Background

- The DOL has increased its number of service provider investigations.
- The DOL has targeted RIAs for a number of years.
- The DOL has begun targeting broker-dealers and recordkeepers for investigation.
Background

- The investigations appear to be part of the DOL’s ongoing Fiduciary Service Provider Compensation Project.
  
  - Purpose is to focus on “the receipt of improper or undisclosed compensation by employee benefit plan consultants and investment advisers.”
  
  - Project is intended to ensure that plan fiduciaries and participants receive comprehensive disclosure about service provider compensation and conflicts of interest.

  - EBSA will also conduct criminal investigations of potential fraud, kickback, and embezzlement involving advisers to plans and participants.
**Background**

- Clearly, if a provider is a fiduciary, it must comply with ERISA’s fiduciary duty *and prohibited transaction* rules.
  - Even if the provider does not acknowledge fiduciary status (“functional fiduciary”).

- Non-fiduciary service providers are subject only to the prohibited transaction rules.
Fiduciary Definition

ERISA has only three types of fiduciaries . . . and the definition is “functional.”

ERISA section 3(21)(A) defines all three . . . a “person is a fiduciary with respect to a plan to the extent . . .”
Fiduciary Definition

(i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,

(ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or

(iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.
Fiduciary Duties


... 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;

(continued . . .)
(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this title . . . .
Why is the DOL investigating service providers?

The Department of Labor is focusing on service providers because of:

- the observations of prohibited transactions by service providers;
- because of a growing awareness of the significant influence that service providers have over retirement plan operation; and
- concerns over conflicted advice that adversely impacts participants.
What is the DOL looking for?

- Regarding CAP, DOL says that investigations:

  seek to determine whether the receipt of such compensation, even if it is disclosed, violates ERISA because the adviser/consultant used its position with a benefit plan to generate additional fees for itself or its affiliates.

  The CAP will also seek to identify potential criminal violations, such as kickbacks or fraud. [Emphasis added.]
What is the DOL looking for?

- Fiduciary status:
  - Broader authority and remedies over fiduciaries.
  - Expanding definition of fiduciary.
Prohibited Transaction Examples

... for Broker-Dealers and RIAs:

- If acting as a fiduciary and receive variable compensation based on fiduciary advice.

- If acting as a fiduciary recommends an investment fund managed by an affiliate.

- If, as fiduciary, recommends investments or investment managers to participants that provide additional compensation (e.g., asset allocation models or managed accounts).

- Where “received undisclosed and unauthorized compensation” to ERISA plan.

- Where receives compensation for use of plan assets.
Prohibited Transaction Examples (cont.)

... for Recordkeepers:

- The retention of float may result in prohibited transactions.
- The retention of gains from correcting trading errors may also result in prohibited transactions.
- Possibly, the DOL may argue that the receipt of excessive fees from abandoned plans.
- The removal and replacement of funds without complying with the Aetna Advisory Opinion.
Prohibited Transaction Examples (cont.)

... for all Service Providers ... forward looking:

- 408(b)(2) disclosures and undisclosed “compensation.”
- Fiduciary status.
- Functional fiduciary status.
- Provider rollover services.
Dear Sirs:

The U.S. Department of Labor (the Department), Employee Benefits Security Administration, is responsible for enforcing the fiduciary provisions of Title I of the Employee Retirement Income Security Act of 1974 (ERISA). Title I establishes standards governing the operation of employee benefit plans and service providers to employee benefit plans such as ______________________

___________________________________________________________________

This office has scheduled ________ _____for an on-site examination to begin __________

_________________________ Investigative authority is vested in the Secretary of Labor by
Section 504 of ERISA, 29 U.S.C. 1134, which states in part: “The Secretary shall have the
power, in order to determine whether any person has violated or is about to violate any provision
of this title or any regulation or order thereunder, to make an investigation, and in connection
therewith to require the submission of reports, books, and records, and the filing of data in
support of any information required to be filed with the Secretary under this title...” The primary
focus of our investigation will be _____ and any subsidiary operations as service providers to
ERISA covered employee benefit plans. The time period covered by our investigation will be
January 1, 2007 through the present.

To facilitate our examination, we request that you provide the documents on the enclosed list so
they may be retained for our files. To the extent that the documents requested exist on electronic
media, those documents should be provided electronically. Additionally records and copies may
be requested during the investigation and should be readily available. Initial background
interviews will be conducted with designated officials familiar with the services provided
by______________ to ERISA covered employee benefit plans.

Your cooperation in this matter will allow for a more efficient review. If you have any questions
about the documents requested, please contact me at _____________________.

Sincerely,

Enclosure
**Document Request:**

- As part of the investigations, the DOL typically requests a large quantity of documents.

- DOL requests:

  ...  

5. *Documents that identify, list, or schedule the company’s benefit plan clients, including, without limitation, the following information: the name, employer identification number and address of the plan sponsor; the name of the plan; the plan number; the dates of service to such plan; the name(s) of the plan trustee(s), investment manager(s) and custodian(s).*

6. *Agreements executed by the company regarding services provided to employee benefit plan clients.*
Document Request:

DOL requests (cont.):

8. Documents constituting or describing an agreement, arrangement or understanding between the company (or an affiliate) and an employee benefit plan client (or such client’s sponsor) that either of the following activities by the company (or an affiliate) would serve as the primary basis for investment decisions regarding investment of the assets of the plan:

   a. rendering advice to the plan as to the value of securities or other property, and/or

   b. making recommendations to the plan as to the advisability of investing in, purchasing or selling securities or other property.
Document Request:

- DOL requests (cont.):

  11. *Documents indicating the names, titles and last known business and home addresses and telephone numbers of the individuals who:*

  a. *rendered advice to employee benefit plan clients as to the value of securities or other property,*

  b. *made recommendations to employee benefit plan clients as to the advisability of investing in, purchasing or selling securities or other property and/or,*

  . . . *including identification of the name and EIN and plan number of each such plan.*
Document Request:

- DOL requests (cont.):

  12. *Documents that describe, list, or schedule any fees charged by the company or an affiliate to manage the assets of, or provide investment advice or other services to, employee benefit plan clients.*

  ... 

  14. *For each of the twenty employee benefit plan clients that generated the greatest aggregate annual fees or compensation (based on the calendar year) for the company and its affiliates, the number of occasions in 2007, 2008, 2009, and 2010 (to date) in which the company provided the services described in document request #8, above, to the plan.*

  ...
Document Request:

DOL requests (cont.):

20. Contracts, service agreements and any other documents relating to any relationships between the company and any mutual fund or mutual fund family whose products or services the company has identified for, recommended to, offered to, or utilized in connection with services provided to any ERISA plan client.

27. Documents sufficient to identify all compensation received, directly or indirectly, by the company from mutual funds or mutual fund families whose products or services the company has identified for, recommended to, offered to, or utilized in connection with services provided to, any ERISA plan client.
Document Request:

- DOL requests (cont.):

28. *Documents sufficient to identify all compensation received, directly or indirectly, by the company from record keepers or other service providers whose products or services the company has identified for, recommended to, offered to, or utilized in connection with services provided to, any ERISA plan client.*
Observations

- Deadline for producing documents may be short.
- Much of the information may not be readily available.
- Some types of documents may not exist.
- DOL requests tend to be over-inclusive.
- Providers need to understand the implications of the questions and the responses.
Recommendations

Experience in handling investigations is important:

- First, negotiate the timing of responding.
- Second, negotiate the volume of materials to be provided.
- Third, “pre-audit” the materials to see what they are likely to show.
- Fourth, consider requesting administrative subpoena.
Recommendations (cont.)

- Firms should conduct an internal audit to review materials (including marketing materials) and issues the DOL focuses on.

- Firms should review all methods of receiving revenues:
  - For 408(b)(2) disclosures (i.e., to ensure that all compensation is disclosed).
  - For prohibited transaction issues related to revenues from fiduciary activities.
Questions
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