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Happily Ever After?

Investment Funds that Live with ERISA, For Better and For Worse (Part 4 of 5)

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This is the fourth article in our five-part serialization of a treatise chapter by Dechert LLP partner Andrew Oringer. The chapter details the ERISA provisions of primary relevance to private fund managers and references relevant authority. This article continues the discussion of prohibited transactions initiated in part three. In particular, this article addresses self-dealing issues relating to fee structures, certain special issues for plans of financial institutions, services for multiple funds, payment or reimbursement of expenses, employer securities and employer real property and certain miscellaneous exceptions (including foreign exchange and cross trading). The third article in the series focused on prohibited transactions, qualified professional asset managers, the "service provider" exemption and the exemption for compensation for services. The second article in the series covered fiduciary duty considerations, including delegation, allocation of investment opportunities, varied interests of fund investors, indemnification and insurance, investments in portfolio funds, enforcement-related matters and diversification requirements. The first article in the series discussed the "plan assets" rules and rules for the delegation and allocation of fiduciary responsibility.

Prohibited Transactions

Self-Dealing Issues Relating to Fee Structures

In Gerneal

In the case of fees paid to the manager of a Plan Assets Fund, questions may arise regarding whether the fee structure passes muster under the self-dealing rules of ERISA Section 406(b)(1). Generally, one relevant question would be whether the structure affords the manager an impermissible level of unilateral control over the amount or timing of the fees,[1] especially since the DOL might argue that the mere presence of an impermissible incentive, even if not acted upon, could implicate self-dealing concerns.[2] While the issues are not inherently more difficult for Plan Asset Funds than for managed accounts,[3] a number of Plan Assets Funds may use structured or complex fee arrangements to a greater extent, with the result that the attendant issues may become less straightforward.

A number of DOL rulings approve particular fee structures,[4] and managers and their advisors will have varying levels of comfort regarding the extent to which a given fee structure diverges from those previously approved by the DOL. A variety of factors could affect the inquiry. Are the fees and fee structure standard commercially reasonable? Should the underlying investment strategy be a "buy and hold" strategy, thus tending to diminish the manager's ability to exert control of the timing and amount of the fees? Should the general strategy be to buy and hold rather than actively trade? These are among the issues to be considered as various performance and incentive fee structures are designed.[5]

Issues can also arise when a manager seeks to raise its fees without seeking express consent or other agreement.

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In such a case, if the plan has sufficient notice of the fee increase and can withdraw from the fund (or otherwise terminate the management relationship) without penalty, then, by choosing to remain invested in the fund (and otherwise continuing the management relationship), the plan fiduciary may be viewed as having approved the resulting increased fees. Under those circumstances, the manager arguably has not exercised its discretion[6] to increase its own fees in violation of Section 406(b)(1).

Valuations

Valuation procedures may raise issues for fee structures under ERISA's self-dealing rules, where (as is frequently the case) fees are based on the value of assets under management or are otherwise affected by asset values.[7] One concern is that if the manager controls the valuation, the manager thereby could effectively increase fees unilaterally in violation of Section 406(b)(1).[8]

One might argue that the mere right to set or affect valuations should not necessarily be viewed as involving prohibited self-dealing.[9] The use of a valuator chosen by the manager may survive scrutiny when the valuator is a well-regarded outside firm and where the valuation is relatively straightforward (e.g., valuing securities for which there is an effective market).[10] Even in those cases, however, the conflicts analysis will not always be clear. To address this point, some Plan Assets Funds provide for the use of a specified valuator as a part of the package of terms offered to investors. [11]

Alternatively, valuations could be provided by third parties involved with the underlying portfolio investments.[12] For example, a Plan Assets Fund that is a fund of funds might use valuations supplied by portfolio funds in which it has invested. Sometimes, the manager of the Plans Assets Fund might retain a residual right to adjust the valuation provided. Such a right may be reserved as a general matter or (particularly where upward adjustment is possible)[13] may be reserved in more limited circumstances (for example, in situations where the valuation has become manifestly inaccurate).[14] When a manager seeks to retain a right to adjust valuations, it may be worthwhile to review whether potential self-dealing issues arise.[15]

Certain Special Issues for Plans of Financial Institutions

Transactions with financial institutions, including both principal and agency transactions, are commonplace. Frequently, these transactions will be feasible only if there is an acceptable comfort level that the transactions are not prohibited, whether because Section 406 is not implicated (e.g., there is no party in interest involved) or because an exemption is available.

The prohibited transactions inquiry for a Plan Assets Fund may be significantly more complicated when an investing plan is sponsored by a financial institution. In such a case, the ability to effect principal trades or proceed with certain agency retentions (e.g., for brokerage services) may be subject to additional complications under Section 406 generally and under a variety of exemptions in light of the institution's status as an employer and moreover as a plan fiduciary.[16] A Plan Assets Fund may consider declining investments from plans of certain major financial institutions, particularly if it has existing or anticipated services relationships with those institutions. [17]

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Services for Multiple Funds

When a manager has responsibility for two funds (or accounts) with adverse interests, and one of the funds is a Plan Assets Fund, issues may arise under Section 406(b)(1) with respect to the manner in which the manager performs its services for the Plan Assets Fund. In addition, issues may arise under Section 406(b)(2) regarding whether the manager is acting in a transaction involving the Plan Assets Fund on behalf of a party (or representing a party) with interests adverse to those of the Plan Assets Fund.[18]

<u>Use of Plan Assets for a Fiduciary's Own Account</u>

ERISA Section 406(b)(1) prohibits a fiduciary from "deal[ing] with the assets of the plan in his own interest or for his own account." Under Section 406(b)(1), issues may arise regardless of whether per se or other objective concerns are present.[19] When the manager's conflicts "may affect the exercise of [the manager's] best judgment as a fiduciary,"[20] a number of approaches may be available.

In some cases, it may be necessary or appropriate to retain, or for investors to retain, an independent fiduciary regarding a particular investment or circumstance.[21] However, care should be taken that the appointee, particularly if appointed by the fiduciary of the Plan Assets Fund as opposed to the investing plans and their other fiduciaries, is sufficiently insulated from the appointing manager's conflicts.[22] Depending on the applicable facts and circumstances, the manager may want to make the independent fiduciary's compensation not contingent on the effectuation of any transaction or generally irrevocable.[23]

Another possible approach to addressing conflicts that may arise when one fund within a family of funds (or accounts) faces another is for the manager to recuse itself from the decision-making process of the Plan Assets Fund regarding the particular matter.[24]

<u>Representing an Adverse Party</u>

Section 406(b)(2) of ERISA prohibits a fiduciary from "act[ing] in any transaction involving the plan on behalf of a party (or represent[ing] a party) whose interests are adverse to the interests of the plan." In some cases, there can be a threshold question under Section 406(b)(2) of whether the Plan Assets Fund is indeed facing another fund (or account) within the same family.[25] For example, a fund may hold both debt and equity issued by a particular entity, and the fund may be facing the entity but not necessarily directly facing the entity's equity holders.[26] In this example, one would need to determine whether the debt holders and the equity holders are engaged in a "transaction" for purposes of Section 406(b)(2). In addition, even when the Plan Assets Fund is facing another fund (or account) managed by the same fiduciary, the two parties may not be adverse, in which case Section 406(b)(2) concerns might be vitiated.[27]

Another possible avenue for addressing Section 406(b)(2) concerns could arise where the entity managing a Plan Assets Fund is not the same entity that manages another fund (or account) within the same family. In that event, the manager might argue that Section 406(b)(2) applies to the fiduciary (i.e., the manager itself), but not to the fiduciary's affiliates.[28]

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Payment or Reimbursement of Expenses

Fund Expenses

A plan fiduciary where properly authorized to do so may generally pay for or reimburse from plan assets direct expenses properly and actually incurred in connection with the performance of a range of services without running afoul of Section 406(b).[29] Examples of expenses that could raise special issues are expenses allocable to more than one investor or group of investors, expenses that may be viewed as not directly benefiting the plan investors (e.g., certain marketing expenses), expenses that could be deemed to be "overhead" expenses, and expenses relating to employee compensation.[30] Indemnification payments and the payment or reimbursement of certain insurance premiums, discussed above,[31] may also raise special issues.

Investor Expenses

Payment by the Plan Assets Fund or by the manager of the expenses of investors or their personnel, for example, travel and entertainment expenses connected with business meetings, may prove problematic under ERISA. Legal concerns arise under Section 406(b) resulting from reimbursements by a Plan Assets Fund or its manager to investors and their personnel, but such payments can also damage reputations and relationships.[32] In addition, payments and reimbursements of this type can raise reporting issues under Section 408(b)(2)[33] and under the rules relating to reporting on IRS/DOL/PBGC Form 5500.[34]

Employer Securities (and Employer Real Property)

Practical issues can arise for a Plan Assets Fund regarding the restrictions under Sections 406(a)(1)(E) and 407, under which plans cannot invest in employer securities (or employer real property) unless (i) the investment is in qualifying employer securities, as defined in Section 407(d)(5) (or qualifying employer real property, as defined in Section 407(d)(4)), and (ii) in the case of plans which are not eligible individual account plans, the investment satisfies the 10% limitation in Section 407(a)(2). The Section 407 limitation can be difficult for a manager of a Plan Assets Fund to administer on several levels. For example, it may not be immediately obvious that any particular security is an employer security. In addition, as to the 10% limitation (where applicable), the manager of the Plan Assets Fund presumably would not ordinarily know what the other holdings of qualifying employer securities (and qualifying employer real property) are. Possible approaches to these issues could be express confirmation that these issues are not the responsibility of the manager of the Plan Assets Fund or the provision to the manager of a list of investments that should not be made by the Plan Assets Fund.

Certain Miscellaneous Exemptions

Foreign Exchange

Some funds engage in foreign exchange (F/X) transactions.[35] The DOL has issued class exemptions for F/X transactions that meet certain requirements.[36] In addition, the statute now provides an exemption for F/X transactions between a bank or broker-dealer (or any affiliate of either) and a plan to which it is a trustee, custodian, fiduciary, or other party in interest.

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The exemption applies if (i) the transaction is in connection with the purchase, holding, or sale of securities; (ii) at the time the transaction is entered into, the terms of the transaction are not less favorable to the plan than the terms generally available in comparable arm's-length F/X transactions between unrelated parties or the terms afforded by the bank or the broker-dealer in comparable arm's-length transactions involving unrelated parties; (iii) the exchange rate used by the bank or broker-dealer (or affiliate) for a particular F/X transaction does not deviate by more than 3% from the interbank bid and ask rates at the time of the transaction as displayed by an independent service that reports rates of exchange in the foreign currency market for such currency; and (iv) the bank or broker-dealer (or affiliate) does not have investment discretion and does not provide investment advice with respect to the transaction.[37] An example of an issue that may arise regarding these exemptions is whether and when an instruction is a standing instruction that does not confer fiduciary discretion or an instruction that does confer discretion rising to the level of fiduciary authority.[38]

<u>Cross-Trading</u>

The managers of multiple funds or accounts[39] may desire to facilitate investment changes by shifting investments between funds or accounts. Doing so, however, even as part of a well-intentioned effort to reduce brokerage or other costs, could run afoul of ERISA Section 404(a)(1)(A)'s "exclusive purpose" requirement and the Section 406(b)(2) proscription against a fiduciary's acting in a transaction on behalf of (or representing) a party with interests adverse to the plan.[40] While there is now a statutory exemption for cross-trades,[41] certain conditions of the exemption[42] may cause the exemption to be unavailable or not worth pursuing, with the result that certain changes in investment portfolios may not be effected internally (i.e., may not be effected without resort to outside counterparties).[43] The DOL has expressed continuing concern regarding discretionary cross-trades[44] and has granted them only limited relief.[45]

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[1] See generally 29 C.F.R. §2550.408b-2(e)(1).

[2] Cf. DOL Adv. Op. 2000-10A (July 27, 2000) ("[I]f a divergence of interests develops between an IRA and the fiduciary (or persons in which the fiduciary has an interest), the fiduciary must take steps to eliminate the conflict of interest in order to avoid engaging in a prohibited transaction."). It is noted that, depending upon the relevant facts and circumstances, caselaw would not necessarily seem to follow that view. See, e.g., Acosta v. Pac. Enters., 950 F.2d 611 (9th Cir. 1991) (stating that a section 406(b)(1) violation cannot be founded on mere allegations that a fiduciary has the power to self-deal, but rather requires a demonstration that the fiduciary actually used its power to deal with the assets of the plan for its own benefit or account); Severstal Wheeling Inc. v. WPN Corp., No. 10 Civ. 954 (GWG) (S.D.N.Y. Sept. 1, 2011) ("Thus, the fact that a plan fiduciary has a conflict of interest does not by itself constitute a breach of fiduciary duty. Instead, plaintiffs must show that the improper relationship or conflict caused the fiduciary to act disloyally."); In re Xerox Corp. ERISA Litig., 483 F. Supp. 2d 206, 218-19 (D. Conn. 2007) (stating that "the cognizable claim with respect to any alleged conflict of interest is not that the fiduciary is subject to a conflict of interest, but rather that in discharging his or her duties under a Plan, the fiduciary breached his or her duty of loyalty"); see also Leigh v. Engle, 727 F.2d 113, 132 n.31 (7th Cir. 1984) (leaving open the question of hether a transaction would be per se prohibited under Section based on a mere potential conflict of interest); Brock v. Citizens Bank of Clovis, 841 F. 2d 344, 347 (10th Cir.) ("While we do not hold the transactions were free of ERISA violation, we simply conclude that the trial court correctly ruled the trustees' approval of the loans was not a per se violation of the statute." (footnote omitted)), cert. denied, 488 U.S. 829 (1988); Friend v. Sanwa Bank California, 35 F.3d 466, 471 (9th Cir. 1994) (declining to hold that a violation of Section 406(b)(1) of ERISA arises in a case in which a plan trustee also acted as a secured creditor); see also cases cited in "Happily Ever After? – Investment Funds that Live with ERISA, For Better and For Worse (Part One of Five)," The Hedge Fund Law Report, Vol. 7, No. 33 (Sept. 4, 2014), n.35. But see Martin v. Nat'l Bank of Alaska, 828 F. Supp. 1,427 (D. Ala. 1992) (determining that a violation occurred, but on the basis that the bank caused the plan to enter into the transaction with knowledge that the bank would benefit).

[3] While "separate account" nomenclature is frequently used in the market, that phrase is not used herein with reference to accounts managed by registered investment advisors to avoid confusion with respect to insurance company "separate accounts."

[4] DOL Adv. Op. 89-28A (Sept. 25, 1989) (ruling favorably regarding a fee arrangement in which each client plan was a large plan with at least $50 million); see also DOL Adv. Op. 86-20A (Aug. 29, 1986) (ruling favorably regarding a fee arrangement where each client plan was a large plan with at least $50 million and no plan had more than 10% of its assets with the manager); DOL Adv. Op. 86-21A (Aug. 29, 1986) (ruling favorably regarding a fee arrangement where each client plan was a large plan with at least $50 million and no plan had more than 10% of its assets with the manager); DOL Adv. Op. 99-16A (Dec. 9, 1999) (ruling favorably regarding a performance fee arrangement where each client plan subject to the performance fee was a large plan with at least $50 million

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and no plan had more than 10% of its assets with the manager).

[5] Different issues arise when a manager seeks to allocate a plan's assets among various funds that it maintains (or possibly among such funds and third-party funds). See, e.g., DOL Adv. Op. 97-15A (May 22, 1997); DOL Adv. Op. 82-26A (June 9, 1982); DOL Adv. Op. 2005-10A (May 11, 2005); see also DOL Adv. Op. 2000-15A (Nov. 15, 2000) (expressly noting that advice was not requested regarding "a formal advice program under which specific recommendations covering asset allocations are made available to plan participants for a separate fee"). The analysis could potentially implicate cross-trading considerations. See generally infra, n.43. But see DOL Adv. Op. 2003-15A (Nov. 17, 2003) (in the context of action by a manager and a trustee in various capacities, stating that the provision of services that results in a divergence of interests between the manager and trustee, on one hand, and the applicable plans, on the other hand, "could" violate §406(b), but suggesting such violations do not inevitably occur). Issues of this type are not addressed herein.

[6] See also 29 C.F.R. §2550.408b-2(e)(1) ("[A] fiduciary may not use the authority, control, or responsibility which makes such person a fiduciary to cause a plan to pay an additional fee to such fiduciary . . . to provide a service.").

[7] Issues may also arise regarding the question of whether the provision of valuation services is itself fiduciary in nature. See generally 75 Fed. Reg. 65,263, 65,265 (proposed Oct. 22, 2010) (to be codified at 29 C.F.R. §2510.3-21(c)(1)(i)(A)(1)), withdrawn DOL News Rel. 11-138-NAT (Sept. 19, 2011).

[8] See 29 C.F.R. 2550.408b-2(e)(1). Valuation issues may also arise outside of the context of the self-dealing rules. See Part Five, nn.44-47 and accompanying text.

[9] In this regard, note that the rulings on fees cited above in n.4 are not uniform in terms of express discussion of the mechanism used regarding the retention of the valuator. Compare DOL Adv. Op. 86-20A (certain valuations performed by the "plan's custodian, trustee or other qualified party selected by the plan, which party will be independent of [the manager]"), with DOL Adv. Op. 89-28A (certain valuations performed by "the client plan's custodian, trustee or some other qualified party that is independent of [the manager], at the expense of [the manager]"), DOL Adv. Op. 86-21A (fees for independent pricing service for certain valuations to be paid by the manager), and DOL Adv. Op. 99-16A (noting that that "foreign currency forward contracts are . . . valued by third parties independent of [the manager]."). See also DOL Adv. Op. 99-16A (noting that the manager "does not invest the assets of any Account in any contracts that are not of sufficient size to be traded on the interbank market or that are not capable of being readily and objectively valued by the independent plan fiduciary by reference to established market settlement prices and quotations").

[10] Even then, technical issues can persist. In this regard, DOL regulations applicable under §406(b)(1) indicate that an appointed fiduciary may be tainted by the appointer's conflicts, to their mutual detriment. See 29 C.F.R. §2550.408b-2(f) (ex. 5). In some circumstances, a reasonableness or similar gloss may be read into the regulations; see DOL Adv. Opn. 83-45A (Aug. 26, 1983) (stating, after citing 29 C.F.R. §2550-408b-2(f) (ex. 5), that, where a manager of real estate owned by a plan retains an affiliate of the plan sponsor to provide services relating to the maintenance and repair of the property, the question of "whether [the] arrangements . . . constitutes [sic] a violation of 406(b)(1) is a factual question," and thus declining to rule (favorably or adversely) on the issue). Otherwise, the use of outside fiduciaries, regardless of their reputation and regardless of the other facts or

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or circumstances surrounding the retention, might be insufficient to address conflict issues in a broader set of situations than §406(b)(1) is intended to reach. See also Part III, n.12 (discussing §406(b) issues in the context of a QPAM retention).

[11] Possibly the valuator could be subject to replacement by the investors or could be replaced by the sponsor on prior notice to the investors, coupled with a right of investors to withdraw. See supra, n.1 and accompanying text.

[12] For example, a Plan Assets Fund that is a fund of funds might use valuations supplied by portfolio funds in which it has invested.

[13] Arguably, a right to adjust valuations downward could be viewed as merely a permissive right to waive or otherwise reduce fees.

[14] In some cases, accounting considerations may favor the retention of residual discretion. See generally FAS 157.

[15] Self-dealing issues regarding valuation generally would arise only where, as is often the case, the fees are based on valuations. However, whether or not §406(b) issues are present, basic valuation issues may arise under ERISA's general reporting rules, as noted below. See Part Five, nn.32-35. While in theory it may be possible for one valuation to be used for reporting purposes and another to be used for fee-related purposes, business issues could arise when such a bifurcation is attempted.

[16] Some exemptions may require independent fiduciaries to make decisions, e.g., Proh. Trans. Class Exempt. 86-128, or may not be applicable where a fiduciary is (or is an affiliate of) the counterparty, e.g., ERISA §408(b)(17).

[17] In the context of services, one might argue that compensation to which ERISA §408(b)(2) or §408(c) applies is exempt not only from §406(a) but also from §406(b). See Harley v. Minnesota Mining & Mfg. Co., 284 F.3d 901 (8th Cir. 2002); see also McCullough v. AEGON USA, 585 F.3d 1082 (8th Cir. 2009) (reaffirming Harley in certain respects). Compare 29 C.F.R. §2550.408b-2(a) (flush language) (expressly providing that ERISA §408(b)(2) does not apply with respect to §406(b)), with ERISA §408(b)(17), (18), (19) (unlike §408(b)(2), expressly limiting certain more recently added exemptions to particular §406 provisions).

[18] The "other" party could be another Plan Assets Fund. See also DOL Adv. Op. 77-47A (June 13, 1977) (confirming that two related funds are not parties in interest to each other but also that §406(b) issues nevertheless could arise). See generally Cutaiar v. Marshall, 590 F.2d 523 (3d Cir. 1979); DOL Adv. Op. 93-18A (May 28, 1993); DOL Adv. Op. 93-16A (May 18, 1993). It is also noted that a range of issues could arise where a fund of funds or similar vehicle invests in other funds some or all of which may be affiliated funds; a discussion of the issues that may arise in such a case is beyond the scope hereof.

[19] Cf. DOL Adv. Op. 91-37A (Oct. 16, 1991) ("As explained in 29 C.F.R. 2550.408b-2(e)(1), if a fiduciary uses the authority, control, or responsibility which makes him or her a fiduciary to cause the plan to enter into a transaction involving the provision of services when such fiduciary has an interest in the transaction which may affect the exercise of his or her best judgment as a fiduciary, a transaction described in section 406(b) . . . would occur, and that transaction would be deemed to be a separate transaction from the one involving the provision of services and would not be exempted by section 408(b)(2). . . . Whether a violation of section 406(b) occurs in the course of the trustees' selection and retention of [the] investment manager of the Plan is

an inherently factual matter."); DOL Adv. Op. 2011-06A (Feb. 4, 2011) ("The Department notes that PTE 84-14, Part I, provides an exemption only from violations of section 406(a) . . . and does not extend relief to transactions that violate section 406(b).").

[20] 29 C.F.R. §2550.408b-2(e)(2).

[21] Where application of the QPAM Exemption is sought in this context, additional issues could arise, as the DOL has evidenced hostility toward the notion of retaining a QPAM with limited authority in the context of a specified transaction. See 47 Fed. Reg. 56,945, 56,947 (Dec. 21, 1982) ("Party-in-interest transactions that are negotiated by, e.g., an employer which sponsors a plan, and are then presented to a QPAM for approval would not qualify for the class exemption as proposed."); 75 Fed. Reg. 33,642, 33,646 (June 14, 2010) ("The Department stated in the preamble to the original QPAM class exemption that, while a QPAM may adhere to investment guidelines established by persons with the power to appoint it, the retention of a veto or approval power by the plan sponsor or its designee would be inconsistent with the underlying concept of the QPAM exemption, that is, the transfer of plan assets to an independent, discretionary, manager. In the Department's view, an INHAM directing a QPAM to negotiate specific terms of a deal that has already been generally agreed upon by the INHAM or the employer represents a more significant limitation on the QPAM's discretion than the imposition of investment guidelines . . . [and] would be inconsistent with the basic premise of the QPAM exemption.") (footnote omitted); see also 62 Fed. Reg. 27,625, 27,627 n.4 (May 20, 1997) (position expressed in the context of a certain application for an individual exemption); 63 Fed. Reg. 60,387, 60,388 n.5 (Nov. 9, 1998) (to the same effect).

[22] 29 C.F.R. §2550.408b-2(f) (ex. 5) (indicating that an appointee may be tainted by the appointer's conflicts, to their mutual detriment).

[23] See supra n.3.

[24] See, e.g., DOL Adv. Op. 86-11A (Feb. 27, 1986) ("[A]bsent any arrangement, agreement or understanding with respect to who will ultimately provide the services in question, [the director] may avoid engaging in an act described in section 406(b)(1) and (b)(2) by removing himself from all consideration by the . . . Board of Directors of whether or not to engage in any transactions involving the Agreements, and by not otherwise exercising, with respect to any such transaction, any of the authority, control or responsibility which makes [him] a fiduciary.") (citations omitted).

[25] See also infra nn.39-45 and accompanying text (relating to cross-trading).

[26] In the context of ERISA §406(a), the DOL has acknowledged that a person dealing with an entity that does not hold plan assets is not generally deemed to be dealing with the entity's equity holders that are plans. See generally American Bar Association, Section of Taxation, Comments on the Proposed "Service Provider" Regulations Under Section 408(b)(2) of ERISA (Feb. 29, 2008), at §II(A).

[27] See DOL Adv. Op. 81-45A (May 5, 1981) (indicating that in some respects parties facing each other may not necessarily be adverse).

[28] See 73 Fed. Reg. 58,450, 58,454 (Oct. 7, 2008) ("[T]he Department notes that an investment manager's exercise of discretionary authority, on behalf of an account it manages, to effect a purchase or sale of a security with another account over which an affiliate of the manager exercises discretionary authority would not, in itself, constitute a violation of 406(b)(2) . . . ."). In making such an argument, the fiduciary may wish to consider the degree of structural and other separateness between the fiduciary and the fiduciary's affiliates, cf. 73 Fed. Reg. at 58,454 ("[A] violation of ERISA's prohibited

transaction provisions could arise in operation if, in fact, there was an agreement or understanding between the affiliated parties to favor one managed account at the expense of the other account in connection with the transaction.”). See also DOL Adv. Op. 91-37A (Oct. 16, 1991) (identifying “controlled group” affiliations as presumptively involving conflicts).

[29] See 29 C.F.R. §2550.408c-2(b)(3); DOL Adv. Op. 86-01A (Jan. 2, 1986) (“[R]egulation section 29 C.F.R. §2550.408b-2(e)(3) provides that if a fiduciary furnishes services to a plan without the receipt of compensation or other consideration (other than reimbursement of direct expenses properly and actually incurred in the performance of such services within the meaning of 29 CFR 2550.408c-2(b)(3)), the provision of such services does not, in and of itself, constitute an act described in section 406(b) of ERISA.”).

[30] See generally 29 C.F.R. §§2550.408b-2(e)(3), 2550.408c-2(b); DOL Adv. Op. 93-06A (Mar. 22, 1993); DOL Adv. Op. 89-09A (June 13, 1989); DOL Adv. Op. 86-01A (Jan, 2, 1986). The DOL has taken the position that an expense is not properly reimbursable unless incurred in connection with a service that is exempt under ERISA §408(b)(2). See, e.g., DOL Adv. Op. 86-01A (Jan. 2, 1986). But see Harley v. Minnesota Mining & Mfg. Co., 284 F.3d 901, 909 (8th Cir. 2002) (“[T]he legislative history of §[408] does not support the contention that the §[408](c)(2) exemption merely clarifies §[408](b)(2).”) (internal citations omitted).

[31] See Part Two nn.12-18 and accompanying text.

[32] These issues received renewed focus after the DOL proposed changes to forms relating to disclosure of certain payments involving union personnel. See, e.g., Vineeta Anand, Union Fund Officials Lose Some Perks, Pens. & Invs. (July 11, 2005). In 2007, a DOL official reportedly warned that payments involving certain types of personal expenses could result not only in §406(b)(3) violations but also in criminal violations. See Cathie Saadeh, DOL Enforcement Chief Threatens Advisers, IM Insight News (Mar. 26, 2007); see also 18 U.S.C. §1954 (“Whoever being a trustee of any employee benefit plan receives or agrees to receive or solicits any fee, kickback, commission, gift, loan, money, or thing of value because of or with intent to be influenced with respect to, any of his actions, decisions, or other duties relating to any question or matter concerning such plan or any person who directly or indirectly gives or offers, or promises to give or offer, any fee, kickback, commission, gift, loan, money, or thing of value prohibited by this section, shall be fined under this title [not more than $10,000] or imprisoned not more than three years or both.”). See generally Michael A. Lawson & Andrew L. Oringer, A Report on Certain Reporting Issues Under ERISA: Disclosure of Fees for Services and Special Issues for Gifts and Entertainment, Pension Plan Investments 2009: Current Perspectives (Practicing Law Institute 2009), §II.

[33] See Part Three, nn.42-47 and accompanying text.

[34] See also Part Five, nn.41-43 and accompanying text (discussing certain reporting issues).

[35] Some funds offer interests denominated using different currencies, either through classes, subclasses, or tranches, or through various feeders. The discussion generally contained herein (i) assumes that the Plan Assets Fund is intentionally being operated as such, and (ii) focuses on the primary investment vehicle rather than on master-feeder structuring. See generally Part One, n.18.

[36] Proh. Trans. Class Exempt. 94-20; Proh. Trans. Class Exempt. 98-54.

[37] ERISA §408(b)(18).

[38] See also Part One, n.29 (citing authority regarding the identification of plan assets in the futures context).

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[39] See also Part Two, nn.7-9 and accompanying text (relating to the allocation of investment opportunities).
[40] ERISA §§404(a)(1)(A), 406(b)(2).
[41] ERISA §408(b)(19).
[42] E.g., ERISA §408(b)(19)(I) (requiring a penalty-of-perjury statement).
[43] While ERISA §406(b)(2) does not have an analog in §4975(c)(1) of the Code, see H.R. Rep. No. 93-1280, 93rd Cong., 2d Sess., at 309 (noting parenthetically that the both-sides prohibition is not included in the Code "because of the difficulty in determining an appropriate measure for an excise tax"), violations of §406(b)(2) are potentially serious matters. See, e.g., Reich v. Strong Capital Mgmt. Inc., No. 96-C-0669 (E.D. Wis. June 6, 1996) (settlement of cross-trading allegations); Citizens First Nat'l Bank v. Cincinnati Ins. Co., No. 96 C 3731 (Aug. 14, 1998) (opinion regarding claims of a liability insurer against a certain bank, making reference to a relevant cross-trading investigation and settlement); see also U.S. Department of Labor, Pension and Welfare Benefits Administration, Employee Retirement Income Security Act 1996 Report to Congress, at 14 ("Under a consent judgment obtained by the Department, Strong Capital Management, Inc. (SCM), agreed to pay $5.9 million to approximately 101 plans. A Department lawsuit, filed simultaneously with the judgment, alleged that SCM directly exchanged and transferred the assets of plan clients with the accounts of other plans, mutual funds and accounts of other clients. SCM conducted at least 1,598 cross-trades of securities among the accounts of plans managed by the firm and other clients. SCM also allegedly failed to obtain separate representation on behalf of the plans in making the cross trades. Sponsors of the plans will receive recoveries of $40,000 or more or more under the judgment."); Strong Capital in Pension Settlement, N.Y. Times, June 8, 1996 ("In a settlement with the Department of Labor, Strong Capital Management Inc. . . . agreed this week to pay $6.9 million to reimburse pension fund clients for trading activities that violated [ERISA].").
[44] DOL Notice, Cross-Trades of Securities by Investment Managers, 63 Fed. Reg. 13,696, 13,396 nn.3-4 and accompanying text (Mar. 20, 1998); see also Proposed Class Exemption for Cross-Trades of Securities by Index and Model-Driven Funds, 64 Fed. Reg. 70,057, 70,058 nn.5-6 and accompanying text (Dec. 15, 1999), granted sub nom. Passive Cross-Trading Class Exemption for Cross-Trades of Securities by Index and Model-Driven Funds, Proh. Trans. Class Exempt. 2002-12, 67 Fed. Reg. 6,613 (Feb. 13, 2002).
[45] Compare Proh. Trans. Class Exempt. 86-128 (relating to nondiscretionary cross-trading), with Proh. Trans. Class Exempt. 2002-12 (relating to cross-trading in the case of certain model-driven funds).