

## Watch Out for ERISA-Prohibited Transaction Pitfalls

Be extra cautious when dealing with the landmines of retirement plans.

**A**dvisors who dabble with the Employee Retirement Income Security Act of 1974 (ERISA) can unwittingly run afoul of its regulatory requirements and/or prohibitions. ERISA is one of the most impactful pieces of legislation passed in the world of investment management.

Along with various structural, administrative, and disclosure requirements, ERISA also introduced the concept of prohibited transactions. Broadly speaking, prohibited transactions could be characterized as certain types of transactions that are presumed to have been improperly influenced due to an interested individual's role or financial interest in the transaction. My colleague and DOL expert regarding advisory matters, Ryan Walter, elaborated.

Advisors face plenty of prohibited transaction concerns in their everyday practices, he said. Prohibited transactions could occur in a variety of common contexts, whether by directing retirement investors to proprietary products, pulling advisory fees from retirement plan assets or using ERISA fiduciary status to solicit new business. Sometimes there are exemptions to prohibited transactions, and often there are not.

These pitfalls can be particularly dangerous when working with a client who is a business owner. Countless businesses of all sizes across the country offer ERISA-qualified retirement plans to their employees. The company offering the plan is generally considered the sponsor of the plan and is tasked with the fiduciary responsibility for managing and administering the plan.

Unique prohibited transaction con-



cerns arise when an individual or entity acts as a fiduciary to an ERISA plan. Ryan stressed that certain restrictions mean that a business owner cannot use the assets of his or her business ERISA plan to strike a deal with an advisor for preferential fees or services. A common example is:

- Business owner hires advisor to manage the assets of his company's ERISA-qualified retirement plan;
- A few years pass, and the business owner is so thrilled with advisor's work that (s)he considers placing some personal assets under advisor's management;
- As a seasoned professional, the business owner recognizes the value of his ERISA plan engagement and, consequently, reaches an agreement with advisor that, in order for the business owner to bring over personal assets, the advisor will need to give the business owner a 50% discount on its traditional fee schedule;
- Advisor, happy to gain the new assets, and with a mind towards potential future deposits, gladly accepts.

On the surface, this seems like a standard business transaction. Each party uses its unique positioning and leverage to reach a mutually agreeable deal. The

ERISA plan took no part in the transaction and was seemingly unharmed.

But a closer look reveals that an ERISA prohibited transaction takes place when a fiduciary uses an ERISA plan's assets in their own interest or when the fiduciary receives a benefit from another party dealing with the plan. By using the ERISA plan engagement with the advisor as negotiating leverage, and by receiving discounted fees for personal services from the advisor, the business owner has unwittingly breached both fiduciary prohibited transaction rules noted above.

Further, the advisor is not insulated from liability. Under ERISA exists the concept of "co-fiduciary liability" in which one fiduciary to an ERISA-qualified plan is equally culpable for the fiduciary breaches of another fiduciary to that plan, if the non-breaching fiduciary either participates in the breach or has knowledge of the breach and takes no action to correct it.

Although both the business owner and the advisor feel like they engaged in a fair, arm's length negotiation, both parties have put themselves and their firms at risk.

As shown here, ERISA is fraught with both seen and unseen dangers. One party's negotiating tactic is another party's prohibited transaction. When working with ERISA plans and business owners, advisors must be ever vigilant of potential abuses of ERISA fiduciary status. **IA**

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