 2013 in the form of a re-proposed DOL Reg. Section 2510.3-21(c), "definition of fiduciary." Based on numerous formal and informal statements by DOL officials, we expect the re-proposed regulation to contain some new PT exemptions, perhaps addressing things like IRA rollovers.

It will be up to the retirement industry to work with our government partners to ensure that this next phase of the reform effort leads to a complete, sensible regulatory portfolio that allows ethical service providers to build business models with confidence, and that allows those who wish to do so to embrace fiduciary status with confidence that the parameters of service and responsibility are known and manageable.

The portfolio is unlikely to be complete if the only relief offered by the DOL is PT exemptions, yet this is likely the only sort of relief that is being contemplated. Broader fiduciary safe harbors are needed but may be difficult to obtain. The last few years have been interesting in the Confucian sense: the next few years should be interesting as well.

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