

What it Means to be an ERISA Fiduciary: A Comparison to the Securities Laws

By David C. Kaleda

Most federally registered broker-dealers (“BDs”) and federally registered investment advisers (“RIAs”) are very familiar with how the federal securities laws and the rules of the Securities Exchange Commission (“SEC”) and an applicable self-regulatory organization (“SRO”) impact their business practices. As required by the SEC and SROs, BDs and RIAs have written compliance procedures and assign compliance officers to oversee their firm’s investment and trading activities. However, the BDs, RIAs and compliance officers may not be as familiar with the fiduciary requirements of the Employee Retirement Income Security Act of 1974 (“ERISA”). There are some substantial differences between ERISA’s standards of conduct and those under the securities laws.

The purpose of this article is to better acquaint BDs and RIAs with the requirements of ERISA, with a particular focus on the standards of conduct, by comparing and contrasting ERISA’s requirements to the requirements of the federal securities laws. The author assumes that most readers of this article have a significant understanding of the securities laws. Therefore, the article is primarily focused on ERISA and only looks to the securities laws in order to give the readers an appropriate frame of reference rather than going into detail regarding when and how the securities laws apply. The author hopes the table accompanying this article will serve as a useful reference tool for determining when ERISA applies and what the practical implications are to a BD or RIA.

Application of Securities Laws versus ERISA

Exchange Act and Advisers Act

A broker-dealer is subject to the Securities Exchange Act of 1934, as amended (“Exchange Act”), and is required to register pursuant to rules established by the SEC and an applicable SRO, if he or she on an interstate basis effects securities transactions or induces another party to enter into the purchase or sale of securities.¹ An adviser is subject to registration under the Investment Advisers Act of 1940, as amended (the “Advisers Act”) if, among other things, the person is an “investment adviser.” A person is an investment adviser if he or she –for compensation, engages in the business of;

- (i) advising others as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or
- (ii) who issues or promulgates analyses or reports concerning securities.²

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There are a number of exceptions that may require an adviser to be subject to state law rather than the Advisers Act.

ERISA applies if a BD or RIA (or other person) is acting as a “fiduciary” as defined under ERISA. The BD’s or RIA’s fiduciary status under the Advisers Act or state law are not relevant for purposes of ERISA. Generally, RIAs and BDs will be fiduciaries under Section 3(21) of ERISA if they perform certain functions with respect to plans or “plan asset” entities.

Section 3(21) of ERISA (commonly referred to as a “3(21) fiduciary”). A person is a 3(21) fiduciary if he or she does any of the following:

- exercises any discretionary authority or discretionary control respecting management of the plan;
- exercises any authority or control respecting management or disposition of the plan’s assets;
- renders investment advice with respect to plan assets for a fee or other compensation, or has any authority or responsibility to do so; or
- has any discretionary authority or discretionary responsibility in the administration of the plan.

Section 3(21) provides for a functional definition of fiduciary. As such, a person is a fiduciary only if it performs one of the functions described above and only to the extent it performs such functions.

A person provides investment advice under ERISA’s functional definition of fiduciary if the person receives compensation for doing the following:

he or she makes recommendations regarding the advisability of buying, selling, or retaining securities;

he or she does so on a “regular basis” pursuant to an agreement that “such services shall serve as the primary basis for investment decisions with respect to plan assets;” and

such advice is individualized to the plan taking into account factors such as investment policies, investment strategies, the plan’s overall portfolio, or diversification of plan investments.³

Notably, the DOL is expected to propose regulations that will significantly broaden this definition and thus the number of financial services providers who are fiduciaries by reason of providing advice.

An RIA may also be designated as a fiduciary under Section 3(38) of ERISA. Section 405(c)(1)(B) of ERISA allows a fiduciary to delegate its investment authority to an “investment manager” as defined in Section 3(38) of ERISA (commonly called

a “3(38) fiduciary”). An “investment manager” for this purpose is a person who (i) has the “power to manage, acquire, or dispose of any asset of a plan;” (ii) falls into one of several specifically listed financial institutions including an adviser registered under the Advisers Act (but does not include a registered broker-dealer); and (iii) acknowledges in writing that it is a fiduciary. Section 405 provides that the delegating fiduciary can significantly shift its potential liability regarding investment management decisions to the investment manager. As such, a BD cannot qualify as a fiduciary for this purpose though it may still be a fiduciary under the functional definition discussed above.

For any BD or RIA, a key determination is whether they are or whether it is acting as a fiduciary for purposes of ERISA. While a 3(38) fiduciary relationship should be obvious because it is intentionally established, a determination as to 3(21) fiduciary status can be much more nuanced.

A broker-dealer, for example, will often not intend to be an ERISA fiduciary. This will be the case if a BD is simply making trades at the direction of another plan fiduciary (such as the employer, an investment committee, or an investment manager) or a plan participant (such as in the case of a 401(k) plan in which the participant can direct account investments).⁴ However, the BD may become a fiduciary if it (i) assumes too much discretion in making trades on behalf of a plan (or a participant’s plan account) or (ii) in making recommendations to a plan (or a participant with an account in the plan) the BD provides “investment advice.” A BD should carefully review its trading operations to assure that it is not inadvertently becoming an ERISA fiduciary.

RIAs, on the other hand, often operate as ERISA fiduciaries due to the nature of their advisory activities. This is particularly so when the RIA has discretion to manage plan assets. Moreover, in providing advice for SEC purposes, the RIA in many cases will be acting as a fiduciary for ERISA purposes. However, this is not always the case. The ERISA fiduciary definition of investment advice may be narrower than the Advisers Act definition of advice in many cases. For example, simply advising on the value of securities or providing investment advice on a one-time basis would not necessarily lead to ERISA fiduciary status. Importantly, any changes to the fiduciary regulation under ERISA may result in some RIAs being fiduciaries in circumstances where they may not be so under current law.

Understanding when a BD or RIA is an ERISA fiduciary is important because, as discussed below, an ERISA fiduciary is held to a standard of conduct that is considerably different from the standards under the Exchange Act and the Advisers Act. The chart accompanying this article illustrates at what point each of the statutory and regulatory regimes apply.

Standards of Conduct under the Securities Laws versus ERISA

Securities Laws - Exchange Act and Advisers Act Standards of Conduct

The standards of conduct under the securities laws are quite different than those under ERISA. Thus, BDs and RIAs should not assume that compliance with the applicable securities laws is tantamount to compliance with ERISA. In many cases, this simply will not be the case.

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BDs, pursuant to the Exchange Act, are subject to antifraud provisions. These provisions have been interpreted by the SEC and FINRA to establish a duty of fair dealing. According to the Second Circuit, the Exchange Act establishes a “special relationship” between the BD and the client whereby the BD is in a position of trust such that the client should be able to assume statements made by the BD are thoughtful and accurate. FINRA Rule 2010 also provides that a BD “in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.”

Inherent in this duty of fair dealing is a requirement that a BD make a “suitability” determination with respect to securities transactions it recommends to its customers. Thus, BDs, based upon a number of criteria, must make a determination that a recommended trade is suitable for at least some investors in general (reasonable basis suitability) and is suitable for a particular customer (customer-specific suitability and quantitative suitability). BDs are also subject to a duty of best execution and a duty to disclose conflicts in certain situations. However, federal securities laws do not impose a fiduciary duty on BDs, although they may be a fiduciary under certain states’ laws.

RIAs, on the other hand, do owe a fiduciary duty to their clients.⁵ Part and parcel to this fiduciary duty is that RIAs owe a duty of loyalty to their clients. An RIA must “serve the interests of his client with undivided loyalty.”⁶ Therefore, the RIA as a fiduciary “must not put himself into a position where his or her own interests may come in conflict with those of his [client],” though there is an exception to this general prohibition “where the [client] gives informed consent to such dealings.”⁷

As such, the RIA should not make investment decisions, including trades in securities, in a manner that will benefit the RIA without first disclosing the existence of the conflict to the client. The content and frequency of such disclosure varies based upon the facts and circumstances of the situation. In effect, informed consent given by a client to the RIA is permitted by the Advisers Act and will overcome a breach of the duty of loyalty owed by the RIA to the client.⁸ The SEC also holds RIAs to a duty to make a determination of “suitability” in delivering investment advice to a client⁹ and, if the RIA has discretion to make trades through BDs, RIAs are required to seek “best execution.”¹⁰

ERISA – Standards of Conduct

ERISA, the regulations thereunder, and guidance issued by the DOL establish an extensive standard of conduct pursuant to which fiduciaries must operate. Such standard of conduct essentially can be broken down into three parts (i) the general fiduciary duty provisions, (ii) prohibitions against self-dealing, and (iii) prohibitions against dealings with parties in interest.

Section 404(a) ERISA sets forth ERISA’s general fiduciary duty provisions. The fiduciary duty established under ERISA is recognized as the “highest known to the law.”¹¹ ERISA provides that a person acting as a fiduciary with respect to a plan has the following duties:

Duty of Prudence: ERISA’s duty of prudence requires that a fiduciary discharge his duties “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.”

Duty of Loyalty: Plan fiduciaries must discharge their duties with respect to the plan solely in the interest of the participants and beneficiaries for the “exclusive purpose” of providing benefits to participants and their fiduciaries and defraying reasonable expenses of the plan.

Duty to Diversify: A fiduciary must discharge his or her duties “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.”

Duty to Follow Plan Documents: A fiduciary must discharge his or her duties “in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of [ERISA].”

ERISA further establishes that a fiduciary is personally liable for any losses incurred by a plan by reason of a breach of fiduciary duty.¹² Furthermore, ERISA specifically provides that the use of exculpatory language as a means of avoiding liability under ERISA is void as against public policy.¹³

In defining how the aforementioned general fiduciary provisions are to be applied by a fiduciary responsible for investing plan assets (“Investment Fiduciary”), the DOL issued regulations further explaining how the aforementioned duties apply in the context of making investment decisions with respect to plan assets.¹⁴ An Investment Fiduciary must give “appropriate consideration” to those facts and circumstances that, given the scope of such fiduciary’s investment duties, the fiduciary knows or should know (are relevant to the particular investment or investment course of action involved) including the role the investment or investment course of action plays in that portion of the plan’s investment portfolio with respect to which the fiduciary has investment duties.¹⁵ The regulation gives some examples of “appropriate consideration.”

While the fiduciary standards under ERISA is high, ERISA does not require omniscience on the part of a fiduciary or that the fiduciary must always be right. Rather than focusing on the outcome of a decision by a fiduciary, ERISA places the focus on the process whereby the fiduciary gathers appropriate facts and information to make a reasoned determination within the standards described above.¹⁶ This process is commonly referred to as “procedural” prudence.

In addition to the general fiduciary duties described above, ERISA strictly prohibits the fiduciary from engaging in a transaction that involves plan assets where a conflict of interest exists. Section 406(b) of ERISA prohibits the following self-dealing transactions:

- A fiduciary may not deal with assets of the plan in his own interest or his own account;

- A fiduciary may not act in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan or the plan's participants and beneficiaries; or,
- A fiduciary may not receive any consideration for his own personal account from any party dealing with the plan in connection with a transaction involving plan assets.

The inclusion in ERISA of both a general fiduciary duty of loyalty and a specific prohibition against self-dealing transactions should be construed by a fiduciary that even if it believes that a transaction was in fact completed with the intent of exclusively benefitting the plan, that transaction may still result in a prohibited transaction if such transaction could be construed resulting in self-dealing as described above. In effect, ERISA assumes the existence of an ulterior motive (that is, self-interest) unless an exemption applies.

Finally, the party in interest prohibited transaction provisions, in effect, prohibit a fiduciary from engaging in a transaction between a plan and almost any person or entity dealing with the plan unless an exemption applies. Thus, as in the context of self-dealing, a transaction that would otherwise be prudent, exclusively in the interest of the plan, and otherwise in line with the general fiduciary duty provisions, a transaction between the plan and a party in interest is presumed to be nefarious. For example, (i) payment of brokerage commissions and advisory fees from account assets, (ii) block trades involving account assets, (iii) cross-trading involving account assets, and (iv) execution of securities transactions by a BD (principal or agency) on behalf of a plan are all prohibited transactions. However, there are myriad statutory and class exemptions promulgated by the DOL that in fact permit such transactions and other common transactions as long as they are done in accordance with the terms of the applicable exemption.

BD and RIA Compliance with ERISA

While they are subject to rigorous standards of conduct under the Exchange Act and the Advisers Act, BDs and RIAs who are also ERISA fiduciaries should not assume that compliance with the securities laws will meet ERISA's fiduciary standards or its prohibited transaction provisions. As discussed above, the fiduciary duty provisions have been interpreted to require a very high standard of conduct in light of the purpose of the plan. Furthermore, ERISA's general fiduciary duty provisions are particularly demanding because they are combined with ERISA's prohibited transaction provisions.

Under the Exchange Act, a BD is only required to recommend transactions involving securities that are "suitable" for the client and to seek "best execution" in making trades. These standards are grounded in concepts of fair dealing, truthfulness, and acting honorably in the conduct of a commercial endeavor. On the other hand, a BD that is a fiduciary for ERISA purposes must act as a "prudent person" would under the circumstances then prevailing as if he or she had the necessary expertise to recommend or engage in such transactions. Furthermore, the fiduciary must act pursuant to a duty of loyalty that requires it to make decisions with an "eye single" toward protecting the

interests of the plan.¹⁷

A fair reading of the Exchange Act's and ERISA's conduct provisions strongly indicates that the prudence standard puts a greater burden on the BD than making a suitability and best execution determination. A trade that is "suitable" and executed at the best price under the circumstances would not necessarily be prudent for ERISA purposes. A determination that a trade is reasonable under a given set of facts solicited by the BD does not necessarily equate to the "care, skill, prudence, and diligence under the circumstances then prevailing" that prudent person with similar skills and experience. The ERISA standard appears to leave less room for error and a violation would result in the BD's personal liability to the plan.

In addition, even if in a given situation suitability and best execution qualified as ERISA prudence, the BD may not be acting exclusively in the interest of the plan's participants and beneficiaries, a standard which does not apply under the Exchange Act. For example, a BD may be engaging in prohibited self-dealing under ERISA if it received a commission or mark up for recommending a security purchased by a plan even if the BD complied with the Exchange Act's best execution requirements unless it complies with the provisions of DOL Prohibited Transaction Class Exemption 86-126.¹⁸ Furthermore, while the relief available under this class exemption applies to the commissions received, the exemption does not apply if the BD may enjoy a benefit from the transaction other than the receipt of a commission.

The Advisers Act, on the other hand, creates a fiduciary relationship between the RIA and its client. However, while the Advisers Act appears to impose a more rigorous standard of conduct than the Exchange Act, an RIA acting as an ERISA fiduciary should not always assume that compliance with the Advisers Act is tantamount to compliance with ERISA, particularly with respect to conflicts of interest. ERISA requires that the fiduciary duty provisions be applied with the understanding that fiduciary decisions are being made with respect to a plan, taking into account the special nature of such plan (for example, the funding of retirement benefits). Thus, investment recommendations or activities with respect to a plan account may be different than those applicable to a non-plan account even for the same customer. In addition, while one recommendation or decision will be appropriate for one plan client, such recommendation or decision may not be appropriate for every plan client.

Also, an RIA will never be in compliance with ERISA merely by disclosing conflicts of interest or potential conflicts of interest even though such disclosure typically suffices under the Advisers Act. Conflicts of interest are by definition contrary to ERISA's fiduciary duty of loyalty and self-dealing prohibited transaction provisions. Furthermore, an RIA would have difficulty arguing that a transaction in violation of these provisions was prudent. As such, the RIA must be able to identify potential conflicts and take steps to avoid them either by complying with an exemption or complying with other DOL guidance.

Based upon the foregoing, the following are several areas with which a BD or RIA should be concerned when acting as an

ERISA fiduciary even though it may be complying with the Exchange Act or the Advisers Act.

Disclosure of Conflicts of Interest: One of the most obvious areas in which there is a significant divergence between the securities laws and ERISA is in the area of conflicts of interest. Under ERISA, the disclosure of a material conflict, by itself, will never be sufficient under ERISA's duty of loyalty and self-dealing prohibited transaction provisions to avoid a violation of ERISA.

Use of Fiduciary Discretion or Authority to Increase Compensation: A BD or RIA breaches its fiduciary duty of loyalty, as well as the self-dealing prohibited transaction provisions under ERISA, if it uses its fiduciary discretion or authority to increase its own compensation. ERISA's exemptions with respect to such activity are limited in usefulness particularly with respect to RIAs. Thus, for example, an RIA or its affiliate typically cannot receive transaction-based compensation or revenue sharing payments from mutual funds in addition to its advisory fee. Notably, however, there is generous prohibited transaction relief associated with the receipt of commissions and similar forms of compensation by BDs if certain requirements are met. However, BDs are cautioned that such relief does not exempt other kinds of self-dealing. In addition, performance fees that may be permissible under the Advisers Act may not be permissible under ERISA.¹⁹

Affiliate Transactions: The duty of loyalty and self-dealing prohibited transaction provisions make engaging in transactions between a BD or an RIA and its affiliates (or in transactions in which the RIA or BD is on both sides) impossible unless the BD or RIA can point to a specific exemption that permits said transactions and it meets the requirements of said exemptions. In other words, transactions between the RIA and its affiliates (or itself) are presumed to be violative of ERISA in the absence of an exemption even if they are anticipated to be beneficial to the plan. Thus, transactions such as cross-trading, block trading, principal transactions, use of affiliated broker-dealers, and others should be carefully evaluated for compliance with the general fiduciary and prohibited transaction provisions of ERISA.

"Party in Interest" Transactions: Even if the BD or RIA is not engaging in transactions with its affiliates or otherwise engaging in self-dealing, the BD or RIA must not engage in transactions with any "party in interest" to the plan unless it can point to an exemption that permits such transactions and the requirements of that exemption are met. Again, notwithstanding compliance with ERISA's general fiduciary and self-dealing requirements, ERISA assumes a transaction with any other party related to the plan is improper unless an exemption applies.

The table accompanying this article illustrates the differences among the three statutory and regulatory regimes.

Identification of Applicable Statute & Regulations		
Registered Broker-dealer	Registered Investment Adviser	ERISA Fiduciary
<p>In the absence of an exemption, the Exchange Act applies to a broker or dealer of securities involved in interstate commerce when effecting securities transactions or inducing another party to enter into the purchase or sale of securities.</p> <p>"Broker" - person engaged in the business of effecting transactions in securities for the account of others.</p> <p>"Dealer" - person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise.</p>	<p>In the absence of exemption, the Advisers Act applies to an "investment adviser" who is any person who –</p> <ul style="list-style-type: none"> • For compensation; • Engages in the business of; • Advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or issues analyses or reports concerning securities. <p>Specific exclusion for BD if advice is incidental and no special compensation is paid.</p> <p>Small and some mid-sized advisers subject to registration at state level, thus state law governs conduct.</p>	<p>ERISA applies to any person who does any of the following:</p> <ul style="list-style-type: none"> • Exercises any discretionary authority or discretionary control respecting management of a plan; • Exercises any authority or control respecting management or disposition of the plan's assets; • Renders investment advice with respect to plan assets for a fee or other compensation; or • Has any discretionary authority or discretionary responsibility in the administration of the plan. <p>"Plan" is an employee benefit plan subject to Part 4 of Title I of ERISA and "plan asset" entities with such benefit plans as investors.</p>

Summary of Standard of Conduct

Registered Broker-dealer	Registered Investment Adviser	ERISA Fiduciary
<p><u>Anti-fraud Provisions:</u> BD may not-</p> <ul style="list-style-type: none"> • cause a client to enter into a securities transaction “by means of any manipulative, deceptive, or other fraudulent device or contrivance.” • use “any manipulative or deceptive device or contrivance” contrary to the rules established by the SEC or SRO to protect the interest of clients. <p><u>Other Duties:</u></p> <ul style="list-style-type: none"> • Duty to deal fairly with clients; • Duty to make suitability determination. • “reasonable-basis” – after reasonable due diligence, reasonable basis to believe recommendation is suitable for at least some investors. • “customer-specific” – suitable for the specific client given such client’s investment profile. • “quantitative” - reasonable basis to believe that a series of recommended transactions is not excessive or otherwise unsuitable given such client’s investment profile. • Duty of best execution - use reasonable diligence to achieve as favorable of a price as possible under prevailing market conditions. • Duty to disclose conflicts in certain situations. <p>BD not a fiduciary under Exchange Act or FINRA rules though may be under state law.</p>	<p><u>Antifraud Provisions:</u> RIA may not-</p> <ul style="list-style-type: none"> • act in a manner designed to manipulate, defraud, or deceive its clients or prospective clients. • engage in any course of conduct that will have the effect of manipulating, defrauding, or deceiving a client or prospective client. <p><u>Fiduciary Duties:</u></p> <ul style="list-style-type: none"> • Duty to disclose material facts; • Duty of loyalty (including a duty to not engage in transactions involving a conflict of interest unless such conflicts are disclosed); • Duty to determine suitability (including a duty to inquire) – reasonable determination that advice is appropriate based upon client’s financial situation, investment experience, and investment objectives; • Duty of best execution - seek best price at which trades could be executed in light of facts and circumstances (dealer mark ups and mark downs, brokerage commissions, etc.). RIA must also consider compensation paid to the RIA. <p>SEC regulations specifically address agency cross transactions, principal trades, custody, and proxy voting.</p>	<p><u>General Fiduciary Duties:</u></p> <ul style="list-style-type: none"> • Duty of Prudence: act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use under similar circumstances; • Duty of Loyalty: discharge his or her duties with respect to the plan solely in the interest of the plan for the exclusive purpose of providing plan benefits; • Duty to Diversify: diversify plan investments so as to minimize the risk of large losses; and, • Duty to Follow Plan Terms: follow the terms of the plan’s governing documents. <p><u>Self-dealing Prohibited Transactions:</u></p> <ul style="list-style-type: none"> • A fiduciary may not deal with assets of the plan in his own interest or his own account; • A fiduciary may not act in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan or the plan’s participants and beneficiaries ; or, • A fiduciary may not receive any consideration for his own personal account from any party dealing with the plan in connection with a transaction involving plan assets. <p><u>Party in Interest Prohibited Transactions:</u> A fiduciary should not cause the plan to enter into non-exempt transactions with parties in interest.</p> <p>Compliance with statutory or administrative exemption (if available) will not result in a self-dealing or party-in-interest prohibited transaction.</p>

Summary and Conclusion

In summary, while the Exchange Act and Advisers Act provide strictly regulate BDs and RIAs, the standards of conduct under the securities laws are very different than those under ERISA. Therefore, BDs and RIAs should be aware of their fiduciary status (and any changes to that status that might come about by reason of DOL regulatory action in the not too distant future). Furthermore, to the extent they are acting as ERISA fiduciaries, BDs and RIAs should not assume their conduct complies with ERISA even though they are acting in accordance with the securities laws.

The price of failing to comply with ERISA's fiduciary requirements can be high. ERISA provides that a fiduciary is personally liable in the event of a breach of the fiduciary duty provisions. Furthermore, ERISA provides for a comprehensive remedial scheme including the fiduciary making good on any losses to the plan caused by the breach and the restoration of any profits gained by the fiduciary in using plan assets to its own benefit. As such, BDs and RIAs would do well to understand if they are fiduciaries and the implications of that status. ♦

(Endnotes)

- 1 Exchange Act § 15(a)(1).
- 2 Advisers Act § 202(a)(11).
- 3 29 C.F.R. § 2510.3-21(c).
- 4 See 29 C.F.R. § 2510.3-21(d) (DOL regulations specifically provide that a registered BD is not a fiduciary if merely executing trades on behalf of plan as long as the BD is not affiliated a fiduciary to the plan and the trade orders are very specific.)
- 5 S.E.C. v. Capital Gains Bureau, 375 U.S. 180 (1963).
- 6 In the Matter of Kidder Peabody & Goodwin, Investment Advisers Release No. 232 (October 16, 1968).
- 7 See In the Matter of Arleen W. Hughes, Exchange Act Release No. 4048 (Feb 18, 1948).
- 8 See Regulation of Investment Advisers by the U.S. Securities and Exchange Commission, SEC, Division of Investment Management

(April 2012) at http://www.sec.gov/about/offices/oia/oia_investment/rplaze-042012.pdf. (The SEC states that "the duty of an investment adviser to refrain from fraudulent conduct includes an obligation to disclose material facts whenever failure to do so would defraud or operate as a fraud or deceit upon any client.")

- 9 See Suitability of Investment Advice provided by Investment Advisers, Investment Advisers Release No. IA-1406 (March 22, 1994).
- 10 In the Matter of Portfolio Advisory Services, LLC, Investment Advisers Release No. IA-2038 (June 202, 2002); see also In the Matter of Renberg Capital Management, Inc., Release No. IA 2064 (October 1, 2002), Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1984 and Related Matters, Exchange Act Release No. 34-23170 (April 28, 1986) and In the Matter of Kidder Peabody & Goodwin at Note 23.
- 11 Donovan v. Bierwith, 680 F.2d 263, 272 n. 8 (2d Cir. 1985).
- 12 ERISA § 409(a).
- 13 ERISA § 410(a).
- 14 29 CFR §2550.404a-1(b).
- 15 Id.
- 16 Donovan v. Mazzola, 716 F2d 1226 (9th Cir. 1983); See also GIW Industries, Inc. v. Trevor, 895 F2d 729 (11th Cir. 1990).
- 17 Kuper v. Iovenko, 66 F.3d 1447, 1458 (6th Cir.1995)

- 18 See DOL Prohibited Class Exemption 86-128 (Exempts certain transactions by registered broker-dealers who are ERISA fiduciaries).
- 19 The SEC's regulations provide that an RIA will not violate Section 205 by including in an agreement an arrangement whereby compensation is determined on the basis of a share of the capital gains upon, or the capital appreciation of, the funds, or any portion of the funds, of a client if the client is a "qualified purchaser." However, the DOL's requirements for performance fees are stricter. For example, DOL guidance provides that, among other things, (i) that the performance fee be based on a calculation of net profits that reflected realized and unrealized gains and losses, (ii) that the gains and losses be determined on the basis of market quotations or on valuations made by independent parties or services selected or approved by a fiduciary independent of the fiduciary receiving the fee, and (iii) that the fee was approved by an independent plan fiduciary after full disclosure of the facts. See DOL Adv. Op. 1999-16A.



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