

# The Investment Lawyer

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## REGULATORY MONITOR

### DOL Enforcement Update

Groom Law Group

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#### Employee Benefit Security Administration Enforcement Activity

During the past couple of years, many of us who counsel investment advisers, broker dealers, and other financial services companies regarding compliance with the Employee Retirement Income Security Act of 1974, as amended (ERISA) have seen a marked increase in Department of Labor (Department or DOL) Employee Benefit Security Administration (EBSA) enforcement activity targeting these firms. While the compliance departments of these firms are very familiar with the Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) examination process, they are not familiar with the examination process undertaken by EBSA's Office of Enforcement (OE). In fact, some compliance officers may not even realize that service providers to ERISA-covered employee benefit plans are in fact subject to OE's examination authority. The purpose of this article is to raise awareness of EBSA's examination authority and update readers regarding recent trends in DOL enforcement activity including joint enforcement efforts by the EBSA and the SEC.

#### Advisers are an Enforcement Priority

Undoubtedly, the Department has increased its scrutiny of benefit plan service providers. In fact, EBSA's Enforcement Manual, pursuant to which OE investigators conduct their examinations, states that "EBSA is strategically focusing more investigative resources on professional fiduciaries and service providers with responsibility for large amounts of plan assets and the administration of large amounts of plan benefits. This will be accomplished by a national enforcement priority that directs investigative resources to the conduct of major cases."<sup>1</sup>

To that end, the Department also implemented in 2013 its ongoing Fiduciary Service Provider Compensation National Enforcement Project. The purpose of the project is "to investigate the receipt of improper or undisclosed compensation by employee benefit plan consultants and other investment advisers."<sup>2</sup> The Department intends to use this Project to, among other things, verify whether advisers and other service providers are complying with the compensation disclosure requirements of ERISA section 408(b)(2).<sup>3</sup> Not coincidentally, the Department filed suit this past December against an investment adviser for failing to disclose payments it received from mutual fund companies and failing to receive approval of those payments from an independent

fiduciary to the plan.<sup>4</sup> The DOL alleges that the adviser acting in its ERISA fiduciary capacity set its own compensation in violation of ERISA's fiduciary duty and prohibited transaction provisions.

In fact, we at Groom Law Group have seen a distinct upward trend in the number of EBSA investigations focused on advisers and other service providers. At last count, we are defending approximately 30 non-employee stock ownership plan EBSA investigations with 15 involving plan services providers. This is very different from just five years ago when most investigations targeted plan sponsors and similar fiduciaries.

### DOL and SEC Cooperation

Coordination of EBSA and SEC enforcement activity has also increased in recent months. The Department has entered into a Memorandum of Understanding with the SEC pursuant to which the agencies have agreed to cooperate in the cross-training of their respective investigators and respective personnel, sharing of information, and joint enforcement efforts.<sup>5</sup> The two agencies have historically entered into such agreements. However, we have recently seen much more evidence of the agencies working together.

Indeed, the SEC during its exams asks very specific questions and requires detailed, written analysis regarding ERISA prohibited transaction exemption compliance. In turn, EBSA requests during its investigations information more typically requested by the SEC or FINRA. In one particular case, for example, the SEC initiated an examination of a dual-registrant. Several weeks later, the Department sent a notice of its intent to conduct an examination and a subpoena to that same registrant. Some of the information requested by DOL in its subpoena was almost identical to information requested by the SEC (including trade blotter information). Additionally, DOL and the SEC are willing to enter into joint enforcement actions, as evidenced in January of 2014 by their joint action against Western Asset Management Company involving cross-trading.<sup>6</sup>

### DOL Focus

The Department's investigators will often conduct a thorough review of an adviser's operations. However, they likely will focus on several key areas:

Compensation Practices: As discussed above, the Department is particularly focused on compensation practices. Among other things, the investigator will look to see whether all forms of compensation (both direct and indirect) are appropriately disclosed, how indirect compensation (for example, revenue sharing, float) is paid to the provider, and whether the plan and provider comply with section 408(b)(2) or other exemptions that permit the payment of compensation. In particular, the Department will focus on arrangements where it believes the provider can control the timing of when it receives compensation or the amount of compensation it receives.

Using Proprietary Investment Funds and Products and Affiliate Relationships: To the extent that an adviser or other service provider is an ERISA fiduciary and it recommends or invests plan assets in a proprietary investment fund or product, the Department will look to see if the investment involves fiduciary conflicts of interest under ERISA section 406(b). For example, they will look to see if there are two levels of fees and, if so, whether that compensation structure results in a non-exempt prohibited transaction. Similarly, the investigator will focus on situations where the fiduciary utilizes an affiliate or another party in which it has an interest to perform services on behalf of the plan.

Investments in "Plan Asset" Vehicles: Collective investment vehicles maintained by a bank or an insurance company, and private funds in which a significant percentage of the investors are governed by ERISA (and such funds are not operating companies, venture capital operating companies, or real estate operating companies), pose complicated ERISA fiduciary and prohibited transaction issues. The Department will look to see whether the manager of these vehicles and funds meet the myriad of complex statutory and class exemptions utilized by

their managers, who are fiduciaries for purposes of ERISA.

Resolution of Investment and Trading Errors: More recently, DOL investigators have been focusing on how firms resolve investment and trading errors and how such practices are disclosed. This topic is discussed in more detail in a prior edition of *The Investment Lawyer*.<sup>7</sup>

### Summary

In summary, the Department clearly has shifted some of its enforcement resources to advisers and other service providers. Further, they appear to be working more closely with the SEC. Compliance personnel should consider this trend when managing their firm's compliance functions. In addition, in the event of a DOL investigation, the firm's compliance personnel should consider how to address some of the aforementioned areas of focus with the investigator, including a

thorough explanation of how the firm complies with ERISA's fiduciary duty and prohibited transaction exemptions.

### NOTES

- <sup>1</sup> See *Department of Labor Employee Benefit Security Administration Enforcement Manual* at [http://www.dol.gov/ebsa/erisa\\_enforcement.html](http://www.dol.gov/ebsa/erisa_enforcement.html).
- <sup>2</sup> *Id.*
- <sup>3</sup> 29 C.F.R. 2550.408b-2
- <sup>4</sup> *Perez v. Ramsay*, W.D.N.Y., No. 6:14-cv-06733 (Complaint filed 12/29/14).
- <sup>5</sup> Memorandum of Understanding Concerning Cooperation Between the U.S. Securities and Exchange Commission and the U.S. Department of Labor (July 29, 2013).
- <sup>6</sup> *In the Matter of Western Asset Management Co.*, Advisers Act Rel. No. 3762 (January 27, 2014).
- <sup>7</sup> Kaleda, David C., "ERISA Update," *The Investment Lawyer*, Vol. 21, No. 2 (February 2014).

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